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FP ENTREPRENEUR

Think you're ready for venture capital? First take a look at your sales, cash flow and forecasts

Brad Cherniak | September 14, 2015 3:14 PM ET

Fotolia *If you have a few million dollars of sales and perhaps a million dollars of cash flow, and a growth forecast for $15 million in sales at the end of five years or so — or $20 million, or $25 million, for that matter — you need go no further. You are officially a tweener — too small for mainstream private equity, too limited upside for venture capital.*

In last month's column on whether or not to raise venture capital, I suggested that if you hope to get the attention of a particular VC, the question you need to ask yourself is, am I confident my company will be even close to a 10-bagger in roughly five to seven years? If you've applied the test, and decided you still want to raise venture capital there are still a couple of last considerations before you begin.

First, if you have a few million dollars of sales and perhaps a million dollars of cash flow, and a growth forecast for $15 million in sales at the end of five years or so — or $20 million, or $25 million, for that matter — you need go no further. You are officially a tweener — too small for mainstream private equity, too limited upside for venture capital.

Second, it is critical for you to appreciate the state of venture capital today.

Macro-level observations There is a major supply issue, and has been for years, but not the one you are thinking of. There is too much venture capital out there. The dismal average returns on capital over the short to long term are the evidence of oversupply.

Couple that with the tectonic shift in technology, which has major implications for the profitability of companies, for their owners and to VCs who need to show returns to stay in the game and raise new funds to manage.

The problem has been further obscured by the advent of the unicorn, the billion-dollar (in valuation) startup, such as Airbnb, Snapchat, Shopify and most recently, Kik Interactive, which has proliferated at the highest echelons of the VC industry.

The unicorns have lifted overall VC fortunes, but have not solved the fundamental challenges of securing venture capital that exist for the more prosaic companies and their owners.

Micro-level observations The technology shift mentioned above operates at the individual company level.

It goes something like this:

- The social Web is an unprecedentedly powerful corporate communication and customer service platform, and bandwidth is cheap and ubiquitous.
- The cost to access wide audiences and user bases is now a fraction of what it was, demolishing the barrier-to-entry in most industries.
- Getting found on the Web still takes money, but nowhere near what it used to take to build a business and a product or service delivery infrastructure.
- These latter expenses have been assumed by the scale-driven players such as Amazon, Google, Facebook, Alibaba et al, who control key aspects of the new virtual corporate infrastructure and outsource it relatively cheaply to smaller companies.
- These pseudo-monopolists are able to capture significant rents for their services and accumulate huge hoards of cash, despite the overall technology pricing arc being sharply downward.
- They have become the apex predators of the business world.

As a result, the startups and small companies that have been the staples of the VC diet are becoming part of a feeder system to the apex predators, hungry to expand their market offerings and business models to sustain their profitability.

Another result is that sustainable operating profits are hard to come by in the feeder system. Even the apex predators are unsure of their profit models. And if they struggle to maintain profits, the feeders certainly aren't going to be allowed to roll in them.

So the upside to investing in the feeders is now in getting swallowed up by the apex predators. Most of the action in venture capital has moved into this part of the food chain.

Importantly, there are some VCs still looking for smaller scale startups to help them ramp up and grow into maturity, but this isn't where the major action is.

So, recognizing the state of venture capital, you must now answer a new series of questions to find it, in a nutshell: Who do you specifically appeal to as a company, how and why?

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