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Battle for Control: How Venture Capitalists Affect the Development of Businesses

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SENIOR THESIS APPROVAL

This Honors thesis entitled

**“Battle for Control: How Venture Capitalists Affect
the Development of Businesses”**

written by

Jeffery Neil Wacaster

and submitted in partial fulfillment of
the requirements for completion of
the Carl Goodson Honors Program
meets the criteria for acceptance
and has been approved by the undersigned readers.

Dr. Marshall J. Horton, thesis director

Dr. Kent Faught, second reader

Dr. Randall Wight, third reader

Dr. Barbara Pemberton, Honors Program director

April 24, 2012

Title: Battle for Control: How Venture Capitalists affect the Development of Businesses
By Neil Wacaster

Introduction: In my new podcast series, I interview business leaders to determine the affect of venture capital on the entrepreneur. First, I interview a serial startup entrepreneur to find out the true nature of venture capital, how to go about getting it, and how it affects the creative process. Next, I interview a blogger who thinks that venture capital can be very detrimental to business startups, and get his perspective on related issues.

The Interviewees:

1. Micah Baldwin
 - a. Current CEO of Graphic.ly
 - b. He and his teams have raised over \$350 million dollars of startup money
2. Peter Ireland
 - a. Blogger and author, founder of Antiventurcapital.com
 - b. Wrote "The Smart Startup Guide," which has been widely read by entrepreneurs

Summary of Lessons Learned:

1. Is venture capital positive for businesses?
 - a. Micah: For some companies, it's great, and for some it's not. VC firms are looking for a proven track record and a great team, and venture capital essentially just accelerates growth.
 - b. Peter: Most ventures would do better to use internal funding, because of the level of control that it leaves with the entrepreneur.
2. Micah's advice for entrepreneurs looking for funding:
 - a. Look for well-established VC firms to make your pitch to, ones that have good connections and have worked with CEOs similar to yours
 - b. To have a better chance of getting investment, you should have a great team, large market, and great solution.
 - c. When you make your pitch to investors, have a great presentation, and a compelling product demo
 - d. To help close the deal, have a short time frame. Once you have a lead investor, he or she will help catalyze further investment.
 - e. Once you have investment, keep investor relations strong by maintaining frequent, honest communication.
3. Peter's advice for entrepreneurs looking for funding:
 - a. The only companies that have huge potential to make it really big have any prospect of getting funding. If this is the case, then you have a baton of financing which is passed through four stages.

- i. The first is the investor using his own capital.
 - ii. The second is angel investors to help build up the company.
 - iii. The third is a venture capital firm. Usually they are only interested in companies with a proven track record.
 - iv. The last is an investment bank that would take a company public.
 - b. Trying to get venture capital right off the bat is a very amateurish move. Money is invested primarily on personal relationships.
 - c. The financial projections that entrepreneurs make are usually numbers drawn out of the air, but they usually will begin to believe their own fabrications. Investors are much more realistic.
 - d. If you are waiting for people to pay you for a product, it's a nightmare. You want to be paid up front, at least 50%.
 - e. Essentially, if you have investors, you become their employee.
4. What are the advantages of other forms of funding?
- a. Peter: if capital investment is necessary, crowdsourcing is a better way for businesses to get capital, as they retain more control and have commitment from customers. However, the optimal way is through internal funding.
 - b. Micah: investment from a bank is actually preferable to venture capital funding, as you retain more equity in the company.
5. How does venture capital investment and the startup scene affect the economy as a whole?
- a. Micah: It creates jobs. The U.S. has an entrepreneurial spirit ingrained in the culture, and it is one of the driving forces of the economy.
6. What is the last piece of advice that you would give entrepreneurs?
- a. Micah: Just do it. Thinking only gets you so far, doing gets you further.
 - b. Peter: Entrepreneurship is not for everybody, but it is a calling. If you feel that calling, go find a problem and solve it.

More complete answers given to my questions (not quotes, but a condensed version edited for clarity):

Micah Baldwin:

Is venture capital a positive for businesses?

Micah: for some companies, it's great, and for some it's not. Venture capital money is an investment vehicle, so the money generally goes to whatever company will return the highest ROI.

What do you look for when you're looking for a company to fund one of your businesses?

Micah: You want someone who will be with you through thick and thin. Usually getting a startup off the ground can take up to three years, so you want one with enough money to invest long term. You want a venture capital partner that has good connections and understands where the company and the CEO are, and can help each grow.

When you're approaching a venture capital company, how do you stand out from the crowd and make them want to invest in you?

Micah:

1. Team - must be amazing
2. Solution - must be great
3. Market - must be large

When conducting a pitch meeting, what do you need to show investors?

Micah:

1. Slideshow with what the problem is, how you're solving it, how much money is needed, and how much money will be made
2. Demo the product, hopefully that people are already paying for
3. Hopefully they'll ask you back for a second meeting.

How do you close the deal, and make sure the terms of the agreement are the best?

Micah: Gain momentum and make sure there's a short time frame. The lead investor is important, as they will lead the other investors to move forward.

How does venture capital affect your willingness to try out a new idea?

Micah: VC money is like fuel to a fire. You are able to hire and build faster. Getting money allows you to try new ideas at a much faster rate. It can distract you from focusing on revenue at first, so you may build products that don't generate money.

Would you rather get investment from a bank or from a VC?

Micah: It is better to get investment from a bank if you can, because you would hold more equity in the long term.

When an investor has a large equity stake in a company, how do you make sure that investor relations stay good?

Micah: Frequent communication, never lie, tell them the positive and negative. You should be communicating all of the information the investor needs at least monthly.

What are the factors that affect the decision to pursue a second round of funding?

Micah:

1. You are running out of money

2. You're doing really well, and getting more money can accelerate the process of growth.

How does venture capital investment and the startup scene affect the economy as a whole?

Micah: It creates jobs. The U.S. has natural resources and people, and the American people are entrepreneurial. Having that entrepreneurial spirit ingrained in the culture has driven the economy. Without that, the economy would have a really hard time being successful.

What is the last advice you would like to give to entrepreneurs?

Micah: Just do it. Thinking only gets you so far, doing gets you further.

Peter Ireland:

Please tell us a little about your background and the services you offer to entrepreneurs.

Peter: I have collected information since the late 1980s about how to start a company with minimal capital.

How would you define venture capital?

Peter: Think of it this way. If you have a company that has huge potential to make it really big, then you have a baton of financing. The first leg of the race is run by the investor using his own capital. Next, angel investors help build up the company. Next, the baton is passed to a venture capital firm. Usually they are only interested in companies with a proven track record. The last player is an investment bank that would take a company public. Trying to get venture capital right off the bat is ridiculous, it is a very amateurish move.

Is this system of four runners the best system for entrepreneurs, or can it be improved?

Peter: The free market is always trying to improve the system. The system is slowly changing, with programs such as Kickstarter. It is a very early form of funding. This is an entirely new area of funding, as each small investor is not heavily gambling. If the company fails, then they're not devastated. Traditional venture capital firms are being undermined by these crowdsourcing ventures.

What are some of the myths about venture capital?

Peter: You cannot skip any of the four steps outlined above (unless you're extremely successful and have a proven track record).

Money is invested primarily on personal relationships.

The financial projections that entrepreneurs make are usually numbers drawn out of the air, but they usually will begin to believe their own fabrications.

You say on your website that "Savvy entrepreneurs know how to create cash. Wannabes wait for someone to give them cash." Would you explain some of the best strategies for creating cash?

Peter: Lets look at the opposite answer first. If you are waiting for people to pay you for a product, it's a nightmare. You want to be paid up front, for example, a person buys the product on your website and then you make the product. Also, business customers often will pay up front. Smart entrepreneurs know how to repackage a service as a product. You should get at least 50% deposit up front, with 100% being ideal. Example: paying \$150 dollars up front instead of \$20 per month.

Another important idea is to gauge interest before actually building the product, and you can ask people if they are willing to pay in advance.

It usually takes a lot longer to grow, but if independence and autonomy are important to you, you should try to finance through independent funding. Essentially, if you have investors, you become their employee.

Your website has a ton of helpful free articles which go into a lot more detail on many of these subjects, but you also sell several ebooks, including "The Smart Startup Guide."

Why should the entrepreneurs listening to this program consider buying your products?

Peter: It's a real education to learning how real entrepreneurs start companies. Much of the information on the website is from Inc. 500 entrepreneurs.

What is the word of advice you would like to leave us with?

Peter: Entrepreneurship is not for everybody, but it is a calling. If you feel that calling, go out and try it. Find a problem to solve, whether it is a problem individuals have or businesses have. The advice is 'do what you love and the money will follow,' but that's not entirely true. Be alert for problems. See if you have a problem that others have as well. The more people or companies who share that problem, then the better your chances are when you put together a solution. Always look at it from the perspective of the marketplace.