Alternative Investments - The Stages in Venture Capital Investing

[Venture capital](http://www.investopedia.com/terms/v/venturecapital.asp) is a source of financing for new businesses. Venture capital funds pool investors' cash and loan it to startup firms and small businesses with perceived, long-term growth potential. This is a very important source of funding startups that do not have access to other capital and it typically entails high risk (and potentially high returns) for the investor.   
  
Most venture capital comes from groups of wealthy investors, investment banks and other financial institutions that pool such investments or partnerships. This form of raising capital is popular among new companies, or ventures, with a limited operating history that cannot raise capital though a debt issue or equity offering. Often, venture firms will also provide start-ups with managerial or technical expertise. For entrepreneurs, venture capitalists are a vital source of financing, but the cash infusion often comes at a high price. Venture firms often take large equity positions in exchange for funding and may also require representation on the start-up's board.   
  
**The Stages in Venture Capital (VC) Investing**[Angel investors](http://www.investopedia.com/terms/a/angelinvestor.asp) are most often individuals (friends, relations or entrepreneurs) who want to help other entrepreneurs get their businesses off the ground - and earn a high return on their investment. The term "angel" comes from the practice in the early 1900s of wealthy businessmen investing in Broadway productions. Usually they are the bridge from the self-funded stage of the business to the point that the business needs true venture capital. Angel funding usually ranges from $150,000 to $1.5 million. They typically offer expertise, experience and contacts in addition to money.

1. ***Seed*** - The first stage of venture capital financing. [Seed](http://www.investopedia.com/terms/s/seedcapital.asp)-stage financings are often comparatively modest amounts of capital provided to inventors or entrepreneurs to finance the early development of a new product or service. These early financings may be directed toward product development, market research, building a management team and developing a business plan.   
     
   A genuine seed-stage company has usually not yet established commercial operations - a cash infusion to fund continued research and product development is essential. These early companies are typically quite difficult business opportunities to finance, often requiring capital for pre-startup R&D, product development and testing, or designing specialized equipment. An initial seed investment round made by a professional VC firm typically ranges from $250,000 to $1 million.   
     
   Seed-stage VC funds will typically participate in later investment rounds with other equity players to finance business expansion costs such as sales and distribution, parts and inventory, hiring, training and marketing.
2. ***Early Stage*** - For companies that are able to begin operations but are not yet at the stage of commercial manufacturing and sales, early stage financing supports a step-up in capabilities. At this point, new business can consume vast amounts of cash, while VC firms with a large number of early-stage companies in their portfolios can see costs quickly escalate.
   * **Start-up** - Supports product development and initial marketing. Start-up financing provides funds to companies for product development and initial marketing. This type of financing is usually provided to companies just organized or to those that have been in business just a short time but have not yet sold their product in the marketplace. Generally, such firms have already assembled key management, prepared a business plan and made market studies. At this stage, the business is seeing its first revenues but has yet to show a profit. This is often where the enterprise brings in its first "outside" investors.
   * **First Stage** - Capital is provided to initiate commercial manufacturing and sales. Most first-stage companies have been in business less than three years and have a product or service in testing or pilot production. In some cases, the product may be commercially available.
3. ***Formative Stage* -** Financing includes seed stage and early stage.
4. ***Later Stage*** - Capital provided after commercial manufacturing and sales but before any initial public offering. The product or service is in production and is commercially available. The company demonstrates significant revenue growth, but may or may not be showing a profit. It has usually been in business for more than three years.
   * **Third Stage** - Capital provided for major expansion such as physical plant expansion, product improvement and marketing.
   * **Expansion Stage** - Financing refers to the second and third stages.
   * [**Mezzanine**](http://www.investopedia.com/terms/m/mezzaninefinancing.asp) **(bridge)** - Finances the step of going public and represents the bridge between expanding the company and the IPO
5. ***Balanced-stage*** financing refers to all the stages, seed through mezzanine.