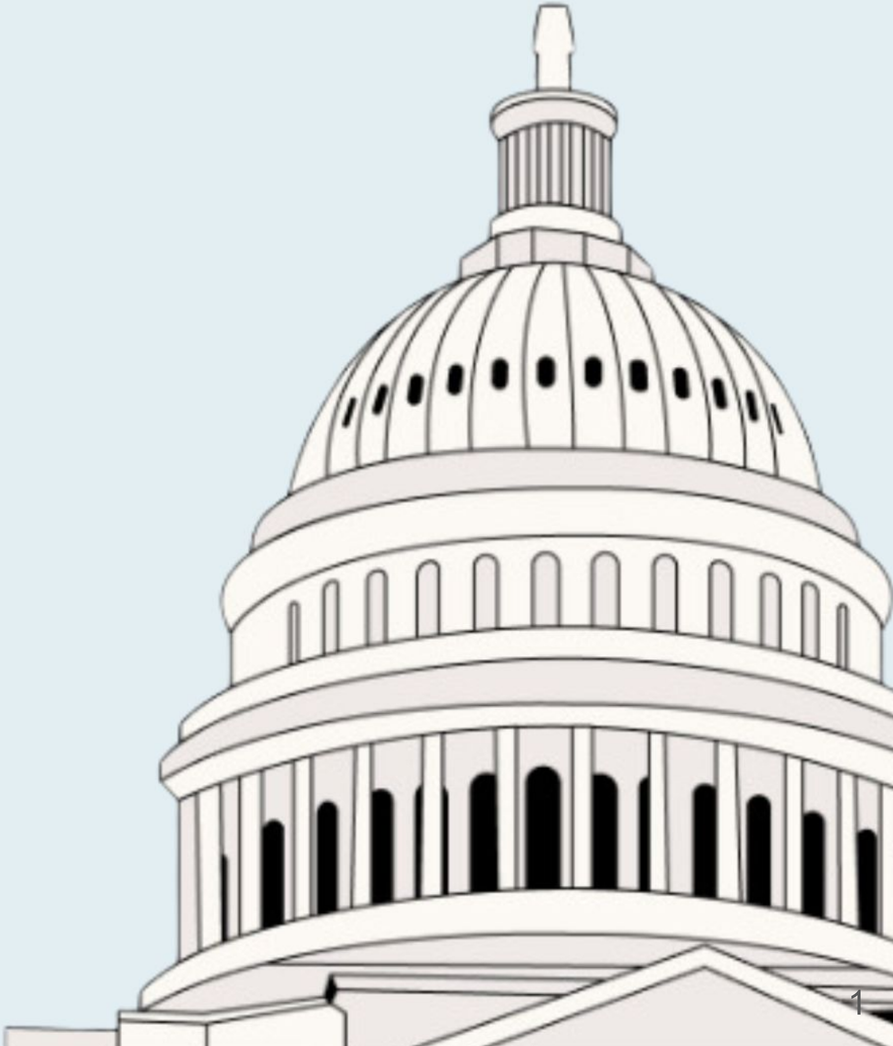
Carta Policy
VC 101



The Economic Engine

of venture capital

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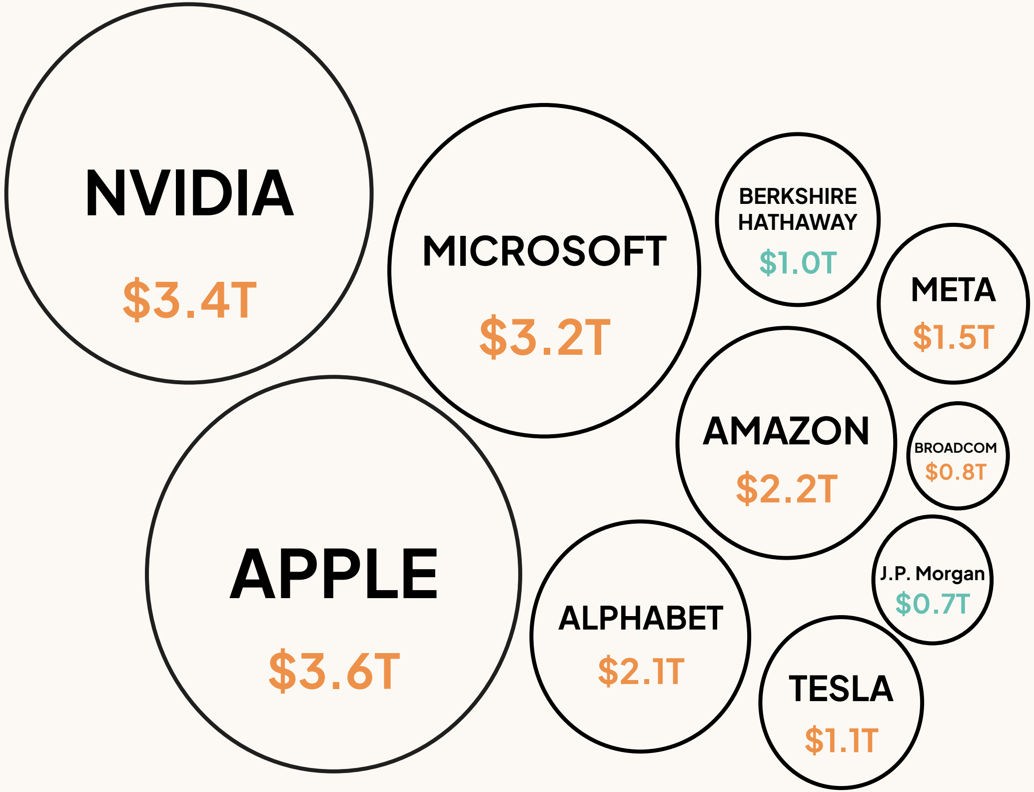
What do the largest public companies have in common?

Venture capital.



VC-BACKED COMPANY | NON-VC-BACKED COMPANY

Source: Yahoo Finance (as of Dec. 2, 2024; rounded to the nearest hundredth of a trillion)

Venture capital drives innovation, economic growth, & U.S. competitiveness

+50% of the public companies in the US were venture backed

¾ of total market value comes from VC-backed companies

8 out of 10 of the top ten US companies were VC-backed

Source: Will Gornall and Ilya Strebulaev, The Economic Impact of Venture Capital: Evidence from Public Companies (June 2021)

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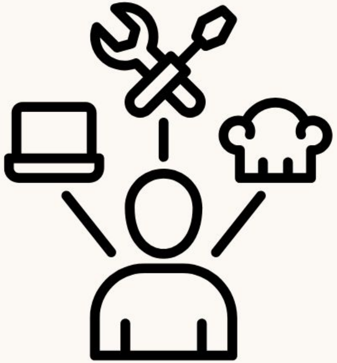
Venture capital is...



Economy & Jobs

Innovation & Competition

Value Creation & Results

From pipe dream to mainstream, venture capital is the catalyst that has revolutionized our everyday lives.

Venture capital has helped us work smarter, feel safer, live healthier, and build lasting connections.

Technology & Innovation

Google
Apple
Intel

Health & Wellness

Genentech
Moderna
Impossible Foods

Travel & Transportation

Uber
Flexport
Airbnb

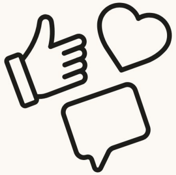
Commerce & Convenience

Amazon
Shopify
Instacart

Safety & Security

Anduril
Palantir
Ring

Social Media & Communication

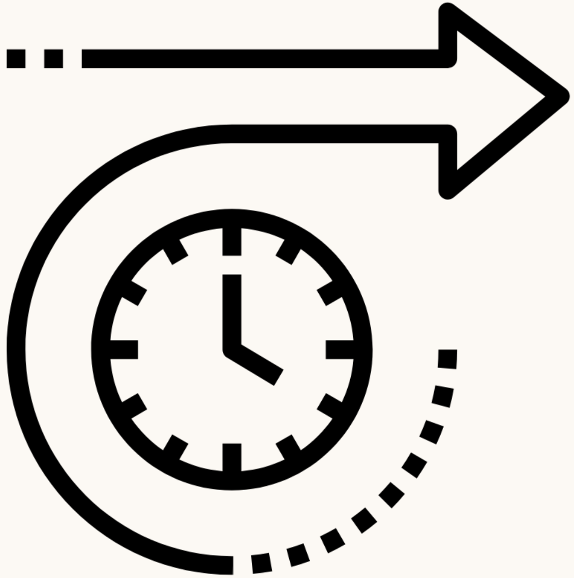


Instagram
Bumble
Zoom

The Fundamentals

of venture capital

Startups and high-growth companies depend on venture capital for long-term, risk-forward investments needed to foster innovation and drive competition.



Company life cycle

Venture capital invests across a company's life cycle.

	Seed	Early Stage	Growth + Expansion	Exit
Activity	Product / business development	Product improvement +scale, customer + revenue growth	Scale to bigger market, enter new segments, maintain profitability, expand hiring	M&A, IPO, stay private
Source	Self, friends + family, grants, crowdfunding, angel investors, early-stage VC	Angel investors, accelerators, VC	VC, private equity	VC, private equity, hedge funds, banks

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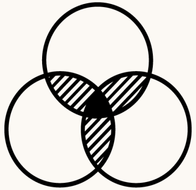
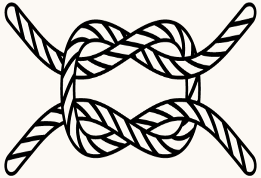
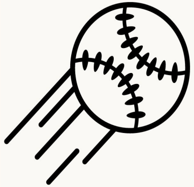
Characteristics of venture capital



Subset of private equity

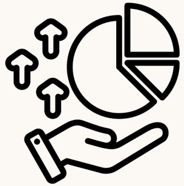


Diversification across array of portfolio companies



Risk-profile incorporates failure in pursuit of outsized returns

Early stage companies that scale and grow quickly



Relatively small investment for minority stake

Long-term commitment, active engagement

PRIVATE EQUITY	vs.	VENTURE CAPITAL
Invest in established companies to optimize operations, drive growth, and build value, leading to profitable exit	**STRATEGY**	Invest in early-stage companies with high growth, high-return potential to help develop, grow, and scale, leading to potential for outsized returns at exit
Mature, established or growth-stage companies; may take public companies private	**COMPANY PROFILE**	Startups and early-stage companies with high growth, high-return potential
Larger investments (millions to billions) in fewer companies	**DEAL SIZE**	Smaller investments (mostly <$10M, particularly at early stages)
Equity and debt	**LEVERAGE**	Equity only
Majority stake (50%+), with exception of growth	**OWNERSHIP**	Minority stake
Directly involved in operations and management; industry expertise to optimize outcomes	**ENGAGEMENT**	Provide guidance, business development support, network and sourcing resources
5–7 years	**DURATION**	6–10+ years
Moderate risk, positive return	**RISK & RETURN PROFILE**	High-risk investments with potential for outsized returns

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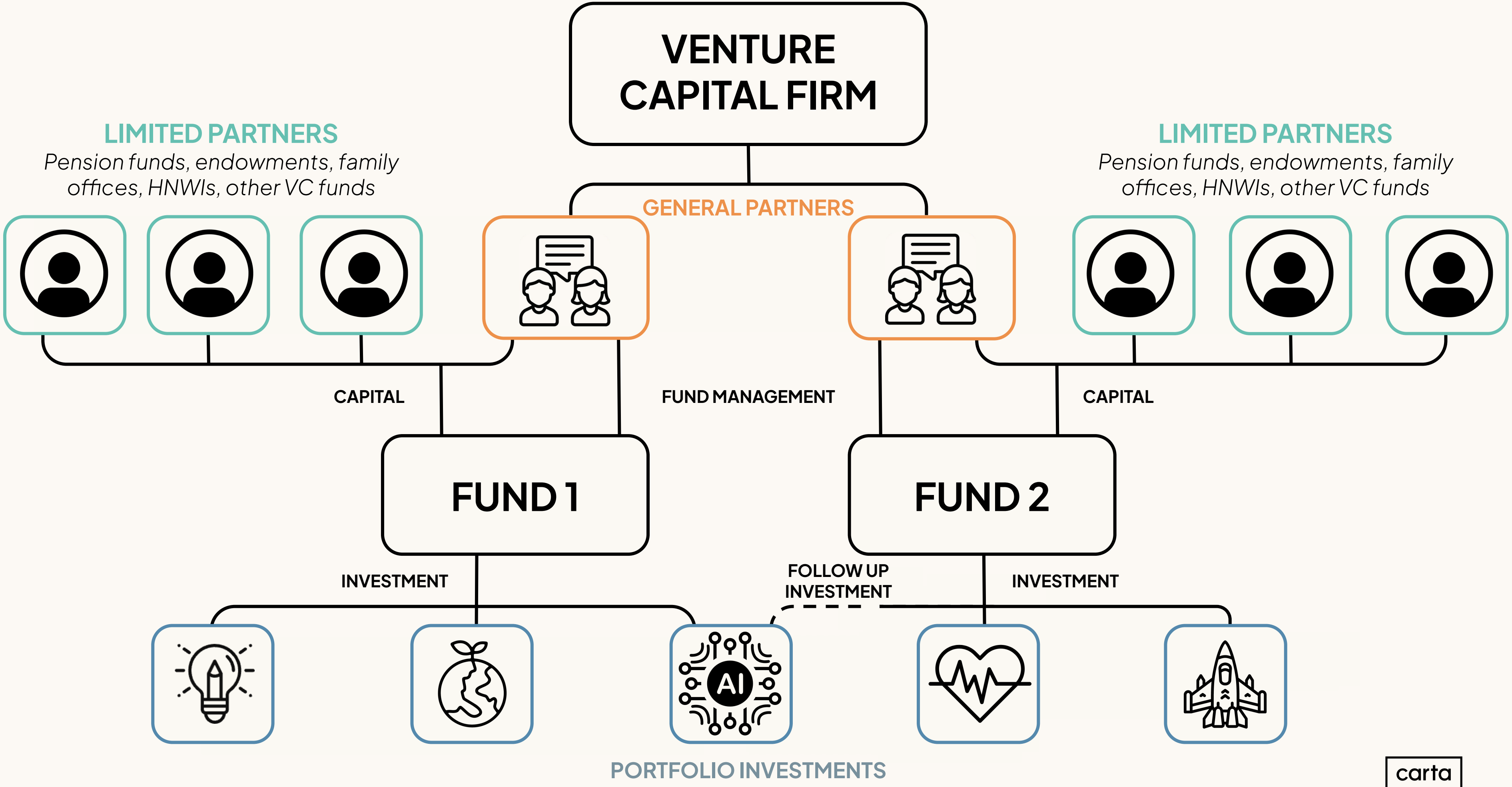
VENTURE CAPITAL FIRM
LIMITED PARTNERS
Pension funds, endowments, family offices, HNWIs, other VC funds
GENERAL PARTNERS
LIMITED PARTNERS
Pension funds, endowments, family offices, HNWIs, other VC funds
CAPITAL
FUND MANAGEMENT
CAPITAL
FUND 1
FUND 2
INVESTMENT
FOLLOW UP INVESTMENT
INVESTMENT
AI
PORTFOLIO INVESTMENTS

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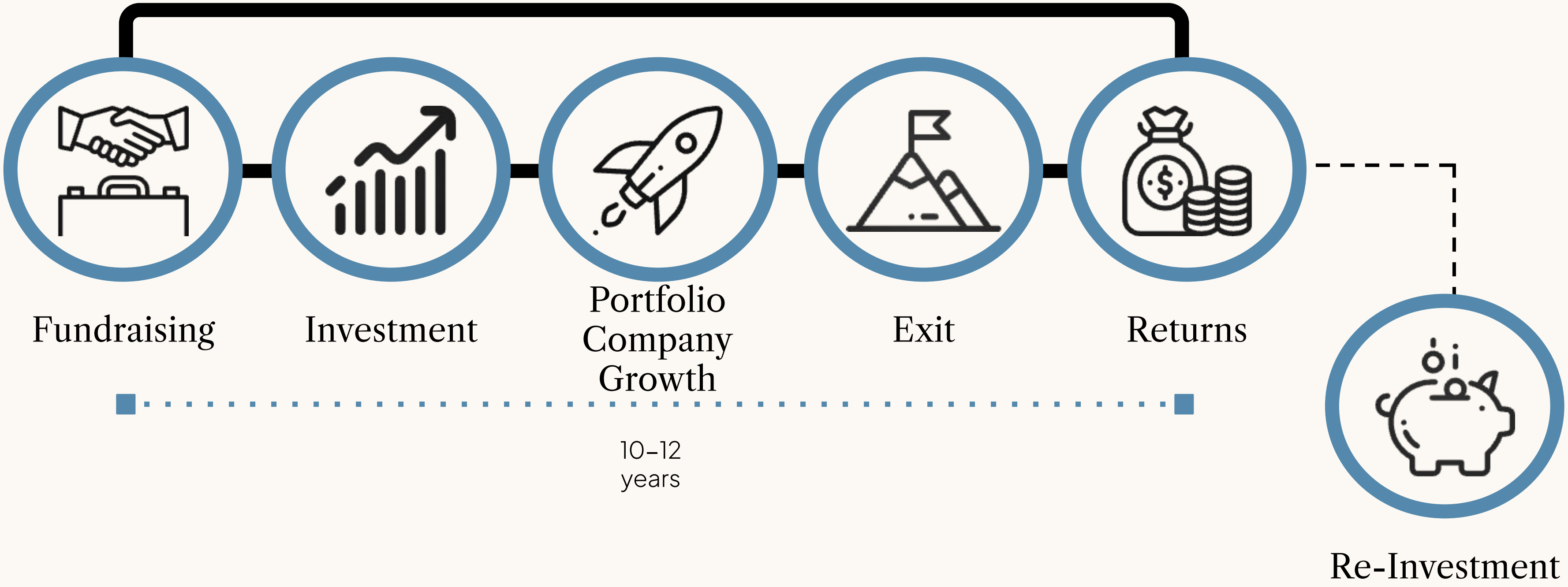
Fund life cycle



The Regulatory Landscape

of venture capital

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Regulatory framework

The Fundraising Process

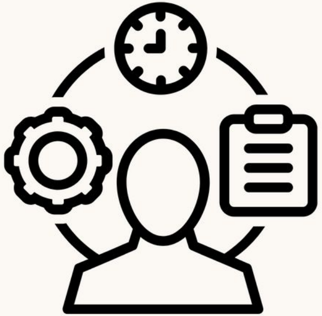
Securities Act of 1933

Regulation D

The Fund

Investment Company Act

Section 3(c)(1)
Section 3(c)(7)



The Fund Manager

Investment Advisers Act

Registered Investment Adviser (RIA)
Exempt Reporting Adviser (ERA)

Fundraising: Regulation D

	RULE 506(b)	RULE 506(c)
Investors	Accredited investors (up to 35 non-accredited with disclosures)	Accredited investors
General Solicitation	No; requires pre-existing, substantive relationship or demo day	Yes
Accredited Investor Verification	Self-certification	GP must take “reasonable steps” to verify
Form D	File with SEC within 15 days after first close	
Blue Sky Filings	Notice filing with state	

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Fund regulation

INVESTMENT COMPANY ACT

Section 3(c)(1)

Section 3(c)(1)

- 100 beneficial owners
- 1 entity = 1 LP; can sometimes look through structures
- Accredited investors

Qualifying VC Fund

- Up to 250 beneficial owners, if <$12M
- VC fund

Section 3(c)(7)

- Qualified Purchasers ($5M individual, $25M entity)
- Up to 1,999 QPs permitted

Fund manager regulation

SEC-registered investment adviser (RIA)

Private fund advisers >$150M AUM

VC fund advisers who invest in >20% non-qualifying assets

Exempt reporting adviser (ERA)

Solely advises private funds <$150M

Solely advises venture capital funds

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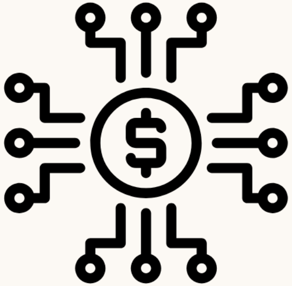
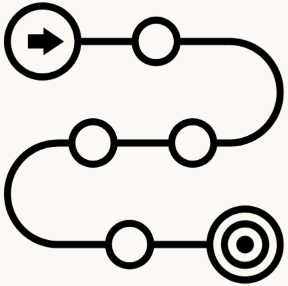
Venture capital fund requirements

80% assets in qualifying investments (direct portfolio investments + cash)



No more than 20% assets in non-qualifying investments (fund-of-fund, secondaries, crypto)

Limited leverage + redemption rights



Private fund that pursues venture investment strategy

Fund manager regulation

Exempt Reporting Advisers

- ☐ **Form ADV**: Uniform doc to register with SEC & states
- ☐ **Anti-fraud:** All advisers are subject to anti-fraud rules
- ☐ **Material nonpublic information:** Written policies to prevent misuse of MNPI
- ☐ **Pay to play:** Political contributions could prevent adviser from providing services to government entities
- ☐ **SEC examinations and enforcement:** SEC still examines and oversees

Registered Investment Advisers

ERA requirements, plus:

- ☐ **Enhanced filing requirements**: Form ADV (Part 2A fund brochure) and Form PF
- ☐ **Compliance:** Written policies and procedures, dedicated chief compliance officer, and compliance program tailored to the business.
- ☐ **Recordkeeping rule:** Maintain extensive records of business, including all written communications.
- ☐ **Code of ethics**: Written code outlining responsibilities and standards of conduct
- ☐ **Custody + audit requirements**
- ☐ **Marketing rule**

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The Future
of venture capital

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Venture capital is frequently overlooked or misunderstood.

That can lead to flawed policy.

New compliance costs and reporting obligations

Greater SEC enforcement and examinations scrutiny

Disclosures around fees, expenses, performance, and operations

Relationships with LPs and vendors

More expensive and harder to raise capital

Smart policy lowers barriers to entry, fosters innovation, and helps companies grow.

Policy can appropriately expand investor access to enable more to benefit from increased returns and diversification.

Expand accredited investor on-ramps to reflect financial sophistication

Permit access to private market investments through professionally managed funds

Increase participation in private market investments through retirement accounts

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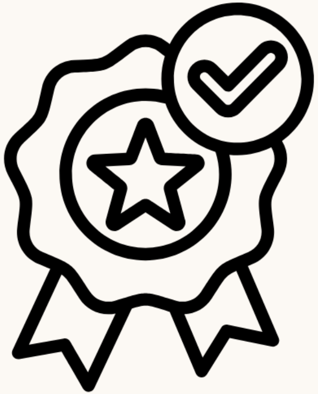
Policy should **bolster emerging fund managers** by lowering barriers, facilitating fundraising, and making it easier to invest in entrepreneurs.

Help emerging managers attract anchor LPs by making fund-of-fund investments qualifying investments

Raise the size and investor limits to help emerging managers assemble competitive funds

Bolster regional networks to make it easier for funds and companies to access capital locally

Tailored regulation balances the risks and opportunities that lower barriers, unlock capital, and unleash innovation



Industry-driven standards and best practices to shape a framework that reflects venture model

The Appendix

Glossary of Terms

- **Accredited investor:** One of two types of investors permitted to invest in startups by the SEC. To become accredited, an investor must meet a specific income or net worth threshold, or pass a financial exam and hold a specific license. The accredited investor qualification is a common way for individual people to start investing in startups. As of today, the criteria are either 1) an income of $200,000 a year single or $300,000 joint in each of the two most recent years; 2) a net worth of over $1 million not counting the value of your primary residence, or 3) taking the test to receive a license Series 7, Series 65, or Series 82. But these requirements may change. At Carta, we believe that more people should be able to become accredited investors.

- **Angel investor:** An individual person with enough capital to invest in startups who invests directly into the company, rather than putting money into a fund. Angel investors often invest in the early stages of a company, usually via convertible instruments. That means angel investors typically take on more risk.

- **Fund:** A legal structure that pools other people's money together to invest. Typically, VC firms are structured into three parts: The general partner, the management company, and the fund.

- **General partner (GP)**: A member of a limited partnership who plays an active role in day-to-day operations and assumes unlimited personal liability for any business debts. In the context of private equity and venture capital, most investment funds are structured as limited partnerships with limited partnership agreements; limited partnership agreements (LPA); the GP is typically seen as the venture fund manager.

- **High net worth individual (HNWI):** An individual with a large amount of investable wealth, typically exceeding $1 million in liquid assets after accounting for their liabilities.

- **Limited partner (LP):** Institutional investors who invest in venture capital funds through a VC firm. LPs bring the money to invest, but typically aren't involved in the day-to-day—though they will have requirements.

Glossary of Terms

- **Management company:** A company that is part of a VC firm. Everything that makes the firm run, like hiring and paying employees and finding office space and software, is done and paid for by the management company. You can think of the management company like the "brand" of the firm, and the "headquarters" of the firm.

- **Management fee:** A fee on a fund charged by the management company so it can handle overhead. Usually, the fee is around 2% of the value of a fund. Along with carried interest, this is the other way a VC firm makes money. GPs often refer to their overall pay structure with the phrase "two and 20," or 2% management fee with a 20% carry.

- **Merger/acquisition (M&A):** When your company gets bought by another entity, or merges with another company. Mergers and acquisitions can be liquidity events. Often, the acquiring company will give you a lump sum payout. If you own common stock (like most employees and founders do), you'll be the last to be paid out.

- **Post-money valuation:** A calculation of the amount of money the company will be worth after an investment comes in. It's based on the price of preferred shares, which are granted to investors. This type of valuation is a way for founders to keep track of the equity they control in a company.

- **Pre-money valuation:** A calculation of the amount of money the company is worth before an investment comes in. Investors often require an employee stock option pool to be created on a pre-money basis, meaning that the pool will only affect the people who owned shares before the investment came in.

- **Preferred stock:** A type of stock that is mainly issued to investors, who usually pay a higher price per share than for common stock. Shareholders of preferred stock get paid out first if the company has an exit event (like an IPO or M&A) or in case of bankruptcy.

Glossary of Terms

- **Priced round:** A way private companies can raise funds from investors by taking money in exchange for shares in the company. In these agreements, the investor pays a clear, defined price for a certain percentage (or number of shares). Priced rounds are typically used by VC firms once a company gets some traction and really starts growing. Those rounds tend to be "lettered," like Series A, B, and C.

- **Qualified Purchaser:** An entity—which could be an individual or a business—with a significant amount of investment capital. This is the second of two types of investors permitted to invest in startups by the SEC. Qualified purchasers are permitted to take on more types of investments than accredited investors, but the credentials are stricter. Individuals need to have either $5 million invested for themselves or $25 million in private capital invested on behalf of other people.

- **Special-purpose vehicle (SPV):** Like a VC fund, but it's designed to only invest in one single thing—often one company. New investors often use SPVs to build a track record when they're just starting out. Investors might also use an SPV when they want to do a deal that's outside the normal operating procedure of their fund.

- **Stock options:** A type of equity compensation that gives you the option to buy shares at the price listed on your equity grant. Early-stage companies tend to give stock options. Stock options aren't stock. That's a big misconception. You still need to buy ("exercise") them at the agreed-upon price ("strike price") in order to be an owner.

- **Securities and Exchange Commission (SEC):** A government regulatory agency whose duties include protecting investors. A private company isn't required to make financial information public, so investing in a private company comes with more risk. For that reason, not everyone can invest in a startup—only people deemed by the SEC to be sophisticated enough to understand the heightened risk involved.

The fine print