Understanding venture capital: Is it the best funding option for your small business?

Some of the biggest companies in the world started off as side hustles – Steve Jobs worked at gaming company Atari while he built the Apple 1 and Mark Zuckerberg started Facebook while a full-time student at Harvard University.

Jonathan Smi | image supplied

Some people choose to be entrepreneurs, perhaps setting their sights on becoming a big corporation. However, if you get there, raising capital can be an obstacle. And as we kick off 2024 – it's important for entrepreneurs to consider every funding avenue available to help fund the growth of their business.

A 2023 SMME and *Side Hustle Insights Report* released by Momentum and Unisa listed raising capital among the top five needs of small business owners – and with South Africa's sluggish economy and high unemployment rate getting funding to small businesses and start-ups is incredibly important.

With all types of funding possibilities such as loans, grants, angel investing, private equity or crowdfunding – when should an entrepreneur consider venture capital?

Jonathan Smit, a senior investment associate with Knife Capital which has R1.3bn of funds under management, provides an excellent overview into venture capital and when an entrepreneur should consider it the right vehicle to provide funding for their business.

Unlike other kinds of loans and investments, VC investors take equity in the companies they choose to support, becoming true partners in the business. This is the investment model used in the hit shows such as the UK's *Dragons' Den* or its equivalent *Shark Tank*.

"Venture capital companies generally look for early-stage companies with high growth potential, getting the return on their investment with the company's eventual sale," said Smit.

Venture Capital companies are, however, by no means infallible when it comes to selecting companies in which to invest and Smit cited figures of five out of 10 companies folding before realising any profit for investors, two or three going on to make investors a modest return and only one or two making significant profits for business owners and investors alike.

Smit advised small business owners on the amount of investment they should go looking for and said entrepreneurs should pitch for amounts they can realistically utilise for growth and absorb into the operation of their organisation.

"Pitch a business, not an idea to investors," said Smit "And be sure that your business is answering a need in the market that really exists."

Timing on the road to business success is also critical and Smit warned those small businesses who still believed venture capital investment was the best solution to grow their business, that the decision to invest can take up to nine months.

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"Prepare to start looking at funding and investment options with at least 12 months financial 'runway' in your business to get you through the analysis and assessment period," cautioned Smit.

Venture capital isn't for everyone, as equity investing is the most expensive for a small business. It may be that a debt-based model – a loan or a grant – may be the best option, as it can always be paid back, whereas venture capital depends on selling equity and ultimately the business.

But if your small business is scalable and sustainable and has a competitive advantage in the marketplace, then the chances are there may be a venture capital company that will be interested in investing in you, you just need to find the one that fits. Understand the risks of each funding model and if you are not certain of which path to take – always reach out for expert advice from a financial advisor.