Venture Capital:

Everything You Need To Know About Raising VC Funding

EarlyGrowth

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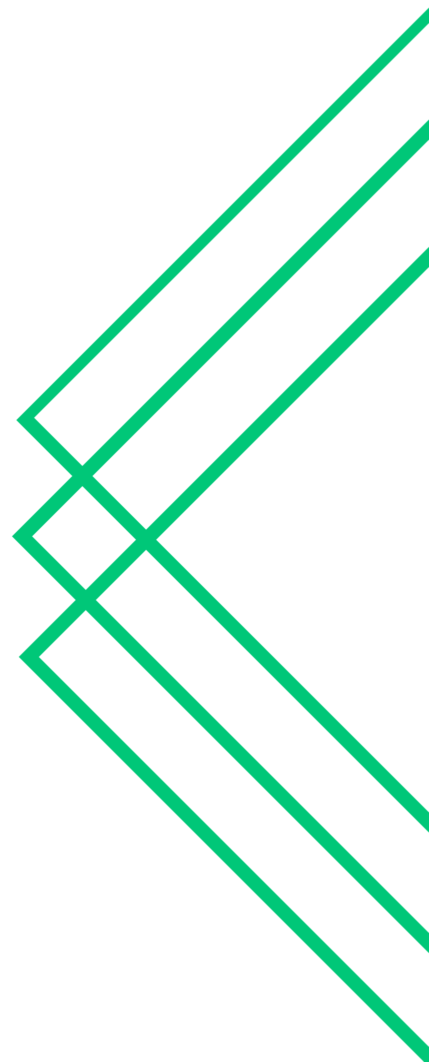

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Introduction

Venture Capital is one of the most frequent topics in the startup world. With questions similar to “How do I find a venture capitalist?” “How much should I raise?” “What are VCs looking for?” The questions can go on and on.

There is much to know about raising VC, and now you don’t have to wonder. With this guide, we answer all your questions.

Chapter 1

What is Venture Capital and When Do You Need it?

You’ve identified a pain point. You’ve come up with a solution. You’ve thought through your offer and it’s a winner. You’re ready for next steps. You’re ready to raise some funding.

Or are you?

Before working your contacts and networking like crazy to connect with VCs, you need to make sure that you’ve fully assessed the business opportunity.

Ask yourself these key questions to prepare for a raise, because if you don’t ask yourself these questions, you can be sure that the VC on the other side of the table will...and you better be ready:

Is it a good market opportunity?
You may think you're solving a problem, but do others agree? Do your research. Start by figuring out who your target market and no, not everyone is your target market. Identify those segments that will be your best potential customers and use financial projections to predict how much you will be able to sell to them. Then go out there and talk to these potential customers. Do they see value in your offering? Does it work the way they want it to? If so, that's market potential.

Is there revenue potential?
VCs are interested in seeing real revenue potential. It all comes down to this: if your company doesn’t have the potential to earn significant revenue, what’s in it for an investor? Use your sales projections to calculate your potential revenue growth. In addition to this, calculate

the spending that will be necessary to achieve this revenue. You can also do some competitive analysis at this point, researching similar companies to find out their gross margins, profit, and overhead, and use these findings as a guidepost.

Does it have potential for large-scale growth?

Revenue potential goes hand-in-hand with large-scale growth. Will there be increasing need for your offering and a growing customer base? In the early stages, you're not ready to scale yet, but you need to already be thinking about scaling. Do you have the infrastructure and financial, legal, and HR systems in place to support you as you scale? Is your original idea enough to sustain growth or will you need to seek out expansion opportunities?

Is it a good time for this idea?

Timing is essential. While your idea might have been a winner last year or next, if the time isn't right now, you're out of luck. Working in a hot sector? Have a solution that stands out? Solving a topical problem? Then timing is on your side.

Do you have the right team in place?

Just as it's not always what you know, but who you know, in the world of investment capital, the motto could read: it's not what you're doing, but who you are. If you don't have an impressive management team, you're not going to get very far. Of course, if your team has a successful track record and/or experience in the industry, you're a step ahead in the game. If you're a new entrepreneur, you can at least make a good team impression by demonstrating a united front, showing that your team knows their business and works well together.

Do you have the right technology in place?
Do you have the right technology to power your solution. It's not necessary that you have state-of-the-art technology (though that's an obvious plus!), but you do need to be sure that you have the proper technology and that you will be able to maintain your competitive advantage with future tech developments further down the road.

In a sense, all of these questions boil down to one big question: Is this something that VCs would be interested in? Every successful and unsuccessful entrepreneur knows that a good idea isn't enough. VCs want to know that your idea has wings. Answering these questions, and using your responses as the foundation for your pitch deck, will help you prove to even the most jaded VCs that your idea is going to fly.

Before raising startup capital, there are some essential questions that need to be asked, plans that need to be made, and materials that need to be gathered.

Analyze your business
In order to analyze your business model and the economics of your startup, you need to ask yourself some hard questions around the areas of your financials, your customers, your sales, and your startup team. Specifically:

Financials
What stage is your company? Pre-revenue? Cash-flow positive? It is not just enough to say early stages. Specifically what has your company done to-date.

What is your revenue/cash/ pricing model? If you haven't sufficiently thought this through, time to go back to the drawing board.

What kind of financing have you taken in to-date? And how much? Maybe you've already received a capital infusion. Where has that money gone and why are you looking for more?

Customers

Who is your target customer?
And no, not everyone can be your target customer.
How many customers do you already have? How many other potential customers exist? This is an exercise in top-down financial projection.

What are your important financial metrics?Customer acquisition cost, lifetime value of your customer, renewal rate, attrition rate? You need to keep an eye on the most relevant KPIs (key performance indicators).

Sales

What percentage of your revenue comes from your largest customer? What percentage comes from your five largest? How long is the sales cycle? You can't begin to measure your pipeline without first understanding the duration of your sales cycle, from start to finish.

What does your sales pipeline look like? You want your pipeline to have a well-distributed set of potential customers well-distributed, with customers at every stage of the sales cycle. And you need to know how many funnel levels your pipeline has, with an ability to track and measure progression through the pipeline.

Team

What is the make-up of your current team? What are your strengths and who do you have coming to the table?

Where, if any, are your team gaps? If your team has gaps, this isn't necessarily a deal-breaker. Be proactive at recognizing and filling; or at least accounting gaps.

Clarify your fundraising game plan

Okay, you've analyzed your business model and now you're ready for some capital; but what does this money look like and where is it going to come from? Here are some key questions to help you to clarify your fundraising goals.

How much money do you need to raise? Your goal is not to get as much money as you can. Your goal should be to outline your next milestones, identify how much you need to hit those milestones, and fundraise to those milestones.

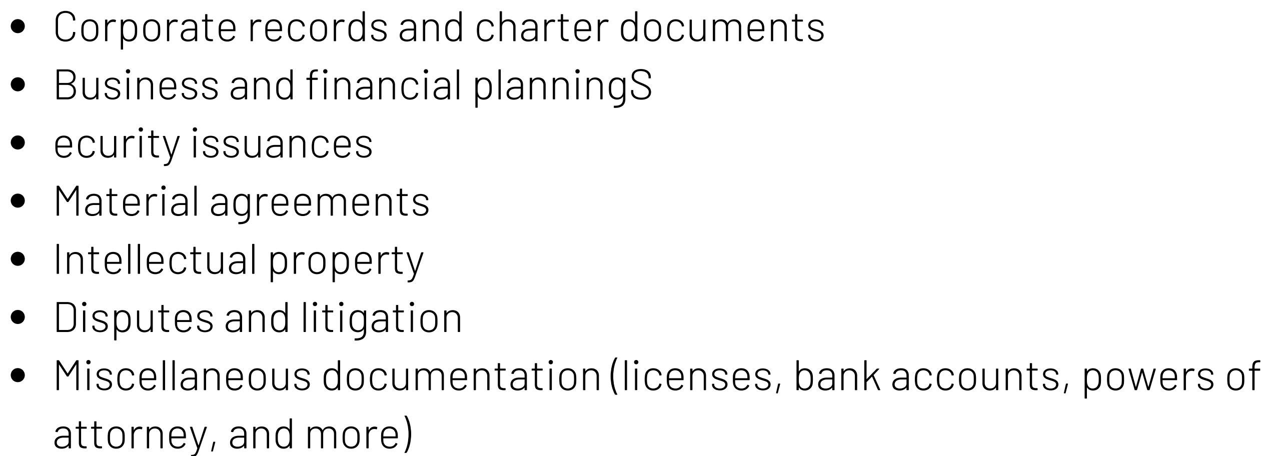
What's that money going to be used for? Again, there should be a direct correlation between the money you raise and the milestones you hope to achieve.

What type of capital is the best fit for your company, and why? Family and friends? Revenue-based financing? Angels? VCs? Bank loans? There are many options when it comes to raising funds. Once you know your goals, you can identify your best capital source.

At what cost and with what terms and conditions? How do the costs and terms of equity, debt, and revenue-based finance compare?

Prepare for due diligence

To prepare for due diligence you need to collect all the necessary documentation. There are many documents that need to be gathered to fulfill this process. Documentation falls into the following categories:



- Corporate records and charter documents
- Business and financial planningS
- ecurity issuances
- Material agreements
- Intellectual property
- Disputes and litigation
- Miscellaneous documentation (licenses, bank accounts, powers of attorney, and more)

Chapter 2

Finding A Venture Capital Investor

How can I connect with investors? That is one of the most common questions I hear from early-stage entrepreneurs. Connect is a good word to use. If you're looking for funding, you don't just want to meet investors, shake their hands and give them your quick pitch. You want to connect with them, to really make a deeper connection.

So how do you do this? We've close figured out 6 keys for making these kinds of real connections:

No cold contact

This is the first rule. Avoid cold contacts. Maybe it could work for some, but I personally don't know of any examples in which a young company was able to whip up investor interest through a cold email. To new entrepreneurs, this can seem like one of those vicious cycles: I don't have any connections to VCs so therefore I can't make any connections.

There is a way out of this cycle. The answer is simple,but admittedly not easy: work your network hard. Do whatever you can to find a contact even if its many times removed. The closer you can get to the source, the warmer your touch. Pore through your social media contacts. Tell everyone you know what you're doing and what you're looking for. Have your pitch ready for the most unexpected opportunities.

And, if and when you do get a warm introduction, don't waste these opportunities. Jump on your chances, show your gratitude, and make sure that you make the same effort to return the favor and help others in your network.

Find your investor hit list
All investors are not created equal, so why would you reach out to any and all investors? First think about what stage your company is in. You want to target early-stage investors, those VCs that focus on seed, startup and first stage financing. Beyond round, you also want to identify those VC firms that specialize in your area, with the caveat that you don't want any investors who have recently invested in companies who are competitors in your space. Once you have your list, talk to other entrepreneurs to get their impressions and feedback. Your fellow entrepreneurs are a great resource for inside knowledge that you can't find anywhere else.

Focus on investor value-add
When you're looking for money, it's easy to forget the other things that an investor can bring to the table. Ultimately, however, it's these value-adds that are of greatest importance. All investors have money, but what else do they have to offer besides money? When narrowing down your targeted list of investors, I recommend that entrepreneurs focus on what I call the RACE: Relationships, Active involvement, Commitment, and Expertise. These are the things that will have the most positive impact on your company.

Target connectors
This is sort of a repeat of my last tip, but such an important one that it bears calling out on its own. When you're creating your list of potential investors, you want to do so with an eye to who is going to best help you with introductions and navigating the waters of starting your own company. Just as you need connectors to get you an in with investors, so too you will you

need connectors to take the next steps once you've gotten your first funding round. If you can find an investor with a wide network and a wealth of experience, you'll be ahead in the game.

Do your research
This point cannot be overstated. Do not make the mistake of contacting investors without first doing your homework. If you do, this is pure hubris and a waste of any warm introductions you've been gifted with. Read websites, follow investors on Twitter, and mine LinkedIn and CrunchBase. You should also check out TheFunded, but beware of the bias that can be built in to these reviews.

Consider incubators
Incubators aren't for everyone; if you're an experienced serial entrepreneur, for example, this is not going to be your path. But for new entrepreneurs, a good incubator program can be a great option. The top programs can be especially hard to get into, but it's worth the effort for the experience and advice you will acquire.Investors are busy people who are bombarded by pitches on a daily basis. We get it! But this doesn't mean that investors are too busy for you. They are in the business of finding great companies and making money. If you have a great company, you're building traction, and you know where you're going and how you're going to get there you will find investors who realize your potential and are interested in funding you.

“Most people overestimate what they can do in one year and underestimate what they can do in ten years.”

-Bill Gates, Co-founder of Microsoft

Chapter 3

Are They the Right VC for You

To raise or not to raise...that is often the question for early-stage startups; and who to raise from? Once you've considered your options, if you decide to raise VC capital, the next step is finding the best VC firm for your company. At first you may think this is a case of beggars can't be choosers: you may be ready to take money from anyone who's willing to give it to you. But there's more to getting startup capital than just the money.

The VC that you choose will shape the future development of your company. Beyond the money, your VC will provide insight, support, and an extended network. Your relationship with your VC is unique: they pay you and work for you; where else do you find that?

The process of finding the right VC is a lot like dating; personal chemistry is paramount; you either click or you don't. But there is also more to attraction than intangible chemistry; a lot depends on the tangibles: what the VC can bring to the table.

To find investors who will add the greatest value for your startup, consider the following questions:

Do they have the key strategic relationships you need?
You'll want to do your research and take a close look at the kinds of relationships they have with partners and customers. What you're looking for is evidence of the VCs' ability to help connect you to your potential customers.

How much money will they be willing to invest in follow-on rounds?
Sure, the initial investment is important, but you want to know that the door is open for future rounds as well. Don't just take into consideration the amount that the VC is willing to invest initially, but the amount that they will invest over the long haul.

What is their reputation?
A good resource for researching VCsThe Funded, an online community of 18K+ entrepreneurs. CEOs can join for free (other execs, lawyers, consultants, etc. must pay a membership fee) to have access to profiles of over 4,000 funds, including ratings and reviews, plus discussions on funding terms, models, and the practices of venture financings.

What is their investing philosophy?
Different VCs have very different philosophies. Some are quick to kill companies are some are much more entrepreneur-friendly. Some have a history of flipping management teams, etc. Consider your vision and goals and find the VC firm that aligns with your philosophy.

Will they be an invested and reliable sounding board?
Experienced VCs have worked with many startups. You want to find a VC that has the experience that helps them lend an ear, give advice, and help you stay on track; without making the same common mistakes that so many startups make.

Will respect be mutual?
This may be hard to gauge, but it's very important. Will the VC respect your business and you, personally? And, on the flip side, do you trust this firm? You want to be assured that they will protect your interests.As with dating, the goal here is to find the right partner, not just to settle for any partner at all. Listen to your intuition and hold out for the VC who shares your goals and can support you. You may think you're in no position to be choosy, but you are, and you can.

Chapter 4

Getting The Meeting

Well, the good news (and the bad news) is that there really are no tricks to raising investment capital for your business. Raising capital requires preparation, persistence and diligence. Before you begin, make sure that you are well organized. Once you start meeting with investors, you need to be on the ball to be able to respond quickly to their requests and questions. If you've got a solid business plan and tested prototype there are only a few simple things you need to do to stand out above the crowd.

Do your research and narrow the field

Make sure you are meeting with the right investors. After a lot of effort has been made and time spent is not a good time to find out a simple fact that could have been made clear early on that this was a dead end. Especially if that simple fact could have been easily found on a Google search. And even worse, if your contact knows someone that could be helpful to you but you've demonstrated yourself to be sloppy you will certainly miss out on an important connection. The strategy of pitching often and pitching everyone is a good one for general networking, but when making serious pitches be sure that you know your investor. Do your homework. Be prepared. Investors want to know that you are someone that cannot easily be surprised.

Listen carefully

You should note all of the feedback you get and be sure to give it the thought and the response it deserves. Objections and criticisms can be very helpful in sharpening your presentation and alerting you to any weaknesses in your plan. Listen carefully to what investors are asking you for and provide it to them. There is often a level of subtlety involved. Investors are looking for keen listeners, someone who can really hear what it is they are asking about. They want someone who can understand all of the implications, and connect the dots.

Oftentimes, it is less about what you say then what you hear, and then what you do with that. Some people can become so focused on their outgoing message that they seem unable to listen or to have a dialogue. You should know your material well enough to be able to relax and engage in a conversation.

Be timely and responsive
This cannot be overstated. Investors are skittish enough, and very sensitive to any sign of unreliability. Your dealings with them will show how thoughtfully and intentionally you will handle your business, and their money. An investor's time is money to him, so handle it just as carefully.

Build relationships
People give money to those they have a relationship with. Though your relationship with an investor will be a professional one, it is still a relationship, and one of profound trust.

Demonstrate
Set goals and accomplish them. Do what you say you are going to do. The most important thing to demonstrate, the uber-coolness of your product aside, is how you are going to make money. Even in the early stages, you should have some idea about this. If you can't demonstrate how you are going to be making money, you have some more work to do.

Be persistent and consistent
Stay on the radar, but don't be a nuisance and don't burn any bridges. Be respectful, polite and cultivate all of your contacts. Raising money requires a strategic, concentrated effort. You will very shortly come to know the investment landscape as well as your market.

You may be wondering what kind of questions will you be asked in the meeting. It's ideal to be able to prepare for these like a job interview. But with each company there will be different questions. I know that's not what you want to hear.

“Scale is important for a startup. Think big, but take one day at a time.”

-Kunal Bahl, SnapDeal

Chapter 5

The Winning Pitch Deck

Then of course, you need a great pitch deck.

One question we get asked often is 'how do I craft a pitch deck that will get me funded?' A great deck is obviously only one element in getting startup funding, but it's an important piece in instilling confidence in potential investors.

Your deck should be 10-12 pages max, with any supporting documents (financials, management bios, etc.) included in an appendix. Here's what you should include:

Mission
Create a brief and cogent one-sentence description of your startup, its reason for being.

Problem/Solution
Clearly define the problem your business exists to solve. What is the customer need? How do you plan to address it? Why is your product/service/approach better than the alternatives?

Market Opportunity
What is the market for your product? Who are your customers? Here's where you describe the structure and dynamics (barriers to entry, intensity of competition, growth rates, and regulatory environment) before outlining and quantifying the size of the market. Make sure to distinguish between the total addressable market versus the segment your business targets.

Market Strategy
Explain how you will make money by going through your business model and the assumptions behind it. Which sales channels will you

se to target customers? What do you expect acquisition costs to be? What are the key risks? And how will you mitigate them? You also need to outline your sales effort and production process, and key partnerships for distribution as well as any strategic business alliances. How will you measure success?

Technology (if applicable for your company)

This is where you show your audience the proprietary assets underpinning your business. Walk potential investors through your offering, explaining its unique value proposition - what makes it best-in-class - and how it will scale. Then elaborate on your strategy for safeguarding your IP, including copyright and patent registrations, and how you would defend against infringements.

Competitive Landscape

It's not enough to say, our product will be the best on the market. Provide an honest appraisal grounded in extensive research and analysis that describes your competitors, details their relative advantages and disadvantages, and demonstrates why/how your business and approach are uniquely qualified to succeed. Don't ignore your competition -- investors will find them!

Financials

Your financial model should include a bottom-up financial forecast with revenue projections for the next 3 years. Be able to explain and defend all of your underlying assumptions and your relevant metrics, including revenue, gross margins, number of users, number of visits, and others that are tailored to your business.

Funding requirements

No surprise, here. Of course you need to cover how much money you want to raise. But you should also explain what valuation (and this could be a range) you're using; whether and when you anticipate needing future financing; your capital equipment requirements; and who your lead/other investors are. What return can investors expect?

I'm also a firm believer in milestone financing. As you go through your planned use of funds, closely tie this to discrete milestones that you will accomplish over a 12-18 month timeframe. That helps investors see where their money is going, and, provided you hit your milestones, sets you up for a much higher valuation going into the next round.

Management Team

For many investors, the quality of the team trumps nearly all other considerations. Describe the backgrounds and past successes, and outline the relevant domain expertise of all members. This is also where you can address skill gaps/future hiring.

Remember that the initial meeting is just the first step in building a relationship with prospective investors. Use each one as an opportunity to refine and retool. As they say, practice makes perfect.

> “The fact is that the amount of money startups raise in their Seed and Series A round is inversely correlated to their success.”

-Fred Wilson, Co-founder of Union Square Ventures

Chapter 6

Getting a ‘Yes’ to VC Funding

We could tell you how to get a yes, but it's better to let you hear it from an actual VC. Marlon Nichols, co-founder and managing partner of Cross Culture Ventures, gave us his thoughts on getting a yes from a venture capitalist:

As an early-stage venture capital investor with a keen emphasis on the seed stage, I spend a lot of time at startup accelerators working with first-time entrepreneurs. Increasingly, and without fail, at some point during these interactions founders ask variations of the, how do VCs evaluate pitch meetings question. First-time entrepreneurs want to better understand the criteria that VCs use to evaluate startups, particularly during the pitch meeting. The quick answer is market, team, business model, projections, and the ask...prioritized in that order of importance.

The most important thing to remember when pitching a prospective venture capital investor is that VCs are, well, VCs, i.e. we are attracted to hugely disruptive companies. A venture investor's goal is to help startups grow into large and profitable businesses. Ultimately VCs seek to provide our investors (limited partners or corporate sponsor) with a significant return on their investment. So, keep this in mind while introducing a potential investor to your company. Now let's visit each section of the pitch conversation from the investor's perspective:

The Market
At the beginning of the conversation VCs want to know the market you plan to address and the size of that market. In other words, what is the problem that your company aims to solve and how large of a pain point is it for your target customers? I am usually excited by

companies entering into a space with large market potential, i.e. companies capable of becoming at least a $500 Million business in a relatively short period of time.

You should also articulate whether the intention is to disrupt an existing market or create a net-new sector (often more intriguing to me). In either case take the time to help the investor understand how you arrived at the stated market size and assumptions. In the case where you intend to disrupt an existing space particularly if there is a clear market leader, you must clearly communicate how you intend to steal market share remember the incumbent didn't get there by luck and that dethroning them will not be an easy feat.

So be sure to communicate a solid understanding of this fact while educating the VC on your companies compelling value proposition. In most cases I'll have an opinion on the market prior to the pitch meeting, but will want to gain a better understanding of how you arrived at your market size figure and accompanying assumptions...I want to understand how founders think about the space and whether they truly understand the market.

The Team

Here investors want to understand why your team is uniquely qualified to take this startup forward. Put differently, do you have relevant experience or domain expertise that you bring to the company? A couple of examples:

A CEO with a Master of Science in computer science, a PHD in robotics, and an impressive track record of building products for top companies, who is now building a 3D imaging company is considered a good investment candidate. Similarly a black male that has

successfully run business development and lead marketing initiatives for an emerging startup would be considered qualified to launch a technology enabled consumer packaged goods company focused on ethnic minorities. Penetrating ethnic markets requires intimate familiarity with the culture and strong marketing acumen.

Team chemistry is also important...investors will want to know how the founders met, how long they've worked together, and how they handle conflict? Generally, I need to believe that the CEO will have the courage and intelligence to successfully lead the company through difficult challenges. There will be many tough turns on the long road to success. The earlier the stage, the more important the team becomes. At the Seed stage I find the team to be more important than the market because the company may very well re-purpose its solution to address a different sector.

Business Model

At this point of the conversation the VC is most concerned about three points.

1. The potential to address the problem in a unique way that is potentially disruptive to incumbents. I want to learn of technology advancements and/ or process improvements that address a market in a new way or have the potential to flip a market on its head. A recent and popular example is Uber. It leveraged existing technology to re-engineer an old process that is changing the concept of and approach to hired vehicles.

2. The ability to sustain a competitive advantage. If the differentiation is technology based then I'd like to know whether the IP is protected or will it at least produce a wide lead on the

competition. If the differentiation is process based, share whether the process can be protected. If not, then traction (e.g. users for consumer companies, brand name beta customers for enterprise companies, etc.) becomes extremely important. Essentially I need to understand if the company has enough of a head start to create a barrier of entry for fast followers.

3. The founder's in-depth knowledge of the business and space. This is usually assessed while discussing key metrics. I listen to see if the entrepreneur focuses on the key elements that determine success, given a particular business model, and whether the plan to drive growth in that area is realistic. I tend to base this on the success and failure of a group of relevant companies. I intentionally did not call out competition as a main section because it is inherit to both the market overview and the business model segments. Others may feel strongly that it is broken out as a separate section, but the important thing is that the founder articulates how exactly the company is different from the competition.

Projections

This portion of the conversation is pretty straightforward and usually is adequately addressed with a fairly detailed profit and Loss statement (P&L). VCs basically want to understand what it will cost the company to generate revenue, how quickly revenues will ramp (the hockey stick), and when the company predicts breaking even. I find P&Ls that contain revenue, cost of sales, gross margin, operating expenses, net profit/ loss, and resource count by type (e.g. engineering, sales, etc.) over a 3 year period most useful.

It’s also very important to disclose your assumptions as this helps investors to further assess whether you truly understand your business. This is the perfect time to share your knowledge of successful companies in your space or those with similar business models, while clearly explaining why your company should be viewed as a comparable (e.g. you are a consumer Internet company that is experiencing user acquisition, monthly actives, retention, etc. similar to Facebook or Twitter during a similar stage).

The Ask

This part of the pitch is much more important than most first time founders appreciate. In many cases startups only state how much capital they intend to raise and in a few cases whether they prefer a convertible note or a priced round. From an investor’s perspective this is good information, but it is not enough to help me understand how the founder intends to use the funding nor does it help me to determine if the founder understands the steps necessary to build a real company. I recommend that you also use the time to speak about resources and milestones leading up to the next round of funding. Yes you will likely have to raise a few more rounds of funding before achieving a liquidity event. An example:

> We intend to raise $2.5 million; the bulk of which will be used to grow our sales and marketing team. Specifically, we intend to hire a VP of sales and two sales reps. Then link the resource estimates to the revenue projections and assumptions shared in the projections section.

It is also helpful to share where you are in terms of achieving your fundraising goal (only firm commitments need be mentioned). If this isn't your first round of funding, do mention how much capital you've previously taken, who from, and in what form. VCs partner on (syndicate) deals more times than not so it's always great to learn that a firm that I've had a good experience with is a participating investor in your company.

Remember that the initial pitch meeting is just the first step on your journey to build a relationship with prospective investors. Like all productive conversations a pitch meeting requires that you speak intelligently about topics that matter to your audience. So, if you thoroughly cover the aforementioned topics and approach the meeting with sincerity, humility, and rigor you will likely find success.

> “Planning is valuable, though the plan is usually useless.”
>
> -Ben Horowitz, Co-founder at Andreessen Horowitz

Chapter 7

What You Should Know About a VC Term Sheet

So you think you've found an investor who is committed to backing your company? Good for you. But before breaking out the bubbly, you need to make sure that you've got all the pieces in place to make this deal go through in a way that benefits and protects you, as well as your potential investor.

The Venture Capital Term Sheet

The key to turning this potential deal into a done deal is the venture capital term sheet. As you know, a venture capital term sheet is the short, readable document that is negotiated prior to the actual contract, laying out the important terms of your deal. The term sheet itself is not necessarily legally binding, but it does offer some protection for you and your investors. And, if done well, it will lay the groundwork for the final legal terms of your agreement.

Before executing a term sheet, you need to do your due diligence on your potential investor. You're looking for confirmation that they have a solid reputation and no history of turning tail and running from deals.

Once you know that you're dealing with a trustworthy investor, you're ready to check out the proposed term sheet. For your best leverage, you should try to limit the number of conditions spelled out in the term sheet. You also want to see the terms narrowly drafted.

Elements of a VC Term Sheet

In general, you're looking for a term sheet that covers the following:

- Preferred return
- Protection of valuation and position in regards to future money
- Investment management
- Exit strategies

7 Key Terms

While there are a number of major term sheet deal elements that bear consideration, there are 7 key items that you need to pay particular attention to:

1. Money Raised

There is usually a term around the issue of the minimum offering amount. Your investor will require that a minimum amount of money is raised before they disburse their funds. You need to carefully consider this minimum offering amount. It will be your responsibility to raise this money, so ensure it's a realistic goal.

2. Pre-Money Valuation

You will need to work with your potential investor to negotiate are-money valuation; that is, the value of the company prior to investment. Pre-money valuation can be a bit trick, but essentially the valuation is calculated on a fully-diluted basis. In other words, the value includes all issued stock and anything, such as a stock option pool, that may be converted into common stock. The venture capital fund will compute their percentage ownership of your company once their investment has been added to this value.

3. Non-Participating Liquidation Preference

There are several varieties of liquidation preferences. In all cases, the gist of this term is that investors will get their money back first, before common shareholders get their money back. One liquidation preference to look for is the 1X non-participating liquidation preference, which means that investors will get their investment back prior to common getting a distribution (whereas 2X means that the investor will get double their money back, and so on). This term also gives investors the option to participate pro rata in an exit with

other shareholders. At exit, investors can choose to use the liquidation preference or just participate as shareholders. Interest accrual may be included in this preference.

4. 1:1 Conversion to Common
One actual non-negotiable in term sheets is the conversion to common. The crux of this term is that the buyer of preferred can convert to common if he decides it's a better move to get paid on a pro-rata common basis (instead of just taking the liquidation preference). Sometimes the preferred wants to be able to control a vote of the common on a particular issue, but this is a rare occurrence.

5. Anti-Dilution Provisions
These provisions call for protection, for the fund, that your company will not sell stock at a price less than they have paid for it. The basic idea is that if you have a down round, the investors will get the additional stock to preserve their shares. If you don't stick to this provision, the fund has the right to maintain its original percentage interest without additional payment.

6. The Pay-to-Play Provision
Once rare, this is a very common term in venture capital term sheets today, and something that companies and investors can usually agree upon. This term is just what it sounds like: investors must participate in future financing (i.e. pay) if they want to play (i.e. not have their preferred stock converted to common stock).

7. Board Representation
Investors want to ensure their continued involvement as your company evolves, protect their position, and play a role in the

ngoing management of their investment. Towards this end, it is common for a prospective investor to request a seat on the board of directors.

Getting your first potential investor is exciting, but it can also be stressful. It's easy to feel like the investor has all the power during this period. But, you have power too, and a great opportunity. Take this time to negotiate the terms and do your best to knock out unusual conditions. Before executing the term sheet, this is your chance to button-down key issues and position yourself as advantageously as possible for your forthcoming investment.

Chapter 8

You’ve Got the Money in the Bank. Now What?

In the very early-stages, your startup finance strategy may be pretty straightforward. You need to establish your accounting platform and systems, including accounts receivable and accounts payable. You are going to want to identify the best payroll and banking solution for your company. And you definitely want to give some thought to tax considerations.

After you've received your round of funding, that's when your startup finance strategy needs to deepen.

This is a necessity because your investors will expect accurate reporting, but it's also an important step for startups to make to gain a deeper understanding of their own business.

Here's how to build out your finance function post-funding:

Hire a professional
Pre-funding, you may have been managing your finances yourself. Post-funding, it's time to hire a professional to help you manage your day-to-day finances as well as provide strategic financial insight. You probably won't need a full-time hire. At this point. It makes more sense to outsource to get the exact services and level of financial support you need, while keeping your cost structure low. You'll need someone to handle both your transactional accounting as well as higher level financial strategy.

Build your financial infrastructure
By setting up your accounting platform and system pre-funding, you've already built a strong financial foundation. Now you just need to take the next step. Financial infrastructure isn't just about tracking

your accounts payable and receivable and reporting expenses. A huge piece of financial infrastructure is financial forecasting. Performing bottom-up and top-down projections will give you insight into potential revenue and market-share. These projections enable you to set your milestones and identify what you need to achieve these milestones.

Manage cash-flow

Once you have some money (or more money), you need to closely monitor your cash flow and maintain a low burn rate. Presumably you had already set some milestones prior to funding. Now you need to work to these milestones, setting your revenue goals and budget so that the funds you've received will take your company to the next level. Just because you have some money in the bank doesn't mean that you should blow through it. While you may not have to pull those bootstraps quite so tight, funding doesn't give you carte blanche to make large, unnecessary expenditures. Before spending money, make sure that the ROI will be there.

Clarify your funding objectives

Now that you've been funded, it's never too soon to think about your next funding round. Establish a new set of milestones that you'll want to work towards and project out how much you'll need to achieve these milestones. You've done this work before, so you should be a pro at it now!

Become GAAP-compliant

GAAP refers to Generally Accepted Accounting Principles. Your investors are going to want to see what you are doing with their money. You can satisfy investors and ensure compliance by reporting

financial statements in accordance with GAAP principals. Essentially GAAP compliance ensures that your financial reports are an accurate portrayal of your financial position.

Create clean financials.

Clean financials go hand-in-hand with GAAP-compliant financial reports. Accurate financial reporting isn't just for your investors. It's necessary for 409A valuation and for taxes as well.Managing your finances post-funding is certainly more complex than pre-funding, but, with the right systems in place and the right financial support, you should be able to scale efficiently.

It's time to hire a startup CFO

- Look for a CFO once you have institutional investors and/or you've raised more than $500,000. Investors expect to see correct, accurate, and dependable financial statements. That means GAAP, accrual based, and statements.
- Once your business has started generating real revenue, it's time to hire a CFO to make sure that your reporting is dealt with properly. Accounting rules concerning revenue recognition are not only highly specific, often requiring analysis, they are also changing, with FASB phasing in new rules starting later this year.
- Your business, complexity, financial activity, or expenses have increased.
- When you've reached a pain point.

Startup CFOs help to hone a startup's business model and drive growth. They must simultaneously have a handle on the company's cash position: answering questions like are we spending in the right place? How much cash/runway does the business have?

In addition to:

- Managing P&L
- Modeling cash flows
- Tracking financial performance versus plan
- Helping drive discussions with 409A valuation firms (these should be done at least once a year and/or after any substantial change in a company's valuation.)
- Supporting equity and debt negotiations

At the same time that startup CFOs are focused on cash, they need to be strategic business partners: using sound financial metrics and guidelines as tools to provide counsel and guidance that enables CEOs to make business planning decisions around, the right time to hire and how you should we go about acquiring customers. This allows CEOs to keep their focus on product development and customer acquisitions. In short, startup CFOs wear multiple hats.

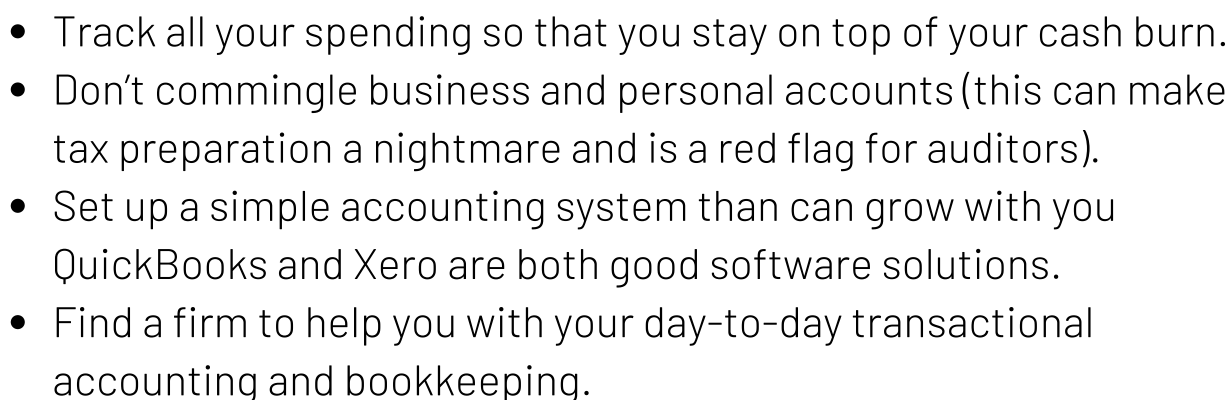
When you're looking for a startup CFO, choose candidates with broad experience working with early-stage companies, who can address those additional areas of focus.

So now you know when you need one, how should you go about finding a CFO for your startup?

Think through which services you need: whether it be annual valuations (if you give employees stock options), day-to-day bookkeeping, month-to-month reporting, or regular tax preparation, and then consider your hiring options:

- Hire experts for each service, making sure you weigh value versus cost. The key is to bring in experts at a reasonable cost.
- Hire a full-time or part-time CFO.
- Bring on an outsourced CFO. Outsourcing frees up your time to focus on other aspects of running your business.

Even if you're not ready (or can't yet afford) to take any of the above steps, there are practical things you can do now to make the eventual transition to professional management easier.



- Track all your spending so that you stay on top of your cash burn.
- Don't commingle business and personal accounts (this can make tax preparation a nightmare and is a red flag for auditors).
- Set up a simple accounting system than can grow with you QuickBooks and Xero are both good software solutions.
- Find a firm to help you with your day-to-day transactional accounting and bookkeeping.

Chapter 9

Creating a Great Relationship with Your VC

Far from the end, receiving funding is actually just the beginning of a whole new stage for you and for your company;a stage full of financial statements, board meetings with VCs and more. A lot is about to change...

The early days will set the tone so take the following steps to build a positive working relationship with your investors:

Define success

If you're doing milestone funding, presumably the VC is on board with your proposed milestones, but this is worth confirming. Make clear what milestones you are shooting for with this funding round and get VC buy-in. If necessary, break down your to-do list of performance objectives into what you are definitely planning on attacking, and what is on your maybe list; if there is enough time and money. In this way you can manage your VCs' expectations and avoid issues further down the road.

Agreeing to the terms of success is also useful in that it is a bridge to a Series B. If you have achieved your milestones and need more capital, your existing VC might agree to insider-led financing, saving you the hassle of trying to find new investors for Series B.

Create a structure

Create a structure for the relationship that keeps the VC informed and involved at a level that you both are comfortable with and that ensures that you are maximizing their benefit for the success of the company. For example, how often should you report out to the VC? Do they want monthly GAAP financial statements? You should review these types of questions with your VC and agree to the terms.

Establish what you expect from your investors
The VC/entrepreneur relationship can sometimes feel like a one-way street, but it shouldn't. If the VC believes in you enough to invest in your company, then what you have is a partnership. In any partnership, there are expectations and ground rules from both parties. Do you expect timely feedback? Active networking assistance? Do you have particular rules for board meetings? Clearly you don't want to go too far with your rules, but establishing some fair and clear rules of engagement makes sense for both you and your VC.

Be transparent
As with any relationship, honesty with your VC is the best policy. If you're encountering some bumps in the road, there's no sense in trying to hide these from your VC; the truth will come out, at some point. You want to create a trusting relationship with your VC and you do this through transparency and honesty.

Depending on your VCs level of involvement with your company, you may wish to seek their counsel in finding solutions to the problems you encounter. More importantly, when you run into a problem, you need to be prepared to propose workable solutions. In other words, don't just tell the VC that you're facing some challenges; show them that you are successfully managing the situation and taking steps to resolve the problems you are facing. This breeds confidence.

Ultimately your relationship with your VC is money-based
They've given you capital and are expecting a certain percentage of return on their investment. Making money for your VC is the best way to ensure a great working relationship. Unfortunately, no startup is a sure thing so, while you certainly want to give your VC the kind of returns they are looking for, there are never any guarantees. What

you can control are the non-money aspects of your relationship. If you can create the conditions under which the VC trusts and likes you;and understands what you are doing; then you're in a good position to get further rounds or future VC money for a new startup that may be somewhere down the road for you.

In Closing...

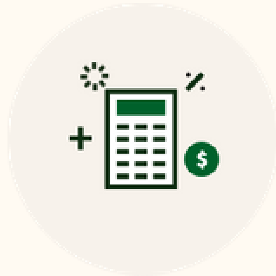
Before you get out there to start raising money, read this guide a few times. Understanding how venture capital works and who the key players are for your industry or sector will help in being successful raising capital.

Now, we aren't saying it will be easy. But this should keep you feeling like a chicken with its head cut off. If you tend to get a lot of rejection, just know you aren't alone. Many now famous founders have gone on to build huge companies after rejection. Keep going.

Know what you're building, what it will take to get there, and who can help you.

What We Do

Early Growth is the largest national firm in the venture capital space.



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An experienced financial team providing monthly accounting for founders who want to get back to focusing on their business.

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Domestic & international tax compliance, including income & sales taxes and R&D credit studies.

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409a Valuations and Cap Table Management solutions to manage your equity & stock options.

Fund Accounting

Helping GPs address monthly accounting, reporting, deal management, and LP communication.

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