How to Get VC Funding

ORACLE NETSUITE

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PART 1: WHAT TO KNOW BEFORE YOU GO

WHAT YOU SHOULD KNOW ABOUT EARLY-STAGE VENTURE CAPITAL BEFORE PURSUING IT

There are many financing options for entrepreneurs looking to build their big ideas, but one of the most sought after is venture capital (VC) funding.

In this section, we'll cover the basics of VC, provide general tips on how to know if it's the right funding option for your company and give an overview of the process. We'll also explain the first three tiers of VC deals: pre-seed or startup, seed and first-round.

We will cover the ideas on a general level. However, we'll further explain the most critical lessons one-by-one in subsequent sections. So read up, do your homework, then get out there and begin pitching.

WHAT IS VENTURE CAPITAL?

Entrepreneur.com offers the following definition for VC.

"Funds flowing into a company, generally during pre-IPO process, in the form of an investment rather than a loan. Controlled by an individual or small group known as venture capitalists (VCs), these investments require a high rate of return and are secured by a substantial ownership position in the business."

VC is also sometimes referred to as "risk capital," because there's a risk of VCs losing their money if the early-stage business doesn't succeed.

VC is funded by institutional and private investors.

Venture capital firms acquire funds from institutional investors such as pension funds, university endowments and financial firms or high net worth individuals like former entrepreneurs or angel investors. VCs then invest these funds in companies with hopes of achieving a significant return.

VCs invest in return for equity.

Venture capital investments are typically made in exchange for an equity stake, or part ownership, in a company, as opposed to being structured as loans.

VC investments include long-term partnerships between companies and venture capital firms. Venture capitalists don't just give you money and walk away. They often want to attend your meetings, help make decisions and give their input on how to run your company. A VC firm will stick by your company's side until it "exits" by "going public" in an IPO or getting "acquired" or "bought out" by a private equity firm or larger company...and that can take a while.

"The median time to exit for VC-backed companies in the U.S. has crept to 8.2 years for an IPO and five years for acquisitions or buyouts," Adley Bowden of Pitchbook wrote on VentureBeat.

IS MY COMPANY READY FOR VC?

The right moment to approach VCs for investment is different for each company. It's possible to attract a VC partner with only an idea, but the majority of deals are closed after a business has three concrete items:

- a founding team
- a minimum viable product (MVP)
- customers

Is VC right for my company?

The exact structure of venture capital investment deals varies between startups and VC firms. However, VC-funded companies tend to share similar characteristics. Typically, VCs invest in companies with ...

High startup costs

Venture capital financing is best suited for companies with substantial startup costs that need funds to grow operations and scale. Companies that don't need much money to get off the ground have plenty of other options.

The potential to grow quickly and change an industry

VC financing focuses on companies that can scale fast, meaning they acquire a large number of customers in a short amount of time. These organizations assume they will generate millions in revenue, be a major competitor in a particular market and end with a successful exit (via IPO, buyout or otherwise). If you are a mom-and-pop business and don't plan to move beyond your region or go public, VC is likely not the best fundraising option for you.

Innovative projects

Venture capitalists look to fund innovative projects that have an opportunity to re-shape a particular market segment. Consider how First Round Capital invested in Uber, because they recognized Uber had the potential to change the transportation market completely.

Don't think VC is right for your company? Learn about other financing options in "Everything You Need To Know About Financing A Business But Never Asked."

There are also more intangible assets a company must have, which VC Scott Maxwell describes—via questions—in an article for Inc.:

1. Is your product uniquely valuable?
2. Is your economic model attractive? (i.e. Does your business model have a solid way to make money?)

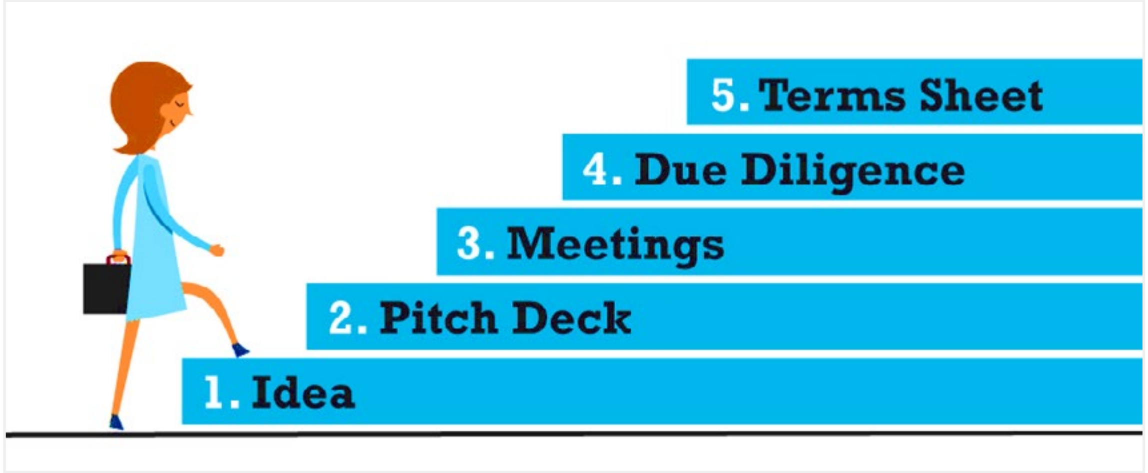
3. Is your business scalable? (i.e. Is there a large market for your business to serve? Is your business model aimed at generating millions in company revenue?)
4. Is your management team capable of growing the company?
5. Do you have any momentum? (i.e. Do you have initial customers, sales or analytics showing adoption of product or service?)

In the next section, we'll further explore how to discern if your company is the right type and stage for VC and what VCs look for when making investments.

If your business hasn't progressed far enough yet to attract venture capitalists, a business incubator might be a good first stop. Incubators like Amplify LA, 500 Startups and DreamIt Ventures offer resources, mentorship and office space, as well opportunities to get smaller amounts of capital (usually up to $100,000, whereas the average seed-round VC deal is $1.7 million).

THE FIVE STEPS TO GETTING VC FUNDING

So you've decided VC is the right financing channel for your company, and you think your company is mature enough to pursue it. Now you need to understand and prepare for the funding process.



As a business founder, you'll likely go through five steps on the path to VC funding:

1. Idea

First of all, you need a great business idea. But as we've mentioned, not every business is right for a VC investment. Venture capital firms invest in specific kinds of companies: typically early-stage, highly-scalable businesses that can grow fast, dominate a market and go public through an IPO. If you want VC money, you'll have to ensure your business fits this bill; otherwise, a different type of financing is your best bet.

2. Pitch

A pitch deck is generally the first piece of marketing collateral you will share with a VC firm. A pitch deck can be cold-emailed to a firm, but the best-case scenario is to get a warm intro, which is when someone from your network introduces you to the VC.

Early-stage pitch decks are often conceptual and idea-based, whereas decks for later stages of funding are more complex, featuring KPIs such as engagement, traffic or revenue.

(Some entrepreneurs prefer to showcase their product in the first meeting in place of a deck. However, if the VC shows interest, the next step is almost always a traditional pitch deck or business plan.)

We'll explain how to make an epic early-stage pitch deck in the next sections.

3. Meetings

To secure financing for your business, you need to meet with VCs. Cold-emailing your pitch deck to VCs is a potential way to score a meeting. However, you'll be much better off utilizing your network as explained above.

To find the best fit, create a target list of VCs that align with your business. CB Insights offers an extensive database of firms that you can search to find financiers in your industry. Then, use your network for referrals to get in touch with VCs, or do cold outreach as a last resort.

The timeline for getting a meeting is different for everyone. If you have a hot idea and a network of business people with direct VC connections, it's possible to get meetings set up within a few weeks.

But if you don't have contacts, securing a meeting can take a long time. Bill Burnham, who worked as a VC and now manages the hedge fund Inductive Capital, offers 10 tips for making contact with a VCs on his blog. His advice includes targeting specific partners at each firm and searching through LinkedIn connections to find direct intros.

We'll provide more tips for targeting and getting in touch with VCs and running VC meetings in the next sections.

4. Due diligence

If your first meeting with a VC goes well, there will be additional meetings—the exact number varies greatly—

and a series of due diligence steps before a VC offers a deal. According to MicroVentures, an equity crowdfunding investment platform, most VCs take a phased due diligence approach. Due diligence includes reviewing the founding team, product, industry, target market, company earnings power and financial viability of the company.

No matter how "done" your deal seems, the due diligence phase is necessary for all venture capital firms. The firm will take time to fact-check all important data and assess current assets alongside any potential risks, eventually determining whether the deal is a good fit.

5. Terms sheet and funding

If a VC wants to finance your company, they will send over a terms sheet that lays out the details of the proposed deal. The terms sheet is a negotiable document that both parties must agree upon. After finalizing a terms sheet, the company will receive funding. We'll cover the specifics of terms sheets in the next sections.

These five steps are the general process of securing funding from a VC. It's not always a straight line to funding, so come prepared and remain persistent during the process.

HOW LONG WILL IT TAKE TO GET VC?

"Time and again, smart entrepreneurs with great ideas underestimate how long fundraising will take," VC Diane Fraiman of Voyager Capital wrote in an article for Fortune.

Fraiman mentioned that most entrepreneurs think they'll be able to close in 90 days, but it can take much longer.

"The simple answer is that 6-9 months is a prudent amount of time for raising money, although there is a significant amount of variation between companies (and over time)," Nic Brisbourne, a partner at early-stage VC firm Forward Partners, wrote on his blog.

You don't want to run out of money while building your business. So when approaching the VC funding process, it's imperative to give yourself plenty of time.

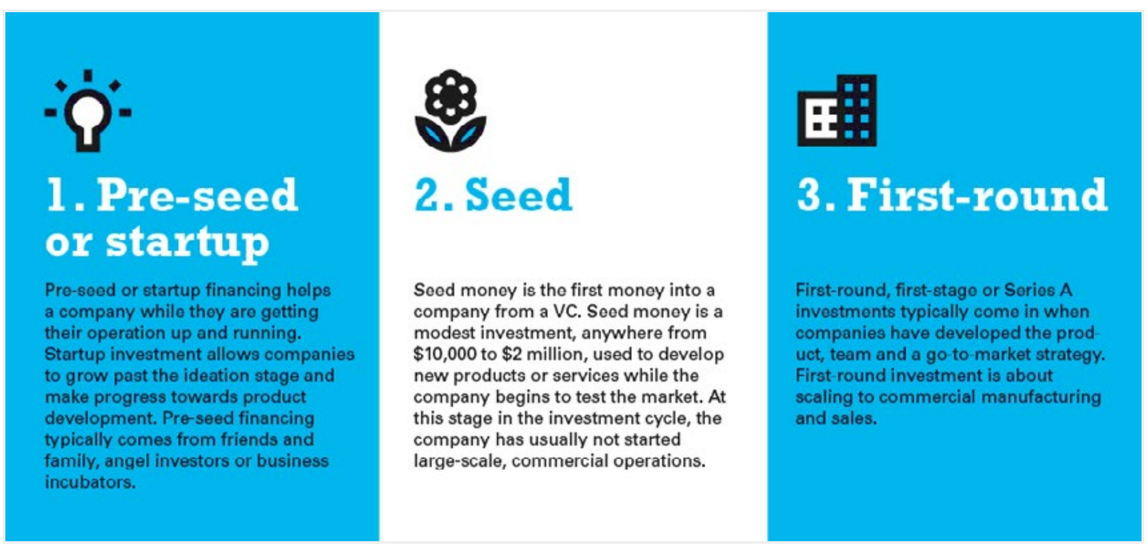
Grant Gyesky is the CEO of a cold brew coffee company, Rise Brewing Co. He described his path to venture capital funding as a long and arduous—but rewarding!—process.

"In 2018, I went on well over a hundred potential investor meetings," Gyesky told Grow Wire. "Getting financing takes a lot more time than people anticipate."

Whether it's to collect offers or deliberate which VC firm is the right fit, Gyesky recommends giving yourself more time than you estimate it'll take to secure VC.

THE FIRST THREE TIERS OF VC FUNDING

For most businesses, the first interaction with a VC will take place in its early-growth stages. Early-stage financing includes three subdivisions:



Venture capitalists can be involved in any of these early stages of a company. However, some entrepreneurs get their seed or startup money from friends and family, business loans, alternative lending sources or other financing devices before approaching VCs.

PART 2: HOW TO TELL IF YOU'RE READY

HOW TO TELL IF YOUR COMPANY IS READY TO PURSUE VENTURE CAPITAL FUNDING

Venture capital is a useful and powerful financing method, but it's not well-suited for every business. VC is geared toward companies that are designed to grow quickly and have high startup costs. For the best chance of scoring venture capital funding, you need a disruptive idea—ideally in an industry where VCs tend to invest heavily—and an impressive management team.

In this section, we'll help you define if your company has the right elements to be considered for VC funding. By evaluating your business as well as the industry in which you operate, you can determine if VC is the best financing option for you.

WHAT KIND OF COMPANIES SCORE VENTURE CAPITAL FUNDING?

High-growth, industry-disrupting companies

Venture capital financing focuses on companies that have the potential to grow quickly and disrupt a particular market through product innovation, with an end goal of a successful IPO or acquisition.

"Disruptive innovation" is a major buzzword. It's "the process by which a smaller company with limited resources is able to launch a product or service that displaces established competitors," Columbia Business School researchers Dana Kanze and Sheena S. Iyengar wrote in the Harvard Business Review.

Examples of industry-disrupting companies include Airbnb in the hotel industry and Uber in the transportation industry.

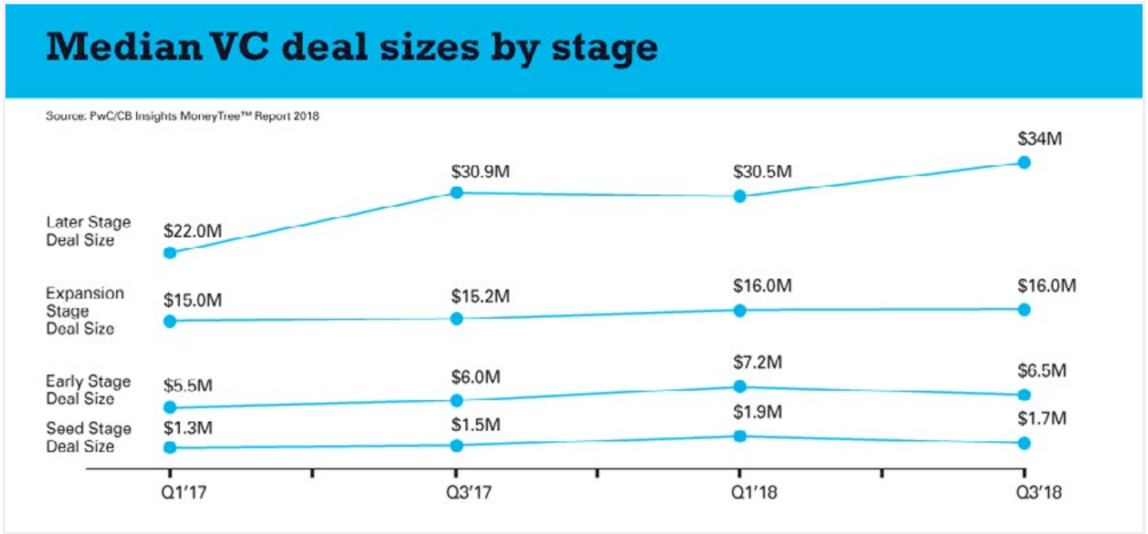
Fun fact: Using the word "disrupt" in connection with a business idea seems to influence investors. Kanze and Iyengar conducted an informal study which found that startups looking to "disrupt" received 1.7 times more funding, on average, than startups that were looking to "build."

See CNBC's list of the top 50 disruptors for 2018 for more examples of the sort of high-growth, industry-shifting business models that entice VCs.

Companies with high startup costs

VC is well-suited for early-stage companies with substantial startup costs that need funds to grow operations and scale the business. Many small businesses—mom-and-pop ones, or those running out of the proverbial garage with intentions to stay small—can often start with just a few thousand dollars. Venture capital, however, is intended for companies that need hundreds of thousands or millions of dollars to get off the ground.

For reference, the median size of seed-round deals was $1.7 million in Q3 of 2018, according to the PwC/CB Insights MoneyTree Report. See the full breakdown by deal size and stage below.



Venture capital is often the ideal financing source for companies that are capital-intensive, or have large upfront operational costs but not the collateral to secure funding from traditional sources like banks. VC fills a void in the investing market by offering funds for many capital-intensive industries such as software, telecommunications, automotive, media or consumer products.

WHICH INDUSTRIES RECEIVE THE MOST VENTURE CAPITAL FUNDING?

In venture capital, not all industries are equal.

"The myth is that VC invests in good people and good ideas," funding expert Bob Zider wrote in a 1998 article for the Harvard Business Review. "The reality is that they invest in good industries."

Statistics on the value of U.S. VC investment in Q3 of 2018 show that Internet business is still the clear leader, followed by healthcare, then mobile and telecommunications.

The entire breakdown of VC funds invested in Q3 of 2018 by industry is depicted on the next page.

A large portion of VC funding is directed at specific industries, but that doesn't mean you should abandon ship if your company doesn't belong to one of them. You can still get venture capital funding. However, it's important to know what you're up against.

HOW BAKED DOES MY IDEA OR BUSINESS HAVE TO BE?

It's very rare to get a VC excited on a pitch deck alone. In most cases, the VC wants to see initial progress, such as a founding team and an MVP. And the farther along, the better.

Whenever possible, come to the table with a few large customers, testimonials and a working prototype.

Tangible progress will go a long way in establishing trust and interest from the VC community.

You should also evaluate your business idea, model and team with questions that include:

- Is your product different from any other on the market?
- Does it serve a unique need within a large, untapped customer segment?
- Can your business model scale, growing larger to support an increase in load, be it customers, transactions or revenue?
- Is your management team uniquely positioned to understand the customer pinch point and capable of spurring company growth?

If you answered "yes" to each of the questions, then it's likely your company will be attractive to VCs.

Mike Whitmire's company FloQast, for example, fit the bill described above when it secured VC funding.

FloQast sells software that helps accountants and auditors close their books faster. VCs saw it as a unique and scalable product within a potentially large market. Plus, Whitmire had previous experience as an auditor with Cornerstone OnDemand, a company he joined pre-IPO, which offered benefits like product insights and hands-on training running large teams. Whitmire was also familiar with scaling a business and had experienced the process of taking a company public. To the VCs that eventually funded FloQast, Whitmire and his company inspired enough excitement and confidence to close the deal.

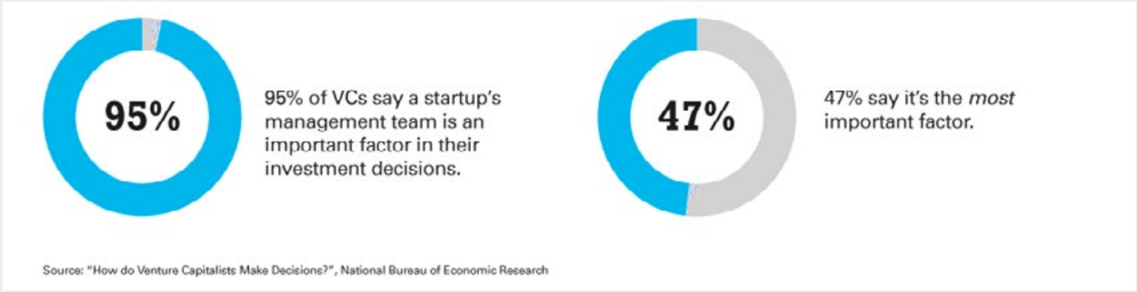
HOW IMPORTANT ARE MY COMPANY'S FOUNDERS?

Very. VCs look closely at company management in regards to their skill set, past experiences and even where they went to school.

The management team

In the research study "How Do Venture Capitalists Make Decisions?", researchers from universities including Harvard and Stanford surveyed over 680 venture capital firms to better understand their decision-making processes.

They found that a company's management was the number-one factor VCs considered when deciding whether to invest.



"The management team was mentioned most frequently both as an important factor (by 95% of the VC firms) and as the most important factor (by 47% of the VCs)," the study states.

Some elements of the management team seem to be more important than others: The study found that VCs judge a management team first on ability, followed closely by industry experience. Secondary factors include passion, entrepreneurial experience and teamwork.

The question of pedigree

Pedigree relates to the past experiences of the company founder, including where they went to school, previous work experience and connections.

Pedigree matters, according to Reuters. The news agency's 2013 analysis of startups with early-stage

VC funding found that nearly 80 percent of them had founders who "had held a senior position at a big technology firm, worked at a well-connected smaller one, started a successful company already or attended one of just three universities—Stanford, Harvard and Massachusetts Institute of Technology."

Lacking an Ivy League degree won't ban you from receiving VC, but it likely won't hurt. Regardless of your background, the most critical factor is a solid management team with strong abilities and industry experience.

Finding personalities that fit

Ann Winblad is a software VC and co-founder of her own early-stage venture capital firm. She agrees that company founders impact investment decisions. Beyond a founder's professional background, Winblad also assesses how founders will work together over time.

"Relationships are a huge component of venture capital investments, especially in the early stage where a company expects to stay onboard anywhere from 6-10 years," Winblad said on a recent episode of the "Grow Wire Podcast." "People have to fit."

One of her firm's recent successful investments, Mulesoft, took 10 years to go public, which is nearly two years longer than the median time to exit of 8.2 years. Winblad's firm coached Mulesoft's leadership team through the entire process.

The long-term nature of VC deals makes relationships important to Winblad and her partners, as they take board seats on portfolio companies and offer ongoing strategic guidance to every partner.

"We have to feel that there will be mutual respect [with a founding team]," said Winblad. "We have to really like, respect and trust them."

To Winblad, a founder's pedigree is less critical than having a great product, excellent communication skills and trustworthiness.

THE BOTTOM LINE

Let's review: To receive venture capital funding...

1. Develop a disruptive idea, in a
2. hot industry, with
3. the best possible team.

Getting funded is more art than science, and not everyone who wants venture capital financing gets it. So give yourself an advantage against the competition. Develop scalable, disruptive businesses that can grow quickly, choose industries that VCs are keen to invest in, and build management teams that inspire investor confidence in the company's ability to succeed.

PART 3: PITCH DECK AND PRESENTATION

THE PERFECT PITCH DECK AND PRESENTATION STYLE TO SECURE VC FUNDING

For an in-person meeting with a venture capitalist, you need to focus on two things: your pitch deck and presentation style.

It's worthwhile to brief yourself on what VCs are looking for, so you'll be in the best position to sell both your business and yourself.

WHAT'S A PITCH DECK?

A pitch deck is a presentation that provides an overview of your business. The deck can share insights about your product or service, business model, market opportunity, company funding needs and your management team. If you're hoping to raise money from a VC, a solid pitch deck will be your calling card and the starting point of most introductory meetings.

Winning pitch decks are brief and clear, and they must cover some standard information. In an article for Inc., Mark Suster, a managing partner at Upfront Ventures, says a pitch deck should be visual, compelling and cover the following:

- Founding team
- Market pain point, market size and how your product/services alleviates this problem
- Company progress in terms of team, product development, major clients and any revenue
- The amount of money you're asking for, how that money will be used and what milestones you hope to reach
- Financials, such as P&L statements, over 3-5 years
- A clear, long-term vision for your company

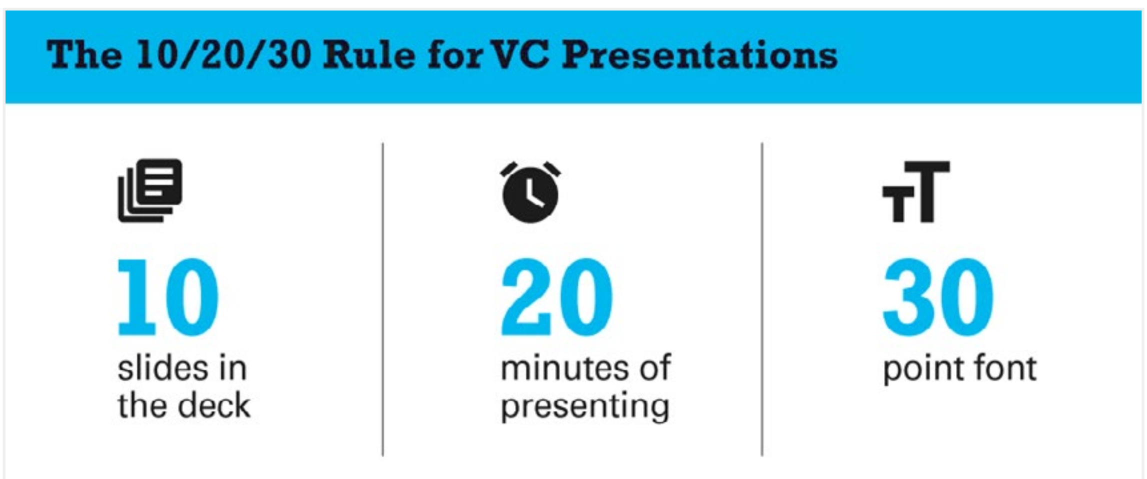
There is some debate about whether an entrepreneur should send a pitch deck prior to the actual meeting. For this purpose, Suster recommends having a separate presentation called a teaser deck that you can send to VCs via email during the introduction phase.

A teaser deck is a simplified version of your pitch deck that includes quicker descriptions of the team, market, problem, solution and company progress. (A teaser deck does not include the amount of money being raised, P&L statements, use of proceeds or any other confidential information.)

You can learn more about Suster's pitch deck strategy in his article for Inc. VC heavyweight Sequoia Capital details a similar list of items to include in your pitch deck on its website.

HOW LONG SHOULD MY PRESENTATION BE?

Consider the 10/20/30 Rule.



"A pitch should have 10 slides, last no more than 20 minutes, and contain no font smaller than 30 points," entrepreneur and business author Guy Kawasaki recommends.

The rule isn't an exact science, but as a bona fide business legend, Kawasaki has crafted and witnessed enough pitches to know what works.

Kawasaki bases his 10-slide recommendation on the idea that the human brain can only process 10 concepts at a time. More concepts will be lost and might even cloud the original concept, he says. So, focus on what's most important, and boil those slides down to 10.

A typical presentation slot is an hour, but with late arrivals and technical difficulties, it's best to shorten your pitch to 20 minutes. This guarantees you'll be able to cover your entire deck and leave time for discussion.

Any font smaller than 30-point leads to information overload on each slide. With too much info, you may feel inclined to read as opposed to present.

ARE THERE PITCH DECK EXAMPLES OUT THERE?

Wouldn't it be amazing to see the pitch decks that companies like Airbnb, Square, LinkedIn and YouTube used to get funding? Well, you can. Companies like these often publish their pitch decks as learning tools for other entrepreneurs.

Aaron Lee, co-founder of online retailer Leneys, compiled 30 of the best pitch decks in an article for Piktochart. Browsing these professional pitches, you'll see that Kawasaki's 10/20/30 rule is not exact but often comes into play.

You'll also notice the decks each have a distinct style yet also share many characteristics. Some of the most common deck tactics are:

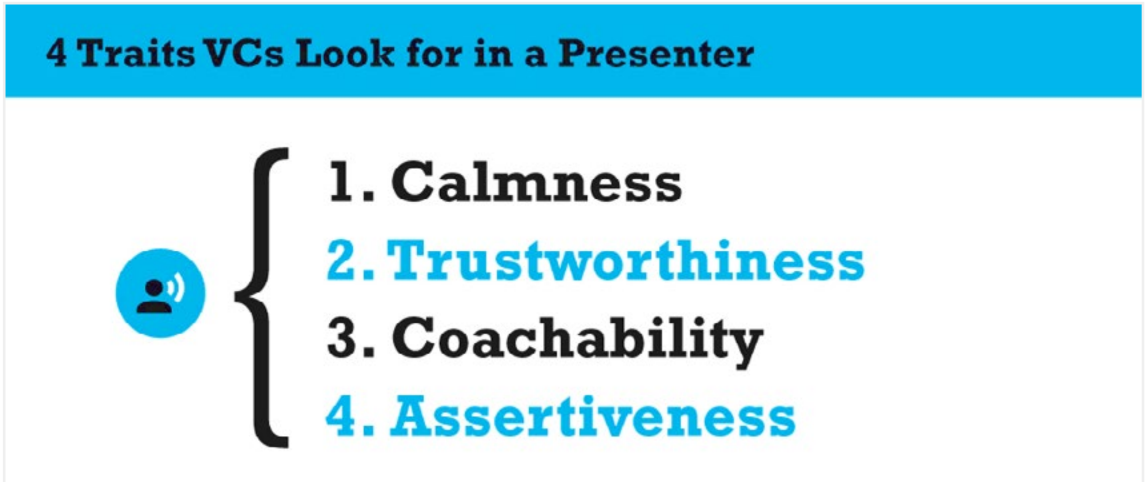
- Hook your audience. Describe your business in simple language that engages your investor.
- Show problem and solution. Paint a picture of the market pinch point, and how your company can solve it. If you've got a competitive advantage, let the investors know.
- Highlight the team. If you're lucky enough to have a seasoned management team, show that.
- Hit em' with the numbers. If you have key metrics that show business growth such as engagement, traffic or revenue, then put them front and center.
- Find your tone. Know who you are (tone) and who you're speaking to (audience), and highlight this in the deck.
- Tell a story. Most of our brains prefer stories to sales pitches. If you can share your pitch in the form of a story, investors will be more engaged.

Note: You don't need all of the elements above to form a great deck. Think about your company offering, and utilize the features that are best for you.

THE PRESENTATION

A pitch deck helps prepare for your VC meeting. But once there, you've got to verbally sell yourself. Even if your idea is a winner on paper, a VC team must also have faith in your ability to carry out the plan.

Harvard Business Review author Justyna Stasik breaks down a study conducted by Lakshmi Balachandra on the interaction between VCs, angel investors and entrepreneurs during the pitching process. After extensive research, Balachandra's study identified four broad conclusions:



1. Calmness tends to beat passion.

In an MIT entrepreneurship competition that used VCs as judges, selected finalists were found to be calm and focused, rather than energetic and passionate.

“The VCs preferred a calm demeanor,” Stasik wrote. “So temper the enthusiasm, and project stone-cold preparedness instead.”

2. Trust is paramount.

Balachandra’s study discovered that investors analyzing a pitch are more concerned with the character and trustworthiness of a founder than perceptions about ability or competency. The study revealed that while survey respondents thought CEOs could learn new skills over time, they believed a person’s character was more difficult to change.

3. Avoid acting like you know it all.

Confidence is one thing, but nobody likes a know-it-all. In Balachandra’s study, investors reacted more positively to pitches in which the founder was open to hearing new ideas. Founders that ranked highly in coachability moved on to the due diligence phase most often.

4. But don’t be afraid to assert yourself.

The study also looked at two sets of traits: We’ll call them Group A (warmth, sensitivity, expressiveness and emotionality) and Group B (forcefulness, dominance, aggressiveness and assertiveness). For better or worse, the investors surveyed were more likely to support founders with Group B behaviors.

THE BOTTOM LINE

To secure VC funding, both your business and you must be attractive to investors. The success of any business depends on not only its model but also its founding team. Knowing this truth, VCs will investigate every deal with these two factors in mind.

So, build a concise, engaging deck to get your foot in the door. Then, portray yourself in the best light possible and close it out!

PART 4: FINDING THE RIGHT VC

HOW TO FIND THE RIGHT VC TO FUND YOUR BUSINESS

Getting an offer from the perfect VC partner must begin with research. You can only score meetings with VCs by first creating a targeted outreach list of firms that are aligned with your business.

The first phase of this process is understanding which VCs are a good fit for your company's goals. The second phase is securing the meeting. This section will give you the tools to accomplish both of these tasks.

PHASE I: CREATE A TARGET LIST OF VCs THAT ARE A GOOD FIT FOR YOUR COMPANY.

All venture capital firms have a specific focus regarding the kinds of companies they fund: They might invest mainly in software, consumer products, fintech, green technologies, AI or any other number of categories. And each firm focuses on different stages of investment (seed, early-stage, series A, series B and series C). Thus, the first step in reaching out to VCs is research. Here's how to start.

1. Find venture capital firms that invest in companies like yours.

Create a roster of VCs that are likely to be interested in the kind of deal you're offering, both in terms of industry and product. Look for firms that have a track record of investing in your industry and have funded companies similar to yours in terms of revenue growth and product focus.

You can start your search for specific firm names on CB Insights, a highly-regarded resource that offers data on active VC firms and associated industries. Additionally, check out the CB Insights data-driven top 100 ranking to familiarize yourself with the heavy hitters of the VC world.

2. Ensure the firm invests in the stage of funding that you seek.

Which stage of financing are you in? Before adding a VC firm to your target list, be sure it's actively pursuing deals in your stage.

Most venture capital firms share their investment ethos or criteria on their company website. For example, the investment criteria for Hummer Winblad Venture Partners (HWVP) identifies a focus on first institutional investments in "disruptive," "emerging" software companies. If you have an early-stage company developing a software product, HWVP could be the right investment partner, and you should add it to your target list. If not, you should leave it off.

3. Check out the firm's past deals.

Another way to determine if your company fits within a VC's investment ethos is to review the firm's recent deals, which you can usually find online. Even top-ranked venture capital firms like Accel Partners openly list their past deals. Reviewing them will help you determine if your company fits the firm's prototype.

For example, Accel offers details on the type of businesses it seeks—and specific names of companies they've funded—in a blog post about their investment in fintech company Monzo:

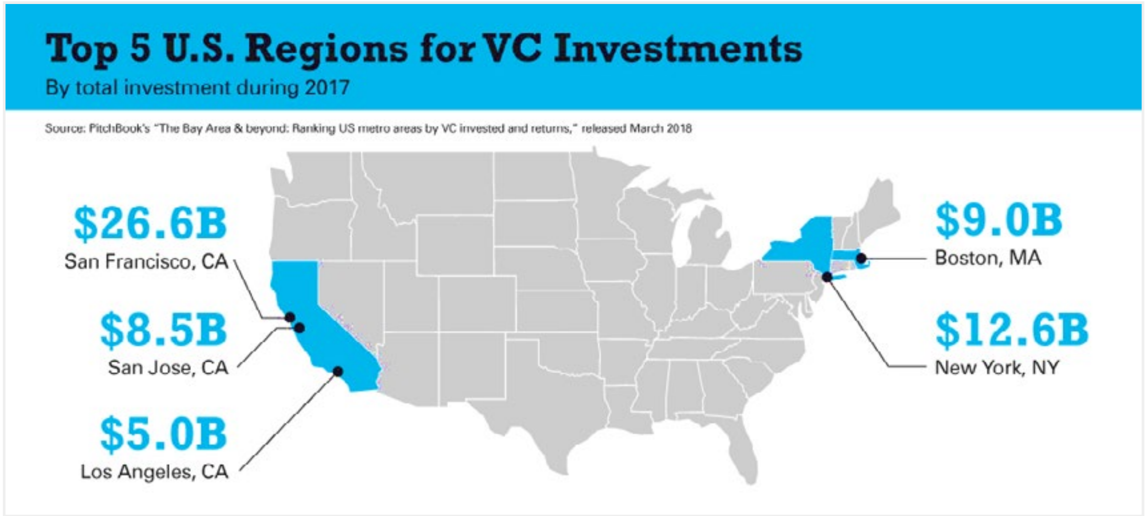
"Over the years at Accel, we've backed many businesses reshaping large consumer categories with delightful user experiences," the post reads. "Spotify with music, Etsy and Flipkart with commerce or Deliveroo with food are great examples."

VC firms are transparent about the types of investments they make, so do your research upfront to find out if your company is a fit. You can also work backward: Locate a business similar to yours that has gotten funded, and find out which firm invested.

4. Consider location.

Some firms only invest locally, while others are open to investing beyond their city and state. If you're based in Denver and one of your target venture capital firms is based in San Francisco, be sure it makes out-of-state investments before sending an email.

It's worth noting that some regions receive more VC funding than others. More than 80 percent of the country's venture capital investment goes to just five metros—San Francisco, New York, Boston, San Jose and Los Angeles—according to City Lab analysis of PitchBook data. If you're operating a company outside of these metros, you might as well be competing for remaining 20 percent. However, VC firms are increasingly willing to invest outside their regions, TechCrunch notes.



Generally, it will be easiest to get attention from a local firm. However, if your business is truly attractive to VCs, location will not be a hindrance. Cleversafe founder Chris Gladwin raised funds for his Chicago-based startup from a variety of VC partners outside his local market: NEA in Menlo Park, In-Q-Tel in Arlington, VA and San Francisco's Alsop Louie Partners. The firms likely chose to invest because Gladwin was an experienced tech entrepreneur with three successful exits under his belt. Their out-of-market deals paid off big-time when IBM purchased Cleversafe for $1.3 billion in 2015.

5. Organize your list.

VC expert Joshua Henderson recommends including 20-30 investors and/or firms on your target list. You might consider tracking your communications in a spreadsheet like this one, courtesy of Corigin Ventures.

PHASE II: REACH OUT TO YOUR TARGET VCs.
Once you've got a target list, it's time to set up meetings. You have two opportunities to make connections: an intro from someone in your network or a cold email to a VC partner.

The "warm intro"

An introduction to a firm via a mutual connection from your business or personal network is called a warm intro. This is the best-case scenario, as VCs are more open to deals that come from a trusted source.

To find warm intros for your target list, ask yourself:

- Do you or your company's team members have any direct contacts at VCs?
- Are there people in your extended network (i.e. parents, mentors, past employers, friends, professors) who have VC relationships?
- Does your company have board members with VC connections?

- Can you utilize LinkedIn or business networking groups to connect with VCs in your area?
- Have you worked with a business incubator or angel investors that can help open up the next phase of introductions?

The “cold email”

You may not have mutual connections to some VCs on your target list. In that case, it’s time to start cold emailing your targets.

This is the more difficult way to get a meeting, but it’s not impossible. Allie Janoch, the CEO of environmental compliance company Mapistry, secured a $2.5 million seed round with a cold email. She outlines her best practices in a post on Medium:

- **Create a template.**
  A general template will be a helpful starting point for your cold email outreach. Put together the critical information about your business and current progress, and state why you’re contacting firms. This email has to grab a VC’s attention, so include any impressive revenue stats, major clients or other eye-catching facts.
- **Personalize emails to individual partners at each firm.**
  Broad information about your company can be pulled from the template, but the majority of each email must be personalized for a select partner at each firm. Partners within firms often have a sector focus. For example, a software VC firm like HWVP might have a partner who specifically funds and is considered the firm’s expert on deals with software companies like Gladwin’s Ocient, which deal with large-scale data storage.

  Research the partner, and get a solid understanding of why they’re the person most likely to be interested in your project. In your email, mention the partner’s industry interests or other deals they’ve done that relate to your business.
- **Be direct and concise.**
  Get to the point quickly. Everything from your email subject line to the layout of the text should be clear, concisely explaining why your company is relevant to the particular VC.

After honing her cold email process, Janoch scored follow-up calls or meetings with a third of her targets, she wrote. The actual email she used to get a deal (with Jason Lemkin from SaaStr Fund) is embedded in her post.

The big pitch

A meeting with a VC is your chance to pitch your big idea and ask for investment. The pitch will include information about your company and detail the product or service you're developing. You'll need to create a pitch deck for this. To learn more, visit Grow Wire's post on "The Perfect Pitch Deck and Presentation Style to Secure VC Funding."

THE BOTTOM LINE

Getting connected to the right VC to fund your business takes a thoughtful and targeted approach, which always begins with research. Once you've nailed a meeting, though, it'll be well worth it.

PART 5: ANATOMY OF A TERM SHEET

EVERYTHING YOU NEED TO KNOW ABOUT A VC TERM SHEET

Rubber, meet road. You've built a business on a shoestring, borrowing from friends, family, savings and your good name. The business is ripe for an infusion of capital, and you've been lucky enough to get some VCs to not only listen but also get interested. You've pitched and re-pitched, you've run and re-run the numbers, and now you can see a finish line in the form of a term sheet—that precursor to receiving an investment. Its purpose is to lay out the basic elements of a proposed deal.

Although it doesn't guarantee investment, a term sheet is a very positive step in a company's VC funding journey. Let's take a closer look at the elements of a term sheet and how they might impact future business operations so that you can decide whether to accept an investment offer. We'll also provide some practical advice, courtesy of a serial founder who has been through dozens of funding rounds.

WHAT IS A TERM SHEET?

The dictionary defines a term sheet as "a non-binding listing of preliminary terms for venture capital financing." CB Insights refers to it as "the first real piece of paper a founder sees from a VC when they decide that they're interested in investing."

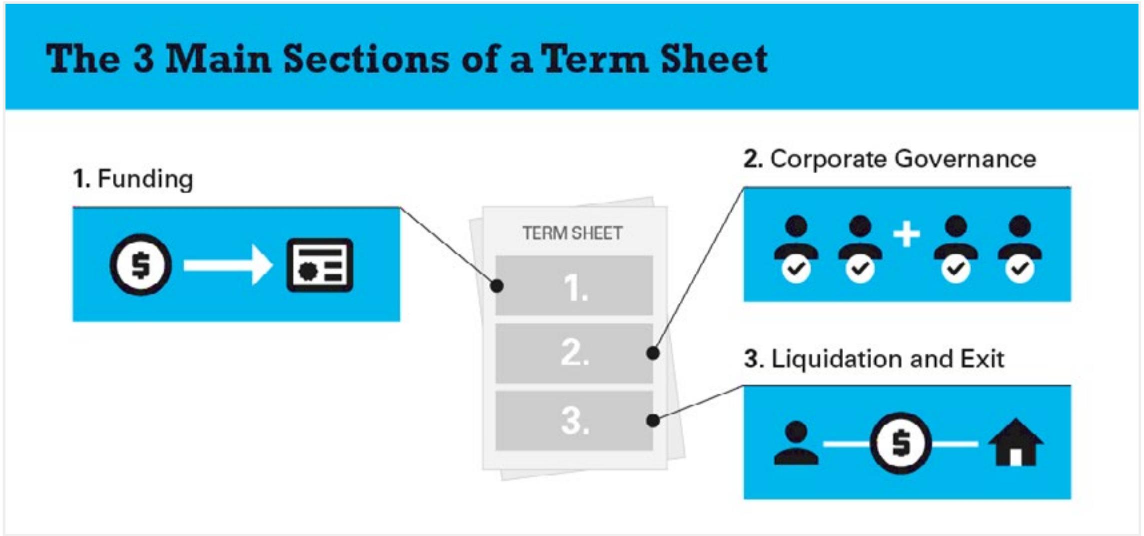
A term sheet might also be called a "letter of intent," "memorandum of understanding" or "agreement in principle."

The term sheet is the first real step toward a successful financing transaction (aka "getting funded"), and it outlines the proposed investment at a high level. If the deal moves forward, lawyers will use the term sheet to draft transaction documents.

A NOTE ON LAWYERS

A lawyer is absolutely crucial in the term sheet process. Your company likely already has one if it's mature enough to pursue VC funding, said Mark Mullen, co-founder of L.A.-based Bonfire Ventures. "A good lawyer will help you set up the company properly so it's prepared to take investment now and in the future," Mullen said. "Then, you and the VC negotiate the deal [i.e. get a term sheet]. Then, the two lawyers—yours and the VC's—put the paperwork together with feedback from you and the VC. A good lawyer should also be able to guide you through the documentation phase after a term sheet is signed."

If you don't have a lawyer, Mullen recommends finding one through your network or discussion boards on Y Combinator, a well-known source of startup advice. VC-heavy cities like San Francisco and L.A. have firms that specialize in early-stage company formation, he added. This type of legal counsel is relatively inexpensive compared to the payoff for your company.



THE 3 MAIN SECTIONS OF A TERM SHEET

A term sheet has three main sections: funding, corporate governance, and liquidation and exit preferences.

1. Funding

The funding section lays out the financial guidelines of the proposed investment. It outlines how much money the VC firm is offering to invest and what it wants from your company in return, specifically some type of security and protection of that security. A security can be "any proof of ownership or debt that has been assigned a value and may be sold," according to the TheStreet.

In typical seed rounds, companies are often not yet "priced," or given a valuation. Thus, in these deals, the security type is generally a convertible note or a safe (simple agreement for future equity, a term pegged by Y Combinator). Later down the line, in Series A deals, securities often take the form of equity, more specifically preferred stock.

Convertible notes were popular in VC circles for the past few years, Mullen said, but they're falling out of favor. For seed rounds below $1.25 million, he recommends pursuing security in the form of a safe agreement.

A good lawyer will understand the market value of companies in your space, as well as conventional deal structures, according to Chris Gladwin, a five-time founder. Y Combinator's "Guide to Seed Fundraising" is a good resource, as it further details options for the funding section.

A NOTE ON NEGOTIATIONS

You may be wondering what terms look like in a "typical" seed-round deal and how much room they leave for negotiation.

"While there are standard parts to a term sheet, there is no one answer as to the appropriate terms in regard to round size, ownership levels, preferences or what type of security is right for a company at a given time in its in growth," said Diane Fraiman, a software and digital media VC with Voyager Capital. She recommends relying on your company counsel—lawyers as well as other mentors—to determine the best terms for you.

Both Y Combinator and the National Venture Capital Association offer templates of what a "neutral" term sheet should look like, for reference.

Fraiman and Mullen agree that negotiation between founders and VCs is common in the term sheet process.

"Like any negotiation, it all depends on what type of leverage you have and what the situation is," Mullen said. "... Naturally, a VC will offer X, and you naturally come back at Y. You might figure it out there, but it might take more discussion."

2. Corporate governance

The corporate governance section of a term sheet outlines the governing structure for the organization. Its main purpose is to define the distribution of power between founders and investors as it relates to company decisions.

For early-stage companies, the corporate governance section outlines decision-making abilities, voting rights, and board composition, according to law firm Katten Muchin Rosenman. It also covers management and information rights and conditions that give investors access to the business premises, operations and financial data.

Corporate governance terms are important to investors, as they serve as protections around an investment. But they should also add value to founders by setting up a supportive relationship with VC partners. When you're assessing corporate governance terms, ensure they both satisfy the security demands of investors and allow you to maintain some level of control over company operations. You should shoot for an equal number of "founder-friendly" and "VC-friendly" board members, according to Startups.co, an educational resource for founders.

Corporate governance is a balancing act. Like in any good partnership, the goal is to find a way to satisfy both parties and develop the best structure for future success. The "Anatomy of a Term Sheet" guide from Katten Muchin Rosenman will be helpful in navigating this part of the document.

3. Liquidation and exit

The liquidation and exit section of a term sheet describes what will happen to investors and shareholders if your company is liquidated, dissolved, or sold. It defines who gets paid first and highlights any particular preferences given to investors.

When your company is liquidated or sold, preferred shareholders will always be paid before common shareholders. (In Series A rounds, VCs usually angle to become those preferred shareholders.) Investors may also push for redemption rights, which require the company to buy back its stock at a specific time or when certain conditions are met. Redemption rights give investors an additional level of security by allowing them to potentially recoup their investment.

FOUNDER DESIRES VS. VC DESIRES

A term sheet is like a tug-of-war between company founders and VC investors, in which founders are looking to "get the best deal" and maintain control of their company while VCs seek to "buy in at the best price" and set favorable investment terms for an exit. (This is when having a good relationship with your VC is handy.)

While the term sheet aims to lay out terms that benefit both parties, this can be a challenge when entrepreneurs and investors have different desires.

When negotiating a term sheet, you should consider the investor's wants alongside your own, according to MaRS, a Toronto-based incubator. MaRS' full list of motivations and recommendations is paraphrased below.

Common founder desires

- Finance the business toward growth and revenue goals while keeping a substantial portion of equity, which they'll cash out in the event of an exit.
- Structure financing so that investors are protected but long-term profit potential isn't given away.
- Develop investor relationships and get financing within a structure that lets the founder keep control of the business.

Common investor desires

- Get the best return for their investment.
- Protect their investment through liquidation preferences and special clauses that give them favorable options if the company doesn't achieve the intended result (i.e. exit via sale).
- Maintain corporate governance protections, such as board seats and voting rights, to stay involved in major decisions.
- Include clauses that keep founders and key members of the management team onboard for as long as they continue to add value to the organization.

Investors can do their part to align the term sheet with entrepreneur desires in many ways, according to MaRS. They might include Employee Stock Option Plans (ESOPs) tied to critical milestones or vesting schedules that guarantee commitment. Veto rights against early sales can ensure the company isn't sold before reaching its full value, and non-compete agreements and intellectual property rights can give investors additional layers of security.

ADVICE FROM A CEO WHO'S BEEN THROUGH 40 ROUNDS OF FUNDING

Chris Gladwin is an engineer, entrepreneur and CEO who has founded five technology companies. His last company, Cleversafe, was sold to IBM for more than $1.3 billion in 2015. Today, Gladwin is the CEO of Ocient, a company developing new ways to manage and analyze large datasets. Gladwin has negotiated more than 40 rounds of funding, making him uniquely suited to discuss term sheets from a founder's perspective.

Gladwin identified three things a new founder should understand about the process.

1. A "hot" company will review multiple term sheets at once.

If your company appeals to one VC, it will appeal to many, Gladwin said. (This is especially true for technology growth companies, he added.)

As professional investors, VCs know which kinds of deals they're looking for. They also know which kinds of deals don't appeal to them.

"If you really have a great opportunity, most qualified investors will be interested," said Gladwin. "Either no one wants to invest or everyone wants to invest."

If your company is getting interest from one VC, Gladwin said chances are you'll be reviewing multiple term sheets. Much like having two job offers at once, multiple term sheets give you leverage when negotiating with VCs for the terms you want. They also give insight into your company's true value.

"Getting two independent term sheets at the same time is an excellent way of processing your value," according to TechCrunch contributor Jonathan Friedman. "You can compare the two in isolation and get a more rounded view of how investors are appraising you."

2. Choosing the right VC is as crucial as selecting the deal terms.

In addition to terms, Gladwin suggests founders carefully assess the VC deal from a partnership standpoint.

"Of course you should focus on the getting the best deal possible, but another important consideration, which is sometimes more important, is choosing the right partner," he said.

The "right" investor is one who comes with benefits above and beyond the terms of the deal, Gladwin said. For example, an investor's expertise and credibility might stand to benefit your business by helping with crucial decisions, offering access to a broader network, and opening up high-level sales and development opportunities.

"Who you have as an investor early on can really make a difference," said Gladwin. "Just like hiring an employee, you want the best person."

For more on this, see "How to Find the Right VC To Fund Your Business."

3. Get advice from experienced professionals.

For new or less experienced entrepreneurs, access to solid mentors and advisors beyond your lawyer is critical during the term sheet review process.

Gladwin recommends building a network of mentors or former investors who are experienced in similar deal structures, so you can call on them for advice.

Then, get ready to sign.

Want to dive deeper into VC term sheets?
"Preparing A Venture Capital Term Sheet," from law firm Morgan Lewis & Bockius, offers a more thorough review.

PART 6: CLOSING THE DEAL

DUE DILIGENCE: HOW TO CLOSE THE DEAL WITH A VENTURE CAPITALIST

Receiving a term sheet from a VC investor means you are one step closer to securing financing. But there are still steps a VC must take before transferring funds: These include performing due diligence, which leads to drafting formal investment agreements.

Deals can fall apart in their later stages. As a founder, you can increase your chances of closing the deal by preparing well for due diligence, becoming familiar with the reasons that deals often go awry and taking proactive steps to encourage a close.

WHAT IS DUE DILIGENCE?

According to BusinessDictionary, due diligence is the "duty of the investor to gather necessary information on the actual or potential risks involved in an investment."

The VC's legal team will request information about the company's financials, outstanding contracts and agreements, employees and management, capitalization table and intellectual property.

There is no standard length of time for the legal due diligence phase. It can range from "a couple of weeks if the deal is simple and if all parties are quickly aligned, to months for a complex deal," VC Clement Vouillon wrote on Medium.

HOW TO PREPARE FOR DUE DILIGENCE

Startup launchpad MaRS recommends choosing a team member to prepare due diligence paperwork using a checklist of the information that VCs commonly want to see. (You can find plenty of these checklists online.)

"Having due diligence binders ready will demonstrate to the potential investor that you are prepared. It will also speed up the review process," the MaRS blog states.

REASONS VC DEALS FALL APART

As an entrepreneur, it's wise to learn about common mistakes that can jeopardize a deal's progress during due diligence.

Nick Hammerschlag of OpenView Partners identifies reasons why a VC might pull out at the last minute in an article for Scale Finance, some of which are summarized below.

Inaccurate information

If VCs discover inaccurate data while performing due diligence, it could cause them to pull out of the deal. Founders should avoid overpromising on product development, exaggerating the company's customer base or breadth of partnerships and misrepresenting revenue, growth rates or other financials.

Of course, most business owners don't purposely misrepresent data. In any case, it's best to be honest about company details from the start of your talks with a VC, as discrepancies will be brought to light during legal due diligence.

Failure to hit projections

A VC may reconsider a deal if a company falls drastically short of projections between the initial deal review and the legal due diligence phase.

"As 'growth' investors, we are looking for sustained growth, and a significantly 'down' quarter would certainly give us pause," wrote Hammerschlag.

When dealing with investors, strive to be realistic in your projections. If metrics like revenue, total sales, customers, users or site traffic fluctuate by season, share this with investors so you don't catch them off-guard.

Legal issues

Investors do not enjoy discovering legal issues such as copyright, patent or intellectual property infringement claims. A pending legal issue won't automatically stop a deal from going through—a founder should always tell the VC about it before the term sheet is drafted.

The phase before due diligence "is an important time to get all of the negatives out there to ensure that there are no surprises that will adversely impact the relationship or your internal [VC firm] champion," Ed Zimmerman, a VC with Lowenstein Sandler LLP, wrote in Forbes.

Poor product release

A VC may lose interest if a company fails to release a product on time or the product flops on the market. This is most often a risk in complex VC deals, where the due diligence phase can span months.

Poor product releases tend to trouble VCs because they're often "factored into the company's financial projections and our assessment/interest in the business," wrote Hammerschlag.

Negative references

Receiving negative references, especially in regards to a company's CEO, serves as a red flag to interested investors.

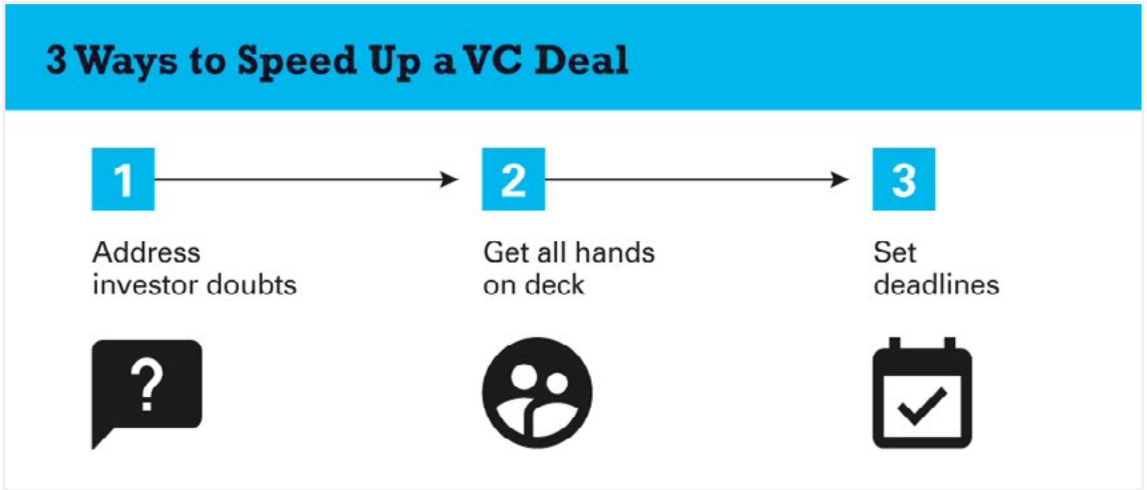
Kirill Sheynkman of RTP Ventures is a software-entrepreneur-turned-VC. During due diligence, he often asks references about a founder's management style, attitude, intelligence, openness to new ideas, strengths and weaknesses, he wrote on Medium. If references don't respond positively, it gives him pause.

STRATEGIES TO HELP DEALS CLOSE QUICKLY

Besides avoiding items that could compromise a VC deal, founders should actively pursue strategies that lead to a quick and successful close.

Address investor doubts up-front

Asking investors about their concerns is a smart way to speed up the close process, Covestor CEO Asheesh Advani wrote in Entrepreneur. Advani recommends asking them directly about any doubts regarding the



proposed deal structure, management team, business model or intended use of proceeds.

"The response to this question will usually indicate whether you'll be able to address those concerns or not," wrote Advani.

The VC's response may also offer insight into what your references should address as they vouch for you. Notifying your references of investor concerns can help them prepare for tough questions.

Participate in the final push

Resting on your laurels is not advised during due diligence. CircleUp Founder Ryan Caldbeck recommends staying "hyper-involved" in the deal at later stages, to ensure your team accomplishes the necessary tasks. During the closing phase, a founder should over-communicate with key stakeholders and remain the VC's primary contact. Caldbeck also suggests assigning tasks from the closing checklist to your team members.

Set deadlines

Founders should work with their legal counsel to propose deadlines for all documents that require signatures during the closing process. Agree upon these deadlines with both your internal team and the interested VC, to hold both parties accountable for closing the deal quickly.

One important deadline is the closing date, which founders should include in financing documentation given to the VC. Advani notes that while this deadline isn't generally enforceable, "investors like to see a closing date because they like to feel that other investors are interested in your business and investing at the same time."

THE BOTTOM LINE

The final stage of a VC funding deal is the time to find alignment across your internal teams, the VC firm and your legal advisors. During this time, founders should follow through on commitments to investors and provide accurate information about the company.

Stay engaged with the process until the very end, and you'll soon see money in the bank.

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