Your Guide to VC Funding

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Part 1: What You Should Know About Early-Stage Venture Capital Before Pursuing It

Although the economic landscape in which entrepreneurs are operating has changed, there are still many financing options for those looking to build their big ideas. Companies in particularly resilient industries, such as those in the technology sector, are still seeking, and receiving, venture capital (VC) funding. And venture capitalists are still willing to spend. In a survey of more than 1,000 VC investors, Paul A. Gompers of the Harvard Business School found that, **"the bulk of VC investors are looking to do new deals, they're just sitting on a ton of money."**

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 through the lens of the current economic environment. We'll also explain the three tiers of VC deals: seed, early stage and later stage.

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?

Venture capital are the funds invested in a company, generally during pre-IPO process. Typically they are controlled by an individual or small group known as venture capitalists (VCs), and they seek a high rate of return, secured by an ownership stake 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.

Gompers predicts: "the pandemic might also delay initial public offerings, forcing venture funds to hold investments longer than planned. To ensure smooth exits, many venture capitalists have redirected their time from deal-making to shoring up portfolio companies." Expect VCs to be more involved with your success if you receive funding, and don't be surprised if it takes longer than planned to reach an ideal exit.

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

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?)

As VCs are shifting their investing strategies in response to the pandemic, a sixth intangible asset has become vital to attracting investor interest. Hustle Fund Co-Founder and VC Investor Eric Bahn labels it as:

6. "Antifragility" (i.e. Can your company thrive in the face of economic downturn?)

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 and early stage VC investors like Amplify LA, 500 Startups and Hustle Fund offer resources, mentorship and office space, as well as opportunities to get smaller amounts of capital (usually up to $100,000, whereas the average seed-round VC deal is $2.1million).

For more alternatives to VC funding, read "8 Ways to get Funded Without VC Cash (and Why it Might be a Great Idea)."

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, go public through an IPO and now, demonstrate resilience in tough economic times.

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 and according to Bahn, **"no matter the economic climate, you're going to need to pitch many more investors than you hope to work with."**

A pitch deck is a presentation that showcases your company and its story to VC investors you meet with. Pitch decks usually take the form of a slideshow presentation and can be cold-emailed to a firm. However, 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.

In today's environment, VCs are now conducting meetings over video conferencing platforms like Zoom and Skype. It's important to understand that while you may be meeting over video the same principals apply as any in person meeting with a VC.

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. That's why Bahn suggests prioritizing angel investors especially if you're pursuing seed round or pre-seed funding. They may not have as much capital to invest, but they aren't under the same pressure as VC firms to deliver returns. A great way to secure meetings with angel investors is by creating what Bahn calls the "flywheel" effect. A common practice for founders seeking funding is to ask angels and VCs if they can introduce them to additional investors. Bahn's "flywheel" method is a simple way to get investors to do this. He says:

Don't ask: "Do you mind sending my company materials to anyone else who might be a good fit?"

Do ask: "Do you mind sending my company materials to just one person in your network who might be a good fit?"

Start with a single, pointed ask to the investors you meet with. It's easier to digest, and you're likely to get more introductions than if you ask them to share your idea with multiple investors. Once you've secured support from one angel investor, then secure support from another, and another to assemble your "flywheel" of funding.

We'll provide more tips for targeting and getting in touch with VCs and angel investors 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—and it's now taking longer. Paul Gompers, mentioned above, says startup founders should expect the “due diligence process to take significantly more time” as firms look to deploy record amounts of capital without in-person meetings. The firm will take that 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 Funding?

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—especially now.

The economic and technological implications of COVID-19 have impacted how long it takes for startups to receive funding. Due diligence will likely take longer and VCs are now deploying an

increased percentage of their capital to their existing portfolio of investments.

During the process, investors may also request additional meetings because they are unable to meet founders in person. “It’s important to be patient when selecting VCs and adapt to the funds that are open. Set up meetings with additional prospects to compensate for VCs who won’t have active funds when you’re ready to secure funding”, Anuj Goel wrote in an article for Fast Company.

VC fundraising takes time. Be patient and persistent in your pursuit.

The 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 stages of venture capital investment. Pitchbook defines all three as:

"**Seed stage:** When a venture capitalist provides an early-stage company with a relatively small amout of capital to be used for product development, market research or business plan development, it's called a seed round. As its name suggests, a seed round is often the company's first official round of funding. Seed round investors are typically given convertible notes, equity or preferred stock options in exchange for their investment."

"**Early stage:** The early stage of venture capital funding is intended for companies in the development phase. This stage of financing is usually larger in sum than the seed stage because new businesses need more capital to start operations once they have a viable product or service. Venture capital is invested in rounds, or series, designated by letters: Series A, Series B, Series C and so on."

"**Later stage:** The later stage of venture capital funding is for more mature companies that may or may not be profitable yet, but have proven growth and are generating revenue. Like the early stage, each round or series is designated by a letter."

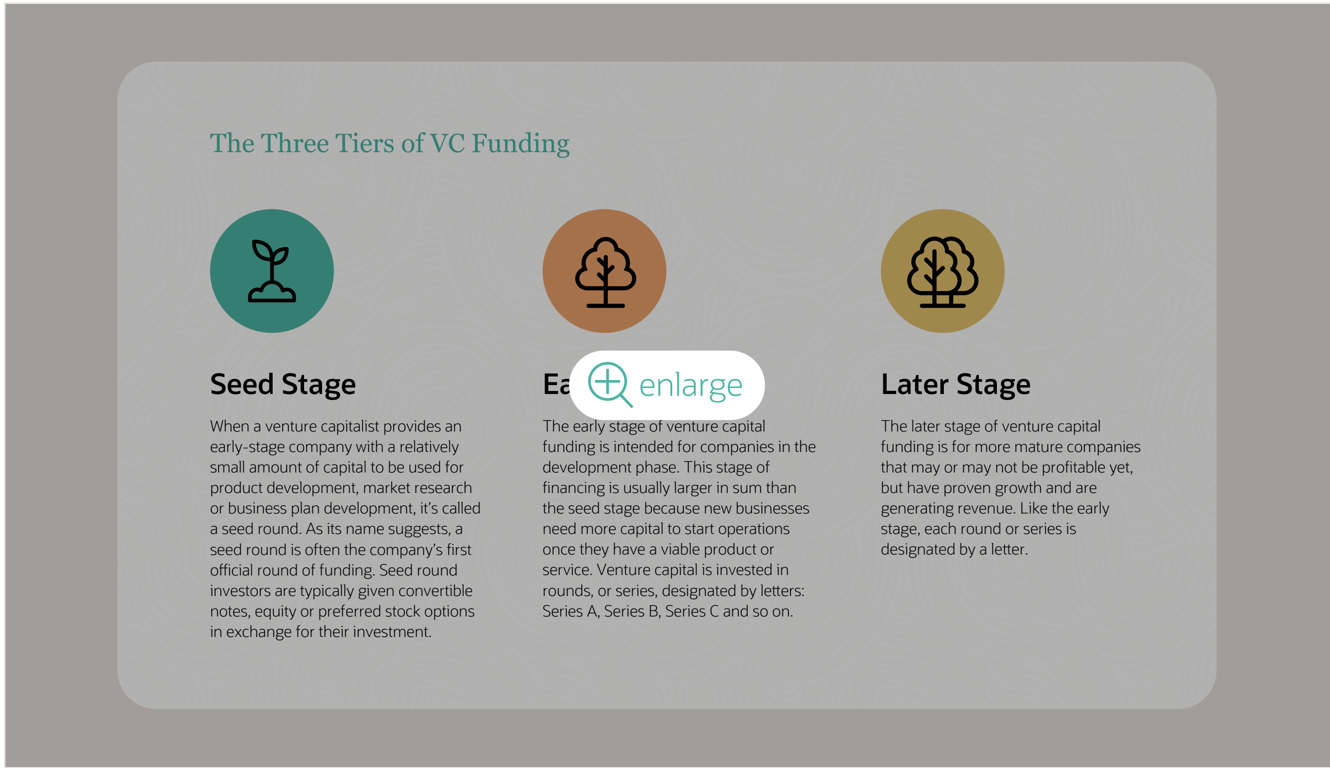


Figure 1: The Three Tiers of VC Funding

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 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. Traditionally, VC has been geared toward companies that are designed to grow quickly and have high startup costs. Add a global health crisis to the mix and VCs are now beginning to focus on longevity and adaptability. For the best chance of scoring venture capital funding, you need a resilient 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 Today?

Resilient companies

Venture capital financing focuses on companies that have the potential to grow quickly. Growth and returns are what VCs are looking for when investing in any company—with an end goal of a successful IPO or acquisition. Getting to that end goal, however, takes time, potentially even more in periods of uncertainty, which is why it's crucial for founders to now showcase resilience.

In a recent study on corporate resilience, George Serafeim of the Harvard Business School found that, **"during a market crisis, investors are looking for evidence that a company can be resilient."** Resilience comes in many forms, but ultimately it is **a company's ability to cope with stress, persevere and ultimately succeed amidst change**. Resilient companies in today's world embrace technology and focus on sustainability. "Startups focused on the 'new normal'—remote work, telehealth, distance learning and fintech—have done well; more than half of the top 25 early stage deals of the first quarter were in pharma and biotech startups" **Adam Bluestein said on Marker, a business publication on Medium**.

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 $2.5 million in Q3 of 2020, according to the PwC/CB Insights MoneyTree Report. See the full breakdown by deal size and stage in the report.

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. investment in Q3 of 2020 show that internet business is still the clear leader, followed by health care, then mobile and telecommunications. The acceleration of companies adoptng new technology during the pandemic has kept investment in the technology sector strong. The entire breakdown of VC funds invested in Q3 of 2020 by industry is depicted later.

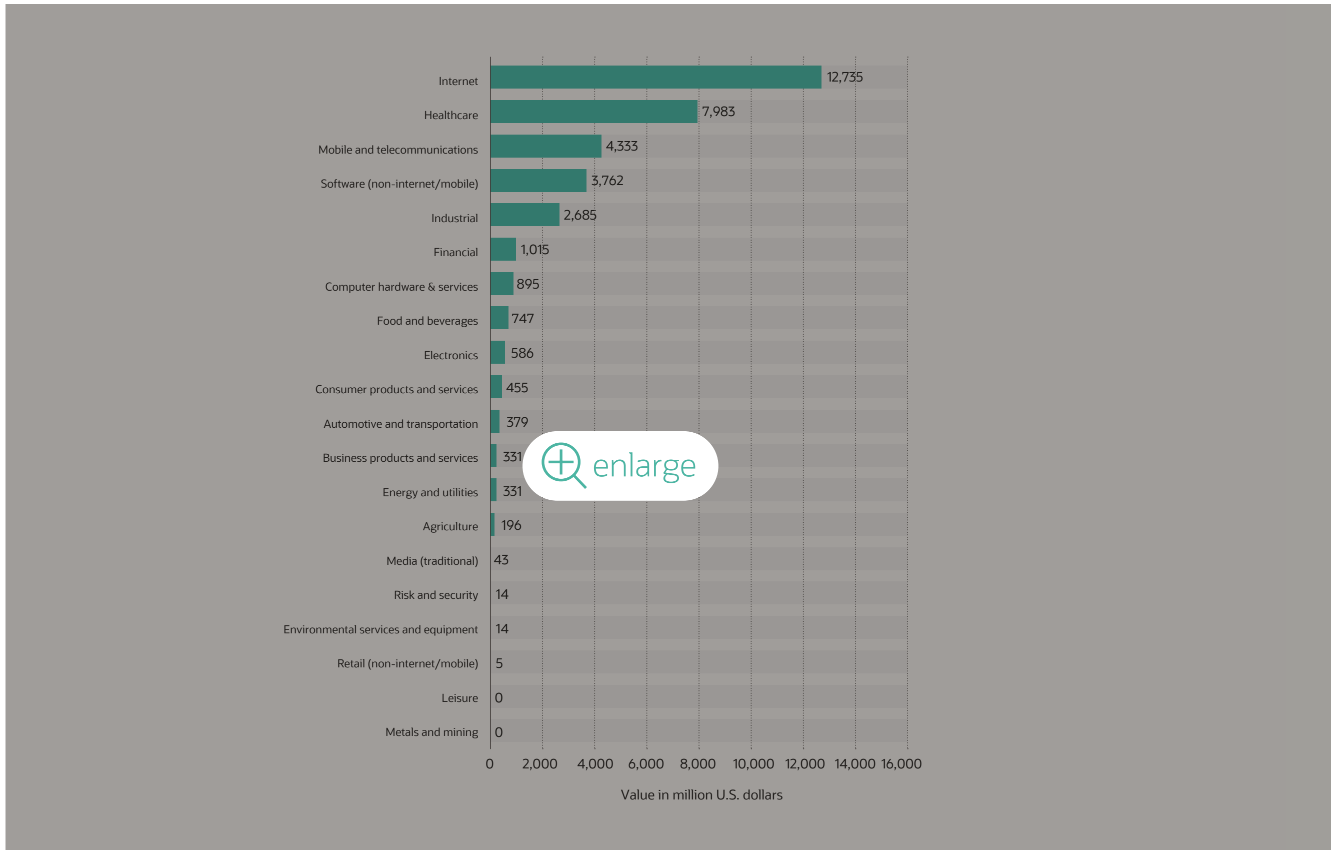


Figure 2: Statistics on the Value of U.S. Investment

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 a minimum viable product (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?
- Does your company have enough cash runway to weather uncertainty and an econcomic downturn?
- 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.

For example, **Jordan DeCicco's company, Super Coffee, fit the bill described above when it secured VC funding**.

As a college freshman in 2015 looking for low sugar alternatives to bottled coffee and energy drinks, DeCicco started Super Coffee. By 2018, VCs had taken interest and saw it as a scalable product within an extremely competitive industry. DeCiccio's management team was crucial in securing a Series A funding round as it demonstrated that leadership could work with employees to shift quickly when new product lines weren't performing. Today, Super Coffee has secured $25 million in Series B funding, and its valuation has risen to more than $200 million in the midst of a pandemic. The key to these wins: a flexible and unified management team that was able to cut spending in other areas without laying off its employees and a commitment to analyzing the impact on cash burn and runway in "what if" cost cutting scenarios. That gave VCs the confidence that they could weather uncertainty, and they closed the deal.

How Important Are My Company's Founders?

Very. If you take anything from the story about Jordan DeCiccio and Super Coffee, it's that your founders and your executive team are crucial. 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 top 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 diversity

Lack of founder and investor diversity has been prevalent in the venture capital community for far too long. Managing Director at Jumpstart Foundry, Eller Mallchok had this to say about diversity in VC in a recent virtual event, "This has been a big focus for the entire venture industry—I have been pushing other firms we are close with to confront the fact there is extreme bias in how we conduct due diligence, how we deal source and that we need to have active strategies to combat that." Investors are recognizing this and exploring strategies for getting outside their networks to invest in founders with diverse backgrounds and experiences.

During the same event, Phil Boyer Principal at Crosslink Capital added that, “in our minds, it’s about internalizing the fact that it isn’t just the right thing to do to invest in diverse founders and teams, but it’s actually good for business.”

Competition for diverse founders is heating up too. In an article for Bloomberg, VC Sean Mendy of Concrete Rose Capital spoke about the fund he and his team put together focused solely backing diverse founders. He commented on similar funds entering the space from corporate investors like Softbank Group Corp. and Base10 Partners noting,

“Competition is good for the space—I want to see as many founders as possible raise money.”

Adding diversity to your founding team and within your business isn’t just a good practice for attracting investor interest, it’s just good business. A collective of different backgrounds and experiences within your team can give you an advantage in dealing with unexpected roadblocks and will make your business stronger in the long run.

The Bottom Line

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

1. Develop a resilient business model in a
2. Hot industry, with
3. A diverse 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, resilient businesses that can grow quickly, choose industries that VCs are keen to invest in, and build management teams that are diverse, agile and 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 a 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 three to five 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.)

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.

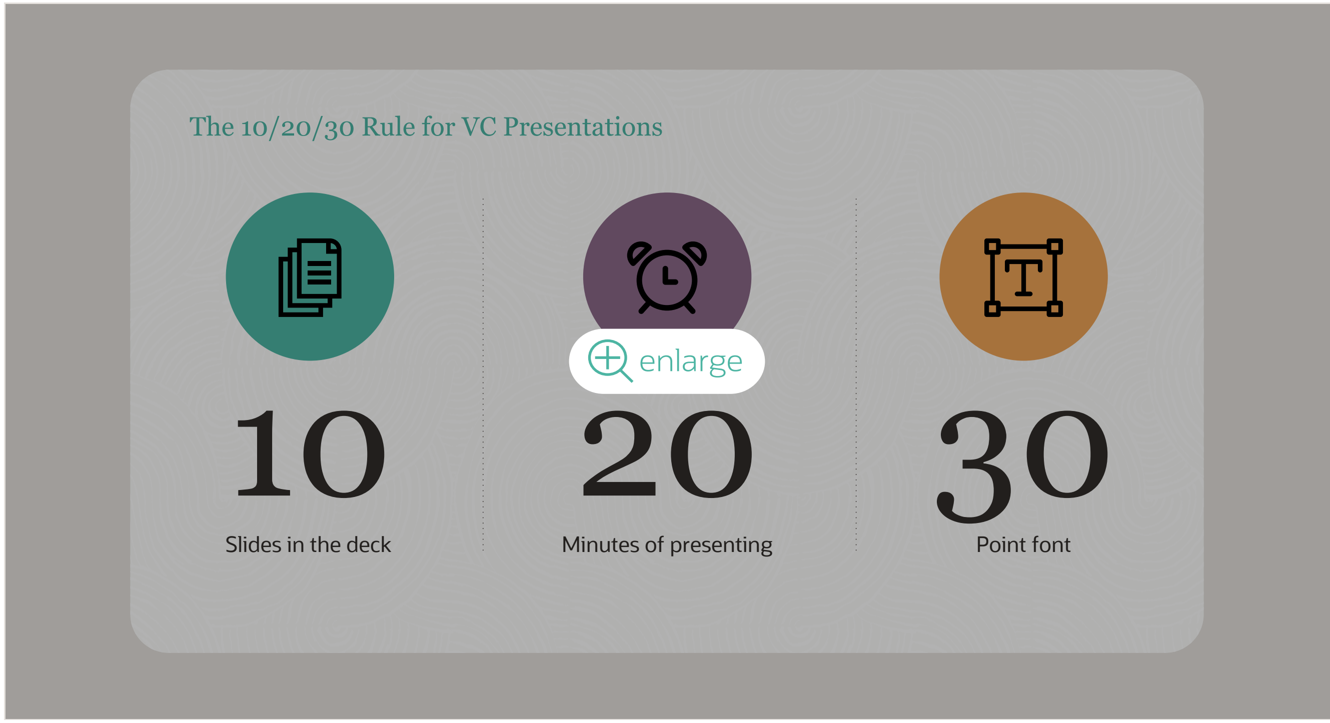


Figure 3: The 10/20/30 Rule for VC Presentations

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. Check out Airbnb's pitch for an example of a strong hook.
- **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. Mixpanel's series-B pitch deck does exactly that.
- **Highlight the team.** If you're lucky enough to have a seasoned management team, like Square, 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. Believe it or not, Facebook's original pitch deck was heavily focused on metrics.
- **Find your tone.** Know who you are (tone) and who you're speaking to (audience), and highlight this in the deck. Manpacks pitch deck leaves little to question about the company's identity.

- **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. Dwolla's founder shared his personal pain with credit card fees which resonated with investors.

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.

To provide founders with a better understanding of how VCs are evaluating pitches, Hustle Fund has been critiquing pitches live on camera. Co-founders Eric Bahn and Elizabeth Yin offer feedback on 5-minute virtual pitches from real founders. While the companies pitching are extremely early stage, you can see why core principals of brevity, clarity and resiliency are necessary for convincing a VC to invest in your company.

The Presentation

A pitch deck helps you 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.

Virtual meetings have greatly impacted the way founders are selling themselves. With almost all VC meetings being conducted over video platforms like Zoom, NFX General Partner Gigi Levy Weiss offers five tells he looks for in video calls:

1. Preparation

Weiss says that he checks "how well they prepared for the video meeting and look at the quality of preparation as a tell sign—including video and audio quality, backup slides, etc." Virtual meetings lack traditional in-person cues like body-language and eye contact, often making it more difficult to stand out. Understanding the challenges associated with video meetings and preparing for any potential pitfalls can go a long way in differentiating yourself.

2. Unexpected Questions

Weiss also tries to derail the flow of each founder he meets with. He often asks unexpected questions during the call that the founder didn't address to get to the bottom of what he cares about, but more importantly to, "see how the founder is dealing with the changes."

3. Team Dynamic

In the case that a founding team is giving their pitch, Weiss makes a point to ask questions to each of the team members. He says he pays particularly close attention to "the team dynamic when hard questions are asked." How your team manages stress during the presentation is crucial, and Weiss says it "is very visible over video."

4. Meeting with Nontraditional Team Members

To make up for a lack of intimate in-person discussions, Weiss also makes a point to set up follow up meetings with additional team members. "Even if it's for five minutes each." He noted, "I'm going wider (meeting more people) where it's tougher to go deeper."

5. Small Talk

Don't overlook the importance of small talk at any stage of your meeting with a VC. Especially now, small talk can be crucial to a VC understanding your personality that can be lost in video sessions. Weiss points out, "Many founders are surprised that I don't just jump into the discussion—but the small talk tells me as much as the actual discussion does."

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 Sway Ventures identifies a focus on early to mid-stage technology companies. If you have an early-stage company developing a software or technology product, Sway Ventures 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 OpenView Venture Partners openly list their portfolio of investments. Reviewing them will help you determine if your company fits the firm's prototype.

For example, OpenView 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 SaaS companies:

"OpenView is differentiated on three key criteria: sector, stage and pace. OpenView invests exclusively in business (enterprise) software companies that have entered the expansion stage, and we'll only execute five investments per year on average," the post reads. "We're thought leaders around the concept of product-led growth (PLG) and invest behind this thesis. PLG businesses are those companies whose product acts as the primary driver of customer acquisition, retention and expansion. (Think Datadog, Calendly or Expensify.)"

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. In 2019, more than 50% of the country's VC deals occurred on the West Coast, while only 4.6% occurred in the Southeast region of the United States according to Axios. If you're operating a company in the Southeast region, you might as well be competing for the 4.6%.

However, because of the drastic shift to virtual meetings and reduced travel caused by COVID-19, VC firms are becoming more willing to invest outside their regions. In a recent NetSuite virtual event, Managing Partner John Cambier of IDEA Fund Partners, noted that the firm operates under the assumption that "companies can be developed anywhere in the country outside of the traditional investing hubs." During the same event, Eller Mallchok, Managing Director of

Jumpstart Foundry, pointed out that the pandemic's impact will increase "competition between funds who are able to say 'we're willing to invest and put capital into this company (without meeting them in person)' versus a fund taking a more traditional approach of 'no we want to fly out and see you' or 'we want you to fly out and see us.'

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, Calif., 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 as well.

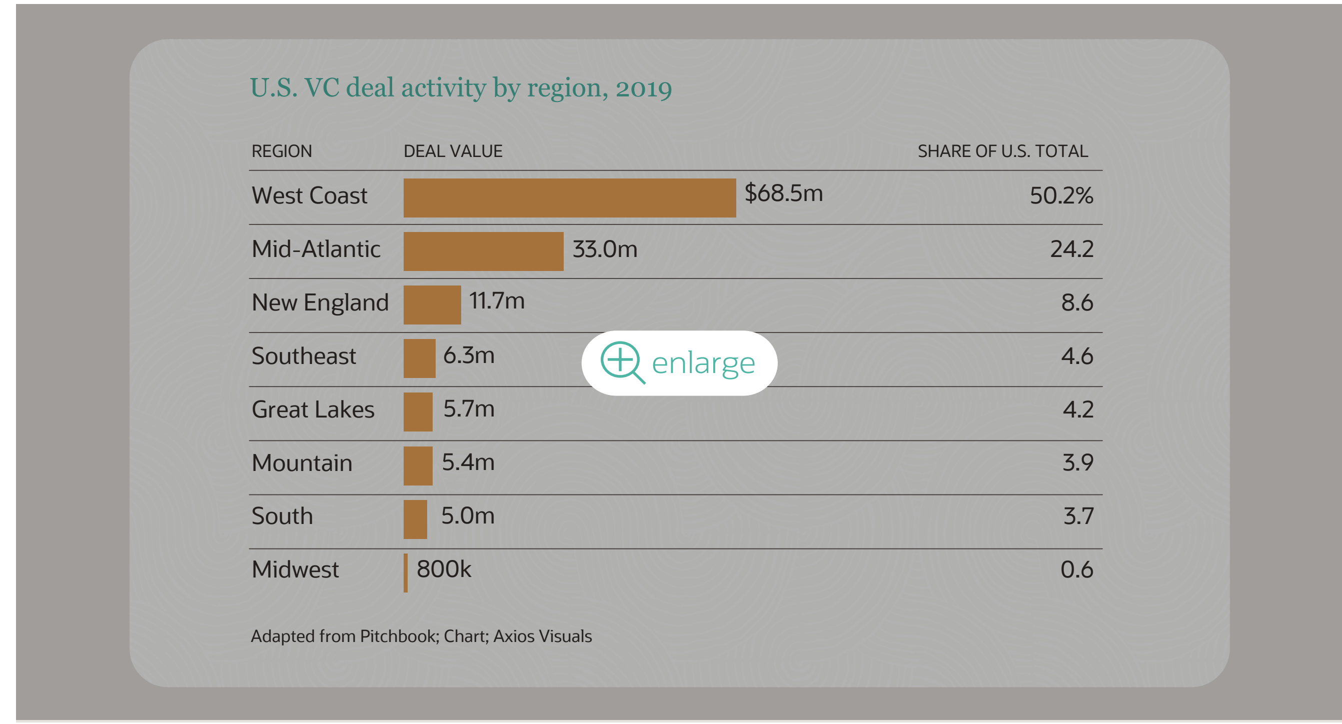


Figure 4: U.S. VC Deal Activity by Region, 2019

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.

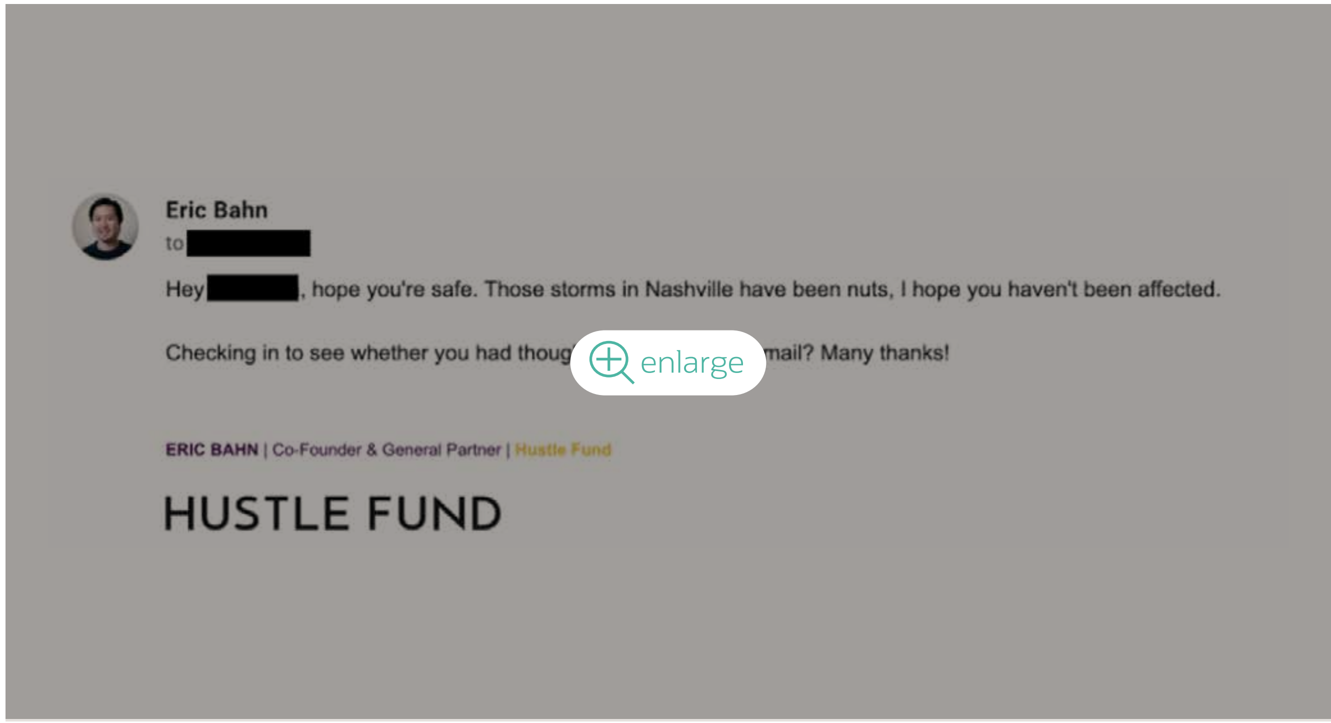
To find warm intros for your target list, ask yourself:

- 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 (see Bahn's tip on angel investors here) that can help open up the next phase of introductions?

Also, don't be afraid to ask investors for recommendations either. Remember Bahn's "flywheel" strategy? Ask for pointed introductions from VCs that you meet with. As we said before, VCs are more open to deals within their networks.

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. Eric Bahn has a few tips for nailing the cold email approach:

- **Email Structure**
  Start with an outline and be sure to include the basics: "who you are, the need that your business serves or the problem it fixes, and why the business has been and will continue to be successful." These components make up the structure of your email. Bahn also says, "In the current climate, you'll also need to mention COVID-19's effect on your business."

- **Differentiate Yourself**
  Don't forget, VCs receive hundreds of cold emails so you'll need to capture their attention. Bahn offers a few creative ideas including name-dropping current investors to make them feel like they are missing out on an opportunity. He also suggests including a link to an abbreviated pitch deck for additional context.

- **Be direct and persistent**
  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.

  Despite your best efforts to craft the perfect cold email, it's very likely you won't receive a response. In this case Bahn recommends following up consisitently. During one of his own attempts at fundraising he followed up with a firm 13 times before he ever heard back. The VC ended up investing in Bahn and his venture.

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?

A term sheet is 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 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.

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.

The Three 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.

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.

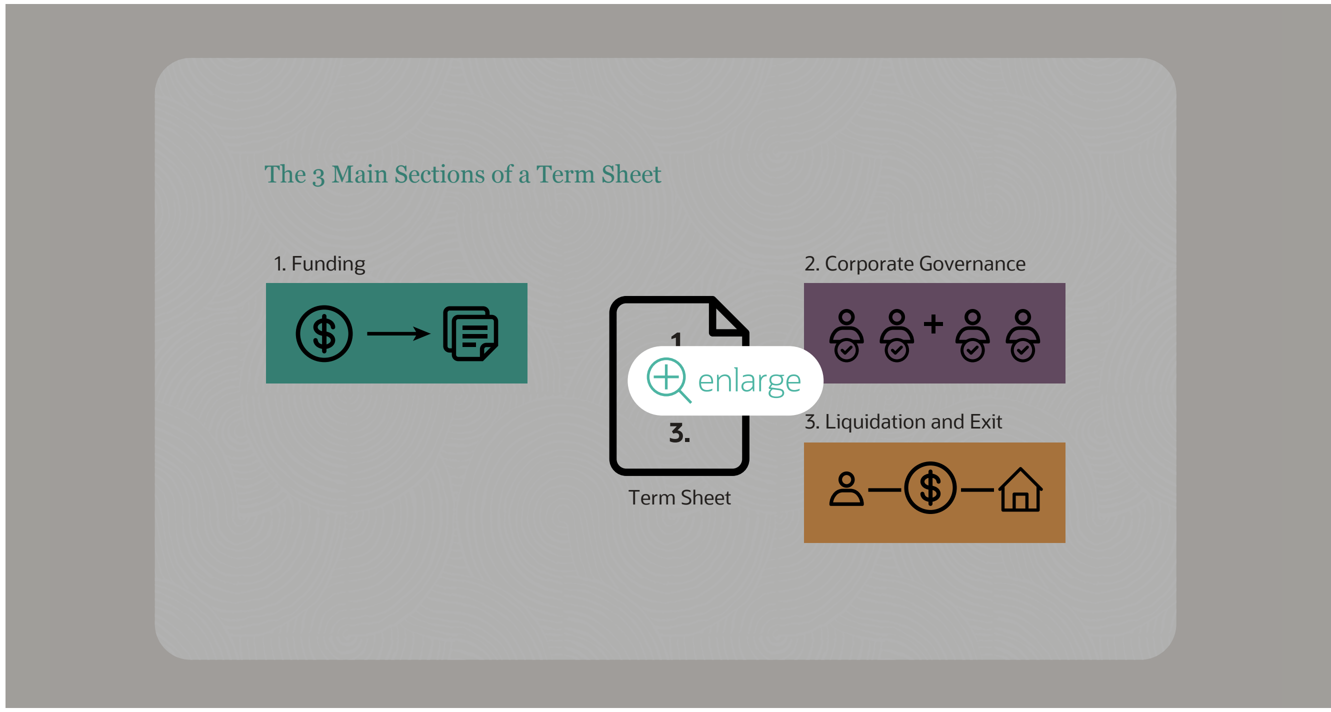


Figure 5: The 3 Main Section of a Term Sheet

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.

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 typically outlines decision-making abilities, voting rights, and board composition. 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.com, 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

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."

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.

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.

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."

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.

Part 6: 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?

Brainyard defines due diligence as "the investigation performed by an interested party, including venture capital and private equity firms, into a merger or acquisition target or to vet companies for potential investments."

In the context of venture capital, this means 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 softwar 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 overcommunicate with key stakeholders and remain the VC's primary contact. Caldbeck also suggests assigning tasks from the closing checklist 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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