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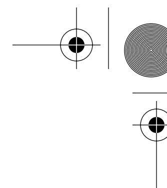

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Introduction

ABOUT THIS BOOK

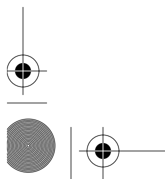
This book, *From Concept to Wall Street,* was written to fulfill that need for all those entrepreneurs, employees in startup companies, investors, consultants, and anyone involved or interested in the industry of investing in startup companies in general, and in high tech startup companies in particular. The book methodically lays out the stages of the startup process, without oversimplifying the issues involved.

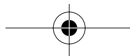
Book Structure

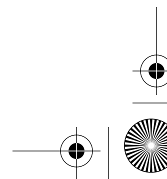
The book is divided into five Parts which address all the major issues related to startup companies and venture capitalists. The Parts are organized in chronological order, starting from the initial idea or concept, through the establishment of the company and the raising of capital, to the eventual IPO or sale of the company.

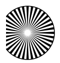
Part I—Establishment and Development of Ventures

Part I serves as a road map for startups. This part reviews the issues which the company must address in the early stages, starting from examining the idea and bringing the initial team together, through the establishment of the company and an examination of the sources of aid available to it in the preliminary stages, the corporate strategy and preparation of the business plan, recruitment and remuneration of employees, and ending in the registration of intellectual property and the economic ways of utilizing such property and realizing the economic benefits that it brings.









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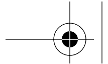
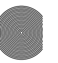
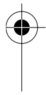




Part II—Financing the Venture

The sources of capital that are available to startup companies are limited. Entrepreneurs usually lack the capital needed in order to realize their ideas and therefore require external sources of capital. In the first stages of the development of a company, internal sources of finance are customarily used, as well as financing from private investors. Then, in most cases, the company soon turns to venture capital funds and other investors. Part II describes the stages of development of the venture, its cash requirements, the milestones of capital raising and capital sources, and provides a practical description of the process of capital raising. It also contains an in-depth discussion of the main contractual arrangements involved in a venture capital investment. Finally, Part II discusses the valuation of the company: The valuation of companies and projects is an essential component of each and every stage in the development of a startup, whether for purposes of calculating the feasibility of projects and investments, or in order to raise capital and debt. This discussion also includes a review of the established valuation models and of their relevance to various types of companies and various stages of capital raising.

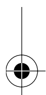
Part III—Venture Capital Investors

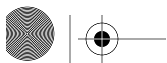
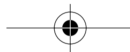
Part III reviews the entities and institutions which invest in startup companies. The focus is on venture capital funds, which in the past few decades have constituted the most significant institutional segment of investors in startup companies. The discussion of venture capital funds also includes the funds' establishment, management, and liquidation mechanisms. A separate chapter is dedicated to private investors (Angels). A description of the methods of investment by corporate investors who, in addition to investing in venture capital funds, invest in startup companies directly or establish internal startup companies, is also included. Finally, Part III discusses direct investments in startup companies by investment banks and other financial institutions, and other sources of finance such as credit and leasing companies.

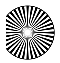
Part IV—Raising Capital from the Public

Once development is completed and sales have commenced (and at times even earlier), comes the stage when the company can raise capital from the public. From the company's point of view, raising capital from the public is not only a vast source of capital, it also constitutes a transition from a private company, in which far more is concealed than is known, to a visible public company that is required to meet high standards of disclosure and transparency. Part IV reviews the advantages and disadvantages of going public, discusses the question of choosing the location of the company's IPO, and describes the process of going public in the United States.

It must be emphasized that going public is important not only to the company itself, but also to investors and entrepreneurs. From the investors' point of view, this means bringing them closer to realizing their investment. In recent decades, the majority of ven-





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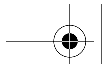
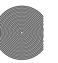
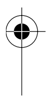
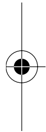




ture capitalists profits was based mainly on the increase in the value of the shares, and not on the stream of payments from a company's cash flow (interest or dividends). Investors therefore demand contractual rights that will award them a certain degree of control over the process of realizing/exiting their investment. From the perspective of entrepreneurs, an IPO renders their holdings in the company more liquid, although various restrictions hinder the immediate realization of the shares.

Part V—Sale of Companies, Restructuring, and Dissolution

Part V focuses on mergers and acquisitions of companies, which are two of the main methods for realizing/exiting an investment and of the major factors underlying the technological revolution. The desire to be bought out by a leading company in the industry drives many entrepreneurs and companies, and allows for the financing of companies whose ability to exist independently in the long term is doubtful. The discussion in this Part reviews not only the phenomenon itself, but also the pros and cons of sales versus IPOs, as well as the main techniques used for mergers and acquisitions, including the contractual arrangements involved in merger and acquisition (M&A) transactions.



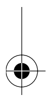
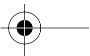
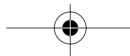
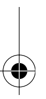
The last chapter in Part V discusses the dissolution of companies. With the collapse of technology stocks and the resultant blow to confidence in the venture capital market, an increasing number of companies are finding it difficult to finance their operations. Some of these companies merge with others, while other companies have no choice but to dissolve (either voluntarily or due to coercion by creditors).

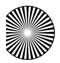
Glossary

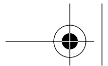
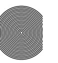
Naturally, the book uses many professional terms that are part of the common venture capital jargon. There are also terms that are used to signify several different meanings. For instance, the term **Venture Capital** (or VC) is used to describe the area of investments of venture capital in startup companies, but in many cases it also refers to Venture Capital Funds or to the people working in such funds. The purpose of the following short glossary is to create a uniform, basic, and common denominator for all readers (for a more comprehensive glossary, see Appendix B).

A **startup** is a company founded by **entrepreneurs** on the basis of an idea, the majority of its assets, termed **intellectual property (IP)** are intangible. Initially, the company's activity focuses on **Research and Development (R&D)**, in order to prove the feasibility of the idea and to develop the prototype/preliminary product.

Financing in the preliminary stage, or the **Seed**, is obtained in many cases from private investors, also known as **Angels**. These angels invest their personal funds in young companies in order to gain a high **Rate of Return**. Down the road, the company is financed in several **Rounds** by venture capitalists of various types, comprising the venture capital industry. The first class of investors is the **venture capital funds**, which specialize in high-risk investments and undertake such investments on behalf of several



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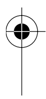

investors (usually **Institutional Investors**). The funds provide investors with screening and investment management services, and offer companies financing and assistance in business management and development. Other investors in startup companies and in venture capital funds are **Corporate Investors**, who typically invest in ventures in areas close to their lines of business, and other financial investors such as institutional investors who invest directly in companies. In consideration for their investment, investors receive part of the company's **Equity**, usually in the form of **Preferred Shares**, which grant the investors preference in dividends, and upon dissolution and sales, as well as other rights protecting the investment and its value. The main terms of the investment are fixed in the **Term Sheet**, after which a detailed investment agreement (**Stock Purchase Agreement**) is signed. In later stages, the company may also receive financing through **Debt**, or by a loan combining debt and equity (**Mezzanine Loan**).

Once the development has concluded and sales have commenced, the company can raise capital from the public through an **IPO**. Listing the company for trade also allows the investors in the company to make their investment more liquid, and after a **Lock-Up Period**, they can sell shares directly on the stock exchange or in the course of a **Secondary Offering**. The main **Exit** techniques are the sale of shares in an IPO, and, subsequently, a **Private Placement** or a **Merger** with, or **Acquisition** by, a strategic investor, in consideration for shares, cash, or a combination of the two.