VENTURE CAPITAL FUND: A HOW TO GUIDE

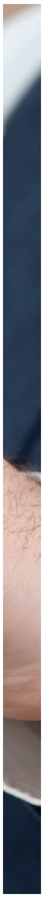
SHAHRAM SAFAI, PARTNER AT LAW FIRM AFRIDI & ANGELL, EXPLAINS HOW ENTREPRENEURS CAN FORM A VENTURE CAPITAL FUND

A **start-up entrepreneur's** choice for funding is generally between raising funds from family and friends, and obtaining venture capital financing.

Family and friends may be willing to invest at a lower price (i.e., to accept a higher valuation of the company at the time they invest) but often bring little else to the table. Venture capitalists may demand a lower valuation but will almost always bring many intangibles that can assist the company to grow faster and to be more successful. Generally, they request a business plan but not audited financials, or a track record.

Venture capital financing can be an attractive funding source for other reasons as well.

Venture capital may allow the entrepreneur to raise all of the capital from one source, or from a lead investor who can attract other venture funds. Venture capitalists have experience with the challenges of start-ups and know how to grow a company to an initial public offering, sale of the busi-



ness, or other liquidity event.

Experienced venture capitalists have a network of contacts who can help the company succeed. Venture capitalists are often able to provide valuable assistance in recruiting other members of the management team. Also, being venture-backed gives an enterprise a certain cachet, which can open doors to other financing and resources.

Venture capital financing has been on the rise in the Middle East and such rise is set to accelerate exponentially in Dubai in the next decade. But how does one form a venture capital fund?

A venture capital fund is traditionally a legal entity that is a limited partnership. The limited partners are passive investors in the fund. The general partner has management and fund investment responsibility. The limited partnership (i.e. venture capital fund) pays a management fee to the general partner for its management services, as well as a percentage of profits (carried interest).

Lawyers experienced in venture capital law play a critical role in assisting to design, negotiate and establish venture capital funds in flexible jurisdictions with established laws such as the State of Delaware in the United State or the Cayman Islands. Establishing a venture capital fund generally takes about one to two months depending on complexity, with bank account opening and other regulatory formalities taking a further one to one and half months.

Generally, the fund's primary purpose is to invest in equity or equity oriented securities of privately held companies in information technology, internet, software, communications, new media, multi-media, entertainment, telecommunications, wireless applications and related industries.

The fund will have an expected size of several million to several hundred million dollars, and have a life of a few years, and sometimes ten years. The net recognised capital gains and losses will be allocated between the limited partners and the general partner. Also, the general partner may make distributions of cash or marketable securities from time to time in its discretion.

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Generally, the general partner appoints an advisory committee of up to five members, who provide advice to the general partner with respect to strategy, investments and conflicts.

The demand for venture capital funding in the Middle East is on the rise as successful start-ups emerge from their cocoon and desire increasingly greater amounts of sophisticated capital to succeed. As a result, the demand and the opportunity for new venture capital funds in the Middle East are quickly expanding.

Shahram Safai practices venture capital law and represents venture capitalists, investors and entrepreneurs. Shahram is also a professional engineer and has previously worked in the Silicon Valley in California practicing venture capital law, mergers, and acquisitions. He is a partner at the law firm of Afridi & Angell.