The Big Picture Of How To Raise Angel And Venture Capital Funding While Still Owning Some Of Your Company At The Time Of Exit

When I looked at the high capital requirements for my first venture-backed startup as a founder, I became disheartened about how much of the company I would own by the time we made it to IPO if I had to raise so much capital selling more and more of my founder shares over so many different rounds. We are not born as babies understanding the big picture of the VC-founder partnership, so let's dive in!

The big picture is that you should expect to raise capital from investors that can also add value to your business beyond just the cash invested. With that cash, you get some work done developing your product and service offerings, grow your team and hopefully get to some revenue based on that initial investment or at least some major product milestones. Then with that progress, you raise more capital at a higher valuation. Try to raise enough capital with each funding round to provide the company with a minimum of eighteen months of runway before you run out of money again. As an active VC, I prefer to see a 24-month runway, and some industries, such as hardware startups, need even more runway and contingency capital. This gives you time to focus on your business and reach some significant milestones over a twelve-month period. Then, leave yourself another six months to close your subsequent funding round and possibly fire people or lower marketing or any expenses to lower your burn rate if you need to. Try to ensure that your next funding round provides you with a minimum of twelve months cash runway, assuming sales remain flat. Eighteen to 24 months of a runway is better, but reality may limit how much you can raise or how much dilution you are willing to take at that moment. Again, this gives you time to make progress and then go back out for more funding leaving ample

time to raise more cash. You certainly do not want to take a meeting with a VC and tell them you have 39 employees and cash for payroll for two weeks, and then you can't pay anyone.

When a startup is in the pre-seed and seed stages, raising capital as a continuous process may make sense. You are not meeting twelve or eighteen-month runways, but just raising cash every other week via convertible notes to keep extending your runway and hopefully keep a cash balance that does not fall below six months or three months at the worst. We'll discuss these convertible notes later. This constant fundraising business may sound horrible, but there are ways to put yourself in a location where you meet a steady flow of investors who want to invest small checks into super early-stage startups and get you through that early phase.

Hopefully, your existing investors invest additional capital at a now higher valuation for a business that is further de-risked than when it was previously. Many investors who passed on your earlier funding rounds will invest in your later rounds as your business matures or do you some favors in advance of investing. Remember to be polite at all times despite your natural levels of frustration with all these strange investor personalities. Keep in mind that most of them already know each other and talk about you. Founders talk about VCs also, so everyone has a reputation to build and uphold. Then with each new funding round, you make more progress with the business. Then with more progress, stronger product, revenues, team, and a refined pitch, you raise more money at a higher valuation. And so it goes.

It is essential to never run out of cash. Your main levers to control this are 1) raise more capital, 2) generate customer revenue, and 3) lower your spending, which often means firing people, lowering or suspending salaries, and re-writing your operating plan.

A bit of high-level advice is always to run an organized fundraising process. Most startups fail to run a well-managed fundraising process. Put in the time to make the best fundraising materials you can. This means a strong fundraising slide deck, maybe a one- or two-page executive summary, your email cover letter, and a robust set of historical and pro forma financials in Excel. Your financials should be semi-confidential, but OK to share with VCs at the correct time. This operating plan shows revenues, expenses, growth, cash balance, etc. This is the control panel of your business where you balance expenses with revenues and funding and never take your eye off your cash balance. A good CEO keeps her eye on cash balance at all times. If you are not natively gifted in accounting and Excel, find a friend to guide you to develop a strong financial model for your business, and spend time with this document every week. We will dive deep into this topic later.

Of paramount importance is your confidential target investor list, which should be a spreadsheet shared online with everyone you trust, which should typically include your existing investors and friends who have existing relationships with angel and VC investors. This is your target list of investors you want to be introduced to by someone that already knows them. Have your network make warm introductions at more or less the same time so that you can run a process and take meetings with many possible investors and run your process resulting in more funding, choice of the best value-added investors, and terms for the company. In my experience, deals are closed faster and on better terms when you choose whom to do the deal with. With most VCs, you can build a syndicate and have more than one. However, many VCs will only invest if they can take 50% or more of the round. So you may fail to get two of those types into one round trying to take 50% or more when your existing investors will want to exercise their legal

right to invest more, and other smaller value-added VC investors want some of your round and bring enormous value beyond their dollars.

This should help you appreciate the importance of the network. Like many industries, a lot of success has to do with who you know and how much they like you. Focus on developing your network, get close to supernode networkers, and spend time every day doing people favors to augment your good karma in the universe and your specific ecosystem.

Before attempting to go directly to investors, I advocate if you can afford the time to take two months of seeking meetings (or Zooms in today's post-Covid world) with other founders, asking them if you can pitch them for feedback, ideas, and practice. If you do this perfectly, you would be living in a top startup hub where these folks are easily accessible. This is less important in a world over Zoom. Ask if you can take 30 minutes to give them your 10-minute pitch and receive 20 mins of feedback. This becomes easy to do if you are an alumnus of a large accelerator program but make the most of whatever you have to work with. Try to block every afternoon for two or three hours of scheduling and taking these meetings where you pitch to other founders. You can go further and try and pitch anyone else in your network that knows VCs or has the means to write a check. Senior or even mid-level execs at Google, Amazon, Microsoft, any VC-backed founder, lawyers, bankers, etc.

Do NOT ask them to invest in your startup. This is the key to this strategy. Ask for funding, and most will not take the meeting. Operate 100% in a world of good karma and barter and exchanging favors. Ask for introductions to other VC-backed founders they may know.

After two months of doing this, not only will you have nailed your pitch and refined your narrative, but you may, depending on how early-stage your business is, come up with an entirely

new business plan, or pivoted to a different future product roadmap. You very well may generate a handful or even one super important partnership for distribution, customer acquisition, or several things more important than what many worthless roadkill VCs can ever do for you other than write you a check to hire people to execute on all the ideas that come from spending time with these other founders. Book 30-minute slots with these founders, but set aside a full hour, in case they are generous with their time.

If you do this well, you will indefinitely raise capital from some of these founders. If they start off compassionately offering their precious time to help you, then they may become emotionally invested and offer to write you a check for $25k to $500k or more. If you do this well enough, you may build up a who's-who of important angel investors, which will create a buzz around the company. Soon every VC will be talking about your company. These CEOs will not keep their mouths shut and mention you to their VCs when they meet them for dinner or breakfast, and you will start to get inbound inquiries asking to meet with you. When this happens during the two months reserved for practice meetings, you should tell them when you plan to start meeting with VCs, but you'd be happy to learn more about that VC fund now if they want to talk to you but wait to hear your pitch until the date you are ready to go into solicitation.

At the end of each practice session or in a follow-up email, ask each founder that sounds positive about you for the names of any VCs and specific partners you can add to your target investor list. If you do this for two months, you should have a smoking hot Target Investor List and be ready for going for the real meetings.

Hopefully, your pitch will now list the names of some highly respected VC-backed founders, including some who may have sold their last company for a double, triple, or home run.

Then try to collapse the meetings with VCs into an intense meeting schedule dedicating 50 to 70% of your time for this activity and try to get multiple term sheets and go with the one that is the best fit not only on the economics, but which one can help you the most and add the most value beyond the dollars, has the right reputation as a VC firm, and has the correct partner that has the best chemistry with you. If you don't like the VC, and you know it, don't take their deal unless it's your only option. My father once told me, "If you don't like someone, they can usually sense it. Even if you think you are hiding it well, they know." The relationship with your VC typically goes to the final exit of your company and can follow you around for the rest of your career even if the VC changes firms, and you go on to five more startups.

Expect to do this fundraising process many times as you go through many different funding rounds at hopefully ever-increasing valuations. A huge mistake, which is all too common, is that the founders and their investors fail to recognize that the market is not responding to the funding round campaign at the current valuation. These teams fail to adjust the proposed valuation or amount of funding at a lower valuation or fail to lower expenses and restructure the company to be able to continue as a going concern. Strangely I see a lot of founders sail their ship straight into the rocks with a rigid hand on the helm, trying to raise more capital, but never make use of the other flexible "sheets on the boat" or levers available to the captain such as lower expenses, focus on customer revenue, and adjust the valuation and terms of the fundraising. Another huge mistake I see founders make is the foolish belief that their existing investors will

continue to fund them. Don't make this wild assumption. Your existing investors may never invest another dollar into your company even if they intended to do so. Some investors say one thing and do another. You might have had their confidence before, but recently spooked them with a crazy email you sent out at two in the morning. It may be that your VC meant it when she promised to fund your next round, but her partners out-voted her, and your champion failed to deliver on her promise. You need to put in the work to make sure you have a plan B and a Plan C at all times. Create demand for your subsequent funding round and make your existing investors pay up to a higher valuation rather than let them corner you in a dark room with the lights off.

Another goal of the CEO should be to potentially map a path to profitability with each funding round. That's always a great plan C. Stop burning cash and tip this monster into profitability and unshackle yourself from all these opinionated and arrogant investors that don't understand your business as well as you do. I appreciate that profitability is not always an option in very early-stage funding rounds. Still, for those operating a business where a few new customers could cover all your costs, that is a great position. Sometimes the economy takes a nosedive, as in 2001, 2008 Covid or war, and you may decide to sail the business as cash flow positive until valuations pick up and funding dilution makes more sense to you. This may require firing some employees to achieve this. Another option to consider when fundraising looks ruinous is to sell the business. Taking the time to accept introductions and a free lunch with sell-side M&A bankers could pay off now. You already have them up to speed on your story, and you tell them your options and ask what a sale of the business might look like. This is also a great perspective to help you raise capital showing your prospective or existing VCs what kind of exit and cash on cash multiple they can expect if you sell the company after this next round.

In summary, expect a lot of different funding rounds. Use each round to give you a long enough runway to make significant progress and ample time to run a process to get more cash in the door. Remember that lowering expenses is always an option. It's not popular with most CEOs, because they are not strong enough to do the firing. A good leader can do this and still fire up the remaining troops with a good Braveheart pre-battle speech sharing a revised operating plan that will carry the entire team into the winner's circle. Firing is difficult for everyone, but if you were going through hyper-growth, you probably made some bad hires, and this is a chance to correct that. Execution is everything, and the team is execution. Hiring should be perfect, but it's not, and so firing enables startups to take risks and move quickly and then make corrections.

What to expect in dilution and how does this end for founders. I made a spreadsheet I presented to my class of students at Chapman University that shows what I call the journey of the founder in an Excel spreadsheet that starts with two cofounders that own the company 50-50 at the formation of the company. It shows how much they raise in friends and family financing and how much they get diluted with that round and shows their ownership after each funding round up to big late-stage pre-IPO funding rounds. It then adds up all the funding they have raised, considering a 1x liquidation preference for these preferred shareholders, essentially all of your investors. This means investors need to be paid back 1x at the time of an exit in most cases. So then, how much is the company sold for with a few different scenarios. How much might need to be paid back to investors, what percentage of the company do you own, and how much do you make? Then consider that divided over how many years this all took and how you feel about it. Is this better than your old job at the big bank, consulting company, or corporate? What happens if you sell early while the liquidation stack (amount of cash you may need to pay back

to investors) is still low and your ownership percentage is high. Suppose you can sell the company for $15m, and you own 33%, and you only raised $1.5m, and it all happens after 24 months before your 26th birthday. In that case, this could put your career on a tear, rather than soldier through 18 years and walk away with nothing, which happened to a friend of mine this year who raised $130m for a Boston startup and is an LP in my fund, thank god for him.

The VC-backed startup career path is an amazing one, and there are many things you can do right and many mistakes that can be avoided. One strategy that can't go wrong is doing favors for lots of people in your ecosystem and network. Trust me. You'll get a return on that investment and feel good about yourself.