Transcript - 2022 02 08 TENFL How to Raise Funding For Your Startup Q A

[00:00:34] Section 1 -- Timeline for raising funding

Hall Martin: My name is Hall Martin with TEN Capital, and today we're going to talk about your timeline for raising funding.-the key here is, it always takes longer than you think it does. And so, one of the benchmarks I found in working with very early stage companies, and that's mostly the people that are here today, is that it would take you one year for every $1 million you are raising, and that includes everything, preparing, pitching, closing, diligence, etc. And there are many steps, and we'll look at those today, and talk about what kind of timeframe that might be. If you do have a very small raise, 250, and mostly family and friends, it can go faster. But we're talking about a full raise, and we're talking about people we don't yet know, and have to build a relationship with, it is going to be a process to build that relationship and close that funding.

So here's a rough outline of what you should be ready to do and put this into your plan as well. And so, the first thing you want to do in month one is check your readiness for raising funding. Ideally, you have a product, you have some units sold, there's product validation, market validation, the product works and people will pay for it, don't have to have a lot, but that really helps have something there or an MVP that's in the market. Second, you've got a core team behind it, someone building it, somebody's selling it. No fair everybody building it and nobody's selling it. Investors look hard at that aspect of it, and will let you go forward based on that or not. And then, you might want to check with your attorney, if you're going to be raising equity and other things, you want to make sure your business is ready for this. You've had, ideally, you've filed any patents that you plan to file such as provisionals, you've gotten your term sheet put together if you are going to raise equity, you know what you're going to do in that direction, you're doing debt, convertible notes or safe notes, then there's a lot less to be done there. But you've got that ready to go also.

Next thing you want to do is put your documents together, you need an executive summary, pitch deck, three to five-year financial projections and a due diligence box. And the due diligence box is just the basic documents that investors expect to see entity filings, patent filings, projections, income statement, balance sheet. And we always recommend you do this because you'll be sending it out a lot, so you might as well go and put it together, and make it look good and make it not a paper chase for the investor. And then, if you feel like your team is not strong enough, you want to put together a board of advisors, two-three people that might be able to fill in the gaps, fill out the slag of the team. And so, think about the optics on it, if you think you need more strength there, take some time to recruit a couple of board of advisors, doesn't mean you have to pay them a lot or anything, but it's a good idea to get them signed up to help you with this.

And then, next is to build a prospect list of investors, these are potential investors that could fund your deal, and you want to put down name, email, phone number, and something about them and start the process of getting ready to go out, reach out to them to pitch your deal. Next thing you want to do is start to prepare this investor list, and I always say you should contact – start with 10 investors you already know, and go out and pitch to them first, and then add 10 new investors per month. Set that as your goal. Every month, we're going to get 10 new investors, and we're going to go back and update or remind the ones we have already pitched upfront, that's not a lot, but as you go forward, that will be a lot. And it's either, email is a good way, but also phone calls and coffee meetings are also helpful as well. And then you start to set meetings to go introduce your deal to the investor, and you start your monthly updates every month, you want to come out with a short update on how you're doing and send it to all the investors on the list.

Next is we're just now in the throes of pitching investors, this is usually month, six to nine, and you’re pitching each investor, and you're going through and answering their questions, showing how it's working, giving them updates, showing how you're making progress with it. And if you have any incentives to offer, sometimes you may want to give people extra equity, if they're going to come in early. This always helps a lot. And the thing to do and realize is that investors, you really have to build a little bit of a relationship with investors before they put in substantial money – maybe they throw a 25k check without much, but anything beyond that, they're going to want to know more about you, you're going to want to know more about them, and think about building a relationship as you go forward. And this helps move the process forward as you do that. So after you pitch the investors, next you want to actually go through and close them. And so, you can do a lot of events and meetings and calls online, so do as much as you can there, sometimes it's with phone calls, sometimes it's with Zoom. And then give them information about your industry, keep them updated about what's going on, demonstrate that this is a great place to invest. The thing you want to think about when you do a fundraiser is you want to tie to hot sectors, you want to get in on the ones, and today blockchain, cybersecurity, health tech, fintech, there's a number of sectors that are very hot and you want to, at some level, be relevant or related to that. If you're off in an area where there's absolutely no growth rate going on, it can be hard to get the investor's mindshare, so think about positioning your deal relative to a hot sector to show that you're going to get some of the benefit of that growth that's going on there.

Once you have these investors educated and so forth, the next thing you want to do is close the investors, and this is where you have to start to go out and have them go through the diligence box, help them make answer any questions they have, they always have questions about it. And it takes seven touches to close a sale, so it will take seven touches to close an investor, go ahead and just count on that and set up follow-up meeting, calls, events, and so forth to generate those touches, answer those questions and keep that ball rolling. You've heard about the flywheel of raising, of closing sales, so you can use that same flywheel for closing investors. Selling your equity is not that much different than selling your product, a lot of the same principles apply, so make sure you're putting that into your planning on how that works. Like I said before, you really need to have your due diligence box or what they call a data room put together, you may have to update it from time to time, but still that is ready to go for anybody that's ready to look at it. And those who are serious investors will go into the diligence phase and ask detailed questions as well.

Finally, after you have the investors on board that say, yes, I want to do it, you have to get the contract signed, make sure you use tools like DocuSign or HelloSign, make it easy for the investor to get in the deal as well. Don't make it hard for them, make sure that it's easy to sign, wire the money, and be in the deal and answering questions they have along the way. So this is the key process that we have going on, I found that some businesses like recurring revenue businesses really don't need to go raise a big chunk of money at one time, like a million dollars, they can raise a little bit every month, and that incrementally helps them improve the business. So you can milestone or structure your race, so that it fits your business, and your fundraise. My role is you shouldn't spend more than a year raising funding, you should, at some point, raise enough to do some of the work, stop the raise, go work on the business, and then come back and do another tranche. So if you have a very large raise, think about breaking that down into stages to give yourself time to work on the business, and then find new investors for the next round that comes up.

So next is, so fundraising will take time, and so, you want to come out with some systems and tools, mailer campaigns, you need a CRM system for that diligence box, you need a Dropbox or Box account or Google Drive. And most of the diligence and so forth takes place online, so you just want to have online tools ready to go for the fundraise itself. And if you need to consult your attorney upfront, that's fine. If you're raising equity, I recommend you have an attorney put the term sheet together, when it gets finalized in the terms. If you're working with a lead investor who's going to do that, that's great. They want to – they often want to share the cost with you on that, but that's probably not a bad thing to do, to get there and be in it.

[00:08:53] Section 2: Providing references for market research in a pitch deck

Hall Martin: here's the question: do we need to provide references of our market research in the pitch deck? I think it's always good to put a reference in there to show people what data you're bringing in, that demonstrates you are doing research, you know your numbers, and you're not just pulling it out of a magazine, you're actually pulling it out of the appropriate database that shows you've actually done deep dive research on this marketplace as well.

[00:09:26] Section 3: Looking for investors

Hall Martin: So I see you're looking for investors. Have you mapped out what I would call the ideal investor profile – just like you have an ideal customer profile, so you have an ideal investor profile. Depending upon your deal, an angel investor may be the best, or it may be a venture capital or it may be a family office, maybe somebody that's a lead investor, or maybe someone that's a follow-on investor. So realize there's quite a range of investors out there and think about what type of investor you're looking for, and what average check size they're writing, and then you can tailor your presentation towards that group. For example, VCs want very large markets and very high growth rates and so forth, and they can be fairly demanding. And if you have the stats and the numbers for that, then by all means you can pursue that. If you don't have the numbers for that, you may want to pursue angels or others as well.

[00:10:23] Section 4: Raising a Seed+ round

Hall Martin: So Brian says, "I've raised 600k, haven't raised this last summer, preparing to raise a final seed or series A". Brian, sound like you've had a good first round there, and you're doing another round. The question we often get when people raise a seed at 600k, and now they want to do a series A is do I do a seed plus, do I do another round at 600 at the same valuation, or do I do a series A at the next level up on evaluation, can I double my valuation with a series A? And I'd say more than half the time the answer is you're not ready for series A, you have to go back and do a seed plus, because you don't have enough revenue or you don't have enough team or you don't have the right metrics, numbers that the investors want. So it's no problem to go do another seed plus at the same valuation you did last time. COVID's changed a lot of the dynamics around these things, it's taking longer, it won't look out of place with investors, it'll look very, very standard. So it just depends on if you really have the numbers that it takes to get your series A.

[00:11:32] Section 5: Raising a round at the pre-revenue level.

Hall Martin: So pre-revenue is going to be hard, it's going to be harder, and what you want to do is get as much validation around your business as you can. So it's best to have raised some money from your network, and so, it's not zero. I say no investor wants to be first, that's the value of family and friends is they will go first, so go and raise 50k from your family and friends and say money's already in. I always say start with a convertible note or a safe note, don't start with a price round like equity, because it can be hard to figure out the valuation at the pre-revenue level, there's just not a lot of data there. It'd be easier to do it later. And a safe note and convertible note, we're not setting the valuation, makes it a lot easier for the investor just to be in the deal, and we'll figure out valuation later. Like I say, don't make people climb the valuation wall, you'll spend a tremendous amount of time trying to figure out what that number is, and that's really not the best use of your time at this stage, best use is to get out to more investors to come in. So let's use convertible notes or safe notes upfront and get some validation behind your idea, show that the product works and people will pay for it, and by that, I mean, you don't have to sell a lot, you have to sell somebody, and you don't have to have a lot of people using it, but somebody who's got – some customer has to say this is going to work, and get validation behind it. So like I say, most people think I need to have huge revenue. I will say, at this stage, very few startups have big revenue, but proof points is what you're trying to build out to show the prospective investors, and having your network put money in is a big proof point. I do get people come to me saying, my family wouldn't put money in, how about yours. Well, no, if your family's not putting money in, my family's not putting money in. So make sure we get enough there that we start to show people that this has got some real promising future as well.

[00:13:31] Section 6: How to evaluate a pre-seed business

Hall Martin: Can you share more on how to evaluate a pre-seed business? So I think the key with a pre-seed business is that you're looking, of course, at the team, that's what a lot of investors do, they just go look at the team and see what their experience is, what their commitment is to it, what they've done before, and see how strong the team is. I know many investors that that's all they invest on is just the team, it doesn't matter where the product is, if the team is the right one, going after the right solution at the right time, then you can play that game, why you, why now, why this, if you can answer those questions, you can make a good case for a pre-seed deal, in many cases as well. So that's what I would focus on is the team and the timing that goes into it, and the market can sometimes play into it as well. If you're going after a very hot market that now is the right time for it is really kicking up. And there's good opportunity, you can make a good argument that this is the right one for it is for you to go after, and not focus so much on the revenue side of it, because we don't have revenue, and it's going to come later. But why you, why this, why now would be a good way to frame it, and make a compelling case for it. The thing with early-stage funding is you want to raise as little as you need to. I get many people coming in at the pre-seed level wanting to raise $5 million, and I say, well, your valuation is very low at this stage, you're giving up a huge amount of equity, going through tremendous dilution, and you really don't need $5 million, you really need 500k to get the first product out; and as you get more revenue and team and product, your valuation jumps up, and you can raise the bigger amounts later. So be thinking minimum raise and minimum viable product and minimum traction, I need to get to the next level, and as you talk to investors, you'll start to get a sense of what those levels are. It's 50k of revenue, it's a product that can work for 20% of your database, and it's just the very – it takes six months to build. When you are in software, the rule is it takes six months to build it, and six months to sell it. If you can't build it in six months, you're scoping it too broad. If you can't sell it in six months, you built the wrong thing. So think hard about minimum viable products and what you have to put out there just to demonstrate that what it looks for. And remember, your MVP is not necessarily your first version product. Oftentimes people, more than often not, the MVP you put out there is the wrong package, the wrong price, the wrong bundle, the wrong feature, and your first product is completely different. So don't get too hung up on the MVP being your base for your final product, because in most cases it is not as well.

[00:16:16] Section 7: How many users is considered a good amount for traction?

Hall Martin: how many users would be considered a good amount of traction? I think the key thing there with users is not the number of users, but the amount of engagement. What you're looking for is some number of users that are using the product extensively, their daily active users, the monthly active users, what you'll find with most investors is they're not going to be impressed with large number of downloads, they're going to be impressed with a large number of engagements, people downloaded and they're using it, and that's what you want to showcase is how many people are using it and how active they're using it to show that we have found a niche in the market where we're getting strong customer feedback and strong engagement. And over time, we can go after more of those. So raw numbers are less interesting than engaging users is where I would frame it.

[00:17:11] Section 8: How many slides go into a pitch deck?

Zaheen: so how many slides or how much information should one actually put in a pitch deck, because we don't really want it to be too much to lay it out on the investor, so that they don't get bored, and they finally do speak to you. So yeah.

Hall Martin: Yeah, 10 to 12 slides is what most people need, you need a problem, need your solution, you need your product. I'm amazed at how many slide decks I get where they don't actually tell me what the product is, they just assume I know what that is. And then, you get into things like the team and the market size and the competitive advantage, competition, financial projections slide, and then the fundraise slide, and then the exit slide. And then, if you have some really detailed things, you can put them in the appendix after the questions, you can put a lot more extra data to answer questions. If you have intellectual property that's worth a slide as well, and so, you end up with about 10-12 slides that it flows from one slide to the next, three bullet points each is what you're looking for. Because you're setting context, you're demonstrating the validations you've done so far, and then you're answering any questions that come from it. And it needs to have some nice design on it to show professional look as well. So that's what I put in there.

[00:18:31] Section 9: Three things never to do in fundraising

Bob Seibel: Yeah, Hall, this is Bob Seibel. What would you say would be the big three things never to do?

Hall Martin: So in fundraising, there's more than three, if I had to start to pick out the top three that you don't do is, I think, number one, don't go out to raise funding without some evidence that you have done your homework, you have a validation behind it, product works and people will pay for it. I have had people come in where the last three businesses they did were sold for nine figures each, these guys can skip that phase, because everybody believes they're going to figure it out. But for almost everybody else, you really need to show a real problem that you have now solved and how are you going to solve it, and there's some defensibility around it. So that's step one as well. Step two is getting your network to support it or not getting your network to support it is a problem. I hear that a lot. My family is not going to put money in, I'm not going to put money in, and no customer is going to buy it, how about you – I get that a lot. And I think that's a real mistake, because every step of the way needs to show validation. And when you can say your family put money in, well, that's validation; where you put money in, that's real validation. And if you are putting money in, take the money, put it in a bank account and call it an investment versus just paying it out of your pocket. So make sure that they know you have skin in the game and make that part of the cap table, and just make that a formal thing upfront. And then third is, I think, the biggest one is not following up, that's the biggest mistake I see. People pitch once and they go away and you don't hear from them again. And when, I ran angel networks, I saw this regularly, people would come and pitch to my roomful of investors, 90% would go away and we would never hear from them again, have no idea what happened, they just disappeared on us. And I have had investors – members come to me and ask what happened to the guy with the thing, and I say, I don't know, I never heard back from them, so they never came back. 10% though did come back, they gave us updates, reminders, and on the fourth update out came the checkbooks, it was like clockwork. Because you have to demonstrate the growth story, not just forecast it, but demonstrate it, which means you're making sales, you're closing, you're hitting milestones, you're making progress, until you have to build a little bit of relationship, and that's not going to be done all in one meeting or one pitch, it's done over about a two-three month period. That's why the follow-up is so important is you have to go back and demonstrate. So follow-up, I'd say, is the big, big third one that we see a lot that most people miss in this area.

[00:21:01] Section 10: How do you build a network of investors?

Speaker 5: how do I build a network of investors or funding network, and how to build that, how do I exactly go about it, what to find, what to look for, and which people or which network should I reach out to?

Hall Martin: Sure. So there's several ways here. One way is, and first is, you always start with your network. Figure out who is an accredited investor, if you're raising angel or VC money. Increasingly, we're finding people doing crowdfunding where they don't have to be accredited investors, but with assuming they're accredited investors, you go to your network and figure out who is and start building that list, and then have them make introductions to others, and then it's a referral to a referral to a referral to build out your network of investors as well. Another technique I've seen that I thought was very effective, if you're working in a space, say, blockchain, for example, what you can do is do some pretty deep dive research and diligence on a topic or several topics around the area in which you're working in, and then reach out to investors and say, I've done this research and be glad to share it with you over coffee. And investors love to be educated about these sectors, there's 200 sectors out there that you can invest in. And if you're in a sector that you can do some research in, and provide it in a meaningful, cogent way, what's trending, what's going on there, what the insights are, where the opportunities are, and so forth, investors love to be educated. And that's always a, what I call, a safe meeting, because nobody's asking you to do anything, they're just kind of – they're just coming to learn, and they're not being asked to invest or go into diligence or making an intro, they're just being asked to learn, and they love to do that. So I'd come up with some research and offer that out and do it in person, so you get to build a relationship or do it on Zoom call, so it's one on one, not just an email blast. You want to go walk through it, answer questions, get to know them a little bit. So the research technique is a really good one I've seen people use quite a bit, and the third one is, if you have access to a venture capital group or an angel group, you can start to research those angel groups and say, hey, I'm going to go do all the angel groups. In Texas, for example, there are 19 angel groups; if you get money from one, you can get money from the others. So you want to go research those guys and start to build a relationship around those groups, because you're going to go back to them at some point with your deal. One of the best tools, techniques I ever heard was _________ came to me once and said, I'm not raising funding today, but in six months, I will be, and I keep you informed of our progress. And over the next six months – and, of course, I said, yes, because I'm curious to see how this is going to work out, and over the course of the next six months, every month, I got an update that talked about how they're building it, and who the customers were, and how it worked – small, short emails, one or two paragraphs, no more, you're dripping it out, it's easy to read. And then, at the end of six months, when he went out to raise funding, he was able to close more quickly, because he had done all those touch points, he had done all the education up front. So if you can get out in front of your fundraise and get some of that education going, and investors love those sessions, because, again, they're learning, they're not actually having to do anything, when you go to them and say, do you want to invest, it's a big lift, they have to go and do due diligence on it, they have to potentially set valuation, they have to lead the deal, they have to get the legal docs, that's a big lift. And so, if on the other hand, you're just saying you want to learn about this new area, you'll find that a lot more people signing up for it, because it's a lot easier.

[00:24:25] Section 11: How do you value a pre-revenue business?

Speaker 5: So how to do a valuation on a pre-revenue or a pre-seed business or startup _________ valuation?

Hall Martin: So, number one is if I were to do a pre-seed deal, I'd probably do a convertible note or safe note, so we have to put a valuation cap on it, but we don't have to put a specific valuation number on it. And so, I would go in that direction. If you had to, for some reason, put a valuation number, you start to look for similar deals, and try to figure out what those other valuations are in that space. And then, I have what I call the rule of four for valuations in the very early stage where, essentially, you're giving yourself $1 million for each of four things in the business: the sales, the team, the product, and the intellectual property. So if I've got robust sales going, then I give myself a million dollars. If I got a full team, everybody's hired in place, working, give myself a million dollars. If I only have half a team hired, well, give myself 500k, something like that. Intellectual property, if I've got all the patents filed and awarded, give myself a million dollars. If only had three provisionals, well, let's call that 250. And basically, you just go through and add up all these different elements, sales, team, product, and the patents, and you can come up with a number around $3 million is my valuation. And when the investor pushes back, and they always push back, they always ask how did you arrive at it, you go back and you show them that equation, and you're now putting – you're now articulating the values that are in the business today. So many valuations are – is the articulating the value that will be in the business tomorrow. And investors have a hard time with that. Today's fundraise gets today's valuation. Tomorrow's fundraise gets tomorrow's valuation. And when everybody pushes back, you need to have an argument for it, you need to have a negotiation for it. And the more you can articulate values that have already been built in the business, the stronger your case is. And the final note is, it's a negotiation, it's not a formula. Formulas help us get to some numbers, but in the end, it will be a back and forth for sure. So yeah, so in the very early stage, it may be hard to find comps, so as you go further down the path it's easier _________ upfront. I will say valuations go up and down with the stock market. Last year, the valuations were very high; this year, we'll see valuations come down as the stock market is correcting back down. And so, just be aware that the investor is going to put that on the valuation. It will ride with the stock market at some level, and so, you have to kind of ride with it as well.

[00:27:12] Section 12: What characteristics do you look for in cofounders?

Bob Seibel: this is Bob Seibel again. You mentioned that the team is very important for pre-seed investors. What really strong characteristics are you looking for cofounders – I'm going to be looking for some cofounders to join my team – what should I be looking for in them?

Hall Martin: Well, the two things you want to think about for team is you need a complete team, and that means somebody is building it, and somebody is selling it. And so, if you're building it, then your cofounder needs to be selling it or vice versa. No fair, we're all building it, and nobody's selling it. I actually saw a business wants where they were all selling it and nobody building it, they ended up with – a software package, they ended up with a, I think, a 50,000-cell spreadsheet with all of it in there. And it's just nuts what they came up with. So the idea is, you really need to have a complete team.

The other thing is you need to start looking at the skills you need to get the MVP out, and get the first version going, and what skills do we need to do to go and build and sell that product, and then go and make sure that that's on the team. It's either in the founder, the cofounder, or you start to recruit a board of advisors, these are informal advisors that are coming in, that are going to step in and do a little bit of work for maybe a little bit of equity, maybe a bit of money, and you got all the jobs to be done are filled, and you've got that covered as well. So those are the two approaches I would look at is see how we get to completeness, and then, when investors ask, can you do this, you can show how the team can accomplish those things. And that's when you're doing in a pitch is you're showing what you want to do is present a deal that investor walks away knowing, yep, they can do that, that's going to happen. And when you pitch, you want to pitch in such a way that with or without you Mr. Investor, this is going to happen anyway, it's fair to complete. If you have enough numbers and validation points, you can make that claim. You can show how this is a, you know, we're going to do this, we're on our way, we're going to get there, and investors love that. What they don't like is deals where you may or may not make it, and it all depends on me the investor, because that’s just a lot of pressure and a lot of work that they're not signing up for. But if you guys can get there all on your own steam, hey, I can just jump on board and be a part of this and contribute where I can and not be under pressure to contribute where I can, so those are some of the dynamics you have to think about from the investor's point of view.

[00:29:39] Section 13: How do you determine how much equity to give to cofounders?

Bob Seibel: One other follow-up question – you mentioned equity, how do you determine what equity you give out to these cofounders?

Hall Martin: valuation question really answers that as far as the higher the valuation, the less equity you're giving away. And so, for those who are not familiar with it, the way you figure that out is you take your pre-money valuation, what the business is worth before the investment, add the investment onto it, and that gives you the post-money valuation. So if my pre-money is $4 million, I’m raising 1 million, my post-money is 5 million, you're giving away the investment divided by post-money, one divided by five, in this case, that's 20%. So, as an entrepreneur, they're pushing the pre-money valuation up, and the investor's pushing the pre-money value down. That's the negotiation you're having there as well. And you have to show that the market rate is where it is, and you have to show that you have the elements that give you the value that you want in that case. I have had entrepreneurs argue, well, I've done the math, and I figured out how much I want to own at the end of this process, so I must be worth $5 million. Well, that doesn't sway the investor, is what's in the business, and what's in the market, you have to show that this is the going rate, and they're getting a good deal out of this.

[00:31:00] Section 14: Metrics need for a crowdfunding campaign

Speaker 5: Yeah, for a crowdfunding campaign, what are the metrics that are used or needed to be showcased for it to be an appealing investment on a crowdfunding platform?

Hall Martin: Well, so growth rates are very helpful in this case. If you have very strong growth rates and revenue's really kicking up, that helps. I will say, they're more about the benefit, and the use case on crowdfunding, and less about the core KPIs, especially, that's why recurring revenue software doesn't do as well on crowdfunding, because the real value is in the CAC/LTV ratio, and the churn ratios and so forth. But when you look at most crowdfunding sites, what you see is improve wellness, increase education, decrease student dropout rates – they promote the benefits at a high level, they come at it from a more emotional level. And when it's $500 on a credit card, that emotion plays a lot better. If you want to start raising 25, 50, 100k checks, emotion plays a lot less, and now it's much more about the KPIs. And in crowdfunding, you're spending money on the social media ad spend. In the Reg D, angel, venture world, you're usually not spending so much money on the marketing, but you're spending your time, going out meeting people, doing the networking like we talked about in the timeline. So there's some different approaches to it. In crowdfunding, the average net investment is like 10% of the fundraise will go into doing social media ad spend. But that can help in some cases, where in the Reg D world, angel and VC, you run out of investors that you know, and now you have to go meet investors you don't know. And that's more work, so there's some tradeoffs between the two.