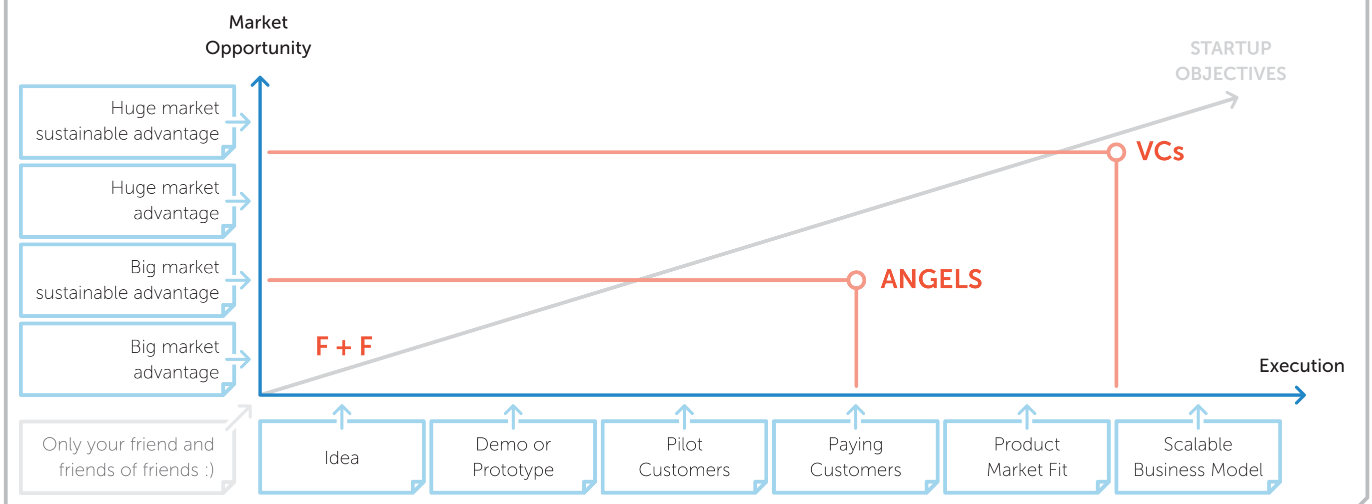
Patrick Negri's Notes on Raising Startup Capital and Being a Startup CEO

iugu

IT'S ALL ABOUT MARKET OPPORTUNITY AND EXECUTION



HOW MUCH MONEY IS IT NECESSARY TO RAISE?

→ Enough money to get to the next step in the board above.

MILESTONES - WHAT IT IS AND THE TIMESPAN

→ Idea => Demo => Pilot Customers => Paying Customers => Product Market Fit => Scalable Sales Model (Company Building => Go to Market => International Expansion, Broader Market** or Both).
→ Product Market Fit like 50 customers.
→ Each step period is likely to be 12 months. It's common to merge some initial steps to a single fundable milestone.
→ Have a buffer (50% to 100% VS Risk), i.e.: If you raised money for 12 months, then you should have a buffer considering 18 months from a step upgrade to another.
→ Fundraising time: 6 months
→ Total for example: 24 months

** Refers to adding features to expand the market or launching new related products.

A FUNDABLE MILESTONE

→ Getting from X to Y, with that, to accomplish that. Spend % on this and that. Example: My plan is to get from paying customers to my market fit.

DO NOT TALK ABOUT RANGES WITH INVESTORS

→ Ex: 12 to 24 months, $1 million to $2 million. Always anchor to the lower value.
→ You may communicate that you do not understand your business.
→ Angels typically don't follow up bad investments (in case you are not delivering enough).
→ Bridge loan (Convertible 0% Discount / X% Interest) can bridge a gap on the next round.

Startups almost never fail. They just run out of fuel (aka money)

→ You can screw up everything else, but if you have a lot of money in the bank, you are okay in some level.
→ On the other side, it doesn't matter how good everything looks like, if you are out of cash, you are out of business. It's really just that simple.
→ The flip-side of this is: Raising money earlier is incredibly expensive. The most successful entrepreneurs try to push these milestones further to make money become cheaper and cheaper. Think about this as the balance.
→ Forget about banks. Banks are willing to lend you money as long you can prove then that you don't need their money.

KEY POINTS FOR NOT RUNNING OUT OF MONEY

- Don't spend more than you can.
- Don't try to jump a step in the funding milestone unless you and everybody involved (team, board, etc.) are absolutely sure this is possible.

CEO DAY-TO-DAY DUTIES

Strategy	Are we doing enough to build sustainable competitive advantage?
Plan	Do we have the right plan in place to scale revenues and profits?
Market	Am I spending enough time with clients, resellers and partners?
People	Do we have the right people? Are we investing enough in development?
Culture	Is this an awesome place to work? Are we staying nimble enough?
Execution	Are we executing our plan? If not, why not?
Financing	Is there enough cash in the bank? For how long?
Board	Do we have the right directors? Am I using them enough?
Me	Am I doing enough to learn and grow as a leader?
Current	What's more important right now?

3 FULL TIME JOBS

- Raising Money
- Managing and Properly Growing the Business
- Selling

THE IDEAL STARTUP FUNDING ON VENTURE CAPITAL

- Raise funds when you are not in need of money
- Have $1 to $5 million revenue per year
- After that, it's easy to dictate the terms. If your revenue is more of a long term thing, then you will need to have some negotiation skills.
- Capitalizing on success VS creating success

  We are already successful and we need your money in order to be more successful. So you and I can cash out.

YOUR GOAL IS TO HAVE A LOT OF OPTIONS

- You need to believe your business or paint your business like a successful business.

  YES: "We currently have these clients on pilot and they absolutely love our product."

  NO: "We currently have some clients on pilot, and if we don't raise money on a couple of months we are out of business."

"ALWAYS RAISING MONEY" MODE ON

- What does it mean?
- In your startup's early stages or between funding rounds, you are not "raising money", but building relationships to raise money for the next step.

BEST WAY TO RAISE MONEY

- Get introductions from some investor who knows you well.
- Get introductions from a CEO from their portfolio companies.

TARGET LIST OF INVESTORS

- C: All the investors considered.
- B: All the ones that go "Yeah, if it gets money, it will be good".
- A: Top priority investors.

How to do it? The investor wants you to find him/her. So their profile and website are always up to date. Good investors generally have their contact info updated.

WHERE TO FIND THEM?

- Through other investors.
- Through your personal network.
- Through blogs — get a sense of what is important. In EUA/EUR, most of VCs are bloggers.

CRITERIA

- Do they have money? (previous investments in 10 year timespan. Investment in 3-4 years)
- Investment fit.
- Geography connection.
- No competitive investments.
- Can they see you as adding value?
- Recommended by people you trust.

WHEN MEETING IN PERSON TO RAISE CAPITAL

- Build emotional connection.
- A product's hand's on is better than a slide.

WHAT TO HAVE?

- 1-to-2-paragraph email
- Investor pitch
- Executive summary
- Demo or prototype

DUE DILIGENCE GENERALS

- Liabilities report
- Employee contracts
- Customer contracts
- Financial history and forecasting (or financial plan)
- Cap table
- Profit vs loss
- The ability and speed to respond
- Company incorporation and contracts
- All minutes and decisions on paper
- Organization chart (people)
- Cap table / shares list
- Good standing
- Audited finances
- Payable and receivable
- Inventory, if applicable
- Assets and depreciation
- Gross margin analysis
- General ledger
- Bank statements
- Outstanding balances and terms of payoffs
- Intellectual properties report
- List of employees, including position, salaries and bonuses
- Resume of key employees
- Schedule of employee benefits and holidays, vacations and sick leave policies
- History of employee problems in the last three years
- List of benefits to employees like health insurances
- Copies of all stock options, stock purchase plans and schedule for grants thereunder
- Copies of documents verifying that the company is up-to-date with all employee related fees
- Licenses and permissions to operate specific business

LOSING MONEY PAINFUL IN ORDER

- Friends & Family
- Angels
- VC (Venture Capital)

FRIENDS & FAMILY VS ANGEL DEFINITIONS

- Friends & Family invest because it's you. They want to support you somehow and also have a chance to have investment success based on your achievements. They want you to succeed and trust you to achieve that goal.
- Angels invest because of the business potential. They feel that your professionalism and know-how along with their past experience can deliver solid value. You alone are not enough, the business needs to meet some criteria.
- In general, you don't want to get money from your family — your grandmother might need the money to pay her mortgage for instance. Family money is only good if they don't need it or else you are going to have a big problem.

WHAT ANGELS SEEK

- The potential to make 10 times their money
- Big market out there
- Something substantial you can offer
-

WHAT VCS SEEK

- 35%-45% IRR
- Possibility to do a "home run"

CONVERTIBLE NOTES FOR AN ANGEL

- Having a cap (e.g. 3 million)
- Having a discount (e.g. 20%)
- Priced round

"I've got a huge risk on that start. The folks in this round aren't getting such risks as I took on that date"

OPEX VS. CAPEX (DEDUCTIBLE ASSETS)

It's preferable to rent rather than buy something in general.

INVESTORS — QUESTIONS TO ASK

- Do they have time to help you?
- How many board seats are there for venture partners?
- How much free time do they have?
  When did they raise money?
- Do they have money to invest?
- Are they interested in your space?

INVESTORS' POINT OF VIEW

- The broader the team's experience, the lower is the company's risk.
- If you have a key technical position that isn't occupied, you have a risk. The question is, "How much risks can you have and still get the investment?"

NO CLEAR BOUNDARIES BETWEEN ROLES

- In the early stages, it's hard to figure out the roles of each employee because generally people must move to solve problems until they exceptionally fill one specific role as the company evolve from a generalist point of view to a specialist point of view.
- You need to do what it takes until you get to the next stage.

FIRST MEETING TIPS

- Do not raise money, look for advise. Align the expectations, what they want.
- Get comments on your business.
- What do I have to accomplish in my business to make you willing to invest in it? That's the multi-million question.
- Did you see the milestones that we have accomplished in the last months? I believe we are ready to move forward.
- Talk to their portfolio companies.
- Research the company you are willing to speak with.
- The two items above demonstrate a message of true interest.
- Be honest.
- Fundable milestones are very easy to verify: idea, demo, pilot, paying customers, product market fit, company building, scalable sales model.
- Don't ask for NDA. It's bullshit from pharmaceutical companies that have formulas or something like that. In the IT or Service world, that doesn't exist. If anyone asks for this, run like hell. Venture is a trust based business.
- Call your trustees (people that introduced you) and ask them to call back to see how it was.

SECOND MEETING TIPS

- Discover the funding date and the return date.
- In general, at the end of due diligence, they will tell you how much they think your valuation is.
- The smaller the size of your valuation compared to theirs, the easier to close a deal.
- If you don't know it, don't reveal a number. Talk about valuations of similar companies and say you are willing to negotiate what they think how much they worth, then work upwards that value. The bottom side: if the value is too low, you can't get higher.
- The up side: if they believe your valuation is X, you probably are not going to get 2X. It's more of a question of accepting their valuation and moving on. One thing that can help: if you had a previous valuation by delivering results, anchor the valuation on that previous one and show that you have made lots of progress since then. (The downside of this is that you often anchor the next valuation based on the timespan of the previous round).
- In general, VCs try to compare your company to similar ones or same market companies.
- Be reasonable. Points of view are often taken in account.

WARNINGS SIGNS (ROADBLOCKS FOR UPCOMING INVESTMENT)

- No founder vesting
- Huge valuation gap (or out-of-touch-with-reality valuation)
- Out-of-market founder salaries. Your salary must be less than what you would earn in the same full-time job description, at least, in the first 4-5 years. Always be reasonable. If you have 2 kids to raise and a home to sustain, your salary must be enough for you to live.
- The money should always be used to get the company forward. If you have any liability or obligation, you need to solve that by your own.
- Backpay using stock (part of options) is acceptable to some point.
- Large percentage of company owned by people that don't work in the company.
- Anything that sounds urgent, risky.
- Clear governance to facilitate boards. CEO, COO, CFO, CTO, CGO, etc.

ADVANTAGES FOR INVESTORS THAT WORK AGAINST YOU

- Talking about time. From the investor's point of view, the longer they wait, the more information they will have about your ability to execute and your company's effectiveness.
- Create a forcing function. Focus on execution, counter use your progress as a chance they are losing as valuable investment. Good deals are hard to find. The biggest fear of a VC business is losing a great deal.

EARLY ROUNDS EQUITY DILUTIONS TIPS

- Before first institutional round: max 30% equity loss, 500k to 2.5m.
- First institutional round (Round A): 30% average equity loss.
- Be careful with pool options, they can dilute you additional 10% before the round dilution.

NEGOTIATION THOUGHTS

- Leverage: it's like having another term-sheet that allows you to get a better deal.
- In general their valuation is lower than what you think.
- They aim to own a certain % of your company. You can raise your valuation if in the end they own the same previously target percentage. They want X% of your company. You want a valuation of $Ym.
- Your primary concern is to build a successful company. Focus on the big issues.
- In general all investors like to say that they have "added value". Your expertise is probably more than theirs to begin with, and, if it's not, your expertise is quickly going to surpass any expertise they build up around your business. When looking for value, you should do it in this order: Networking => Specialization => Branding (Yes, branding is like getting money from a top investor that can help you a lot in next rounds).
- Do not offer discounts on a series round or you will be in trouble.

REFERENCES

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- https://novoed.com/venture-deals-3
- https://novoed.com/startupcapital

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