TEN CAPITAL GROUP

eGuide

# HOW TO RAISE FUNDING

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# Contents

# PART I: How to Prepare for the Fundraise

# Know Your Market

One of the critical criteria in funding startups is the entrepreneur's knowledge of the target market and customer. Size of market, growth rates, and segmentation are key components the entrepreneur should know well. Let's look at three ways to understand your market better.

## Web

The first place to look is on the internet. You'll need to first identify which industry(s) you're in. From that, you can find out several facts about your target market size.

## Trades Associations and Conferences

The next step is to find out what trade associations and conferences are related to it. You can contact the trade association and find out more about the market. Usually, the director of the association has the key market information you're seeking and will make that available to you in an email or phone call. Their job is to foster the growth of their industry segment by informing others about it.

## Conference Attendance

The third step is to attend a trade conference. You'll learn more from those on the exhibit hall floor than you can from articles or other means. It's worth a day walking the show to get the details.

## A Word About Reports…

Finally, avoid market research reports. These reports cost anywhere from $2000 to $25000. Most of these are merely a compilation from a direct mail campaign that is far from comprehensive. While they can be helpful, they certainly aren't worth the money.

# The Business Model

After you validate the market, the next step in the process of starting a company is to identify the business model. The business model in short answers the question: how do you make money? To better understand business models, this site outlines the top nine:

### Brokerage Model

bringing buyers/sellers together

### Advertising Model

promoting products/services to an audience

### Infomediary Model

gathering information about an audience and monetizing it

### Merchant Model

selling goods/service either wholesale or retail

### Manufacturer (Direct) Model

selling goods/services directly to the user without an intermediary

### Affiliate Model

providing purchase opportunities wherever people may be

### Community Model

selling ancillary products/services in a community

### Subscription Model

charging for ongoing use of a product/service

### Utility Model

charging based on how much of a product/service is used

## Defining the Business

In today's web-based world, it's common to use two or more of these models in the same business. Before fundraising, it's essential to identify the business model. The business doesn't have to generate a great deal of revenue, but it needs to have a clearly defined business model that is scalable.

# Business Plans vs. Business Models

In starting a new venture, most begin by trying to write the business plan because everyone tells you how much you need one. So, you sit down to write the business plan, and you start through your checklist. Typically, this is how it goes:

> *"Management team -- well so far, there's only me, so I'll just add two more positions to be determined later. Next, it's a Problem to be Solved. Well, that's an interesting question. I'm solving so many problems; I'll just say, we're going to save the customer time and make it easier for him to do his job. That should cover it. "*

If the above description sounds familiar it should because most everyone starts by trying to write the business plan, but there's not enough information to carry it through at the early stage. There are too many decisions still to be made. There's too much information not yet accumulated.

Instead of working on the business plan from day one, work on the business model. Focus on how you are going to generate revenue and what will be your core costs. If you figure out this, then you have the critical elements of a business plan. You can fill in the other pieces based on the business model. For example, the management team positions will become clear once you know the business model. The problem you are solving is much clearer, and so it goes with the other elements of the plan.

# You Need Three Businesses – Not Just One

There's a common saying in the business world:

> *"There's the product you market, the product you sell, and the product that makes money. "*

McDonald's mastered this when they marketed the Big Mac. When you bought a meal, they would ask **"want some fries with that?"** They made almost all their profit off the coke drinks. At the time it was rumored to be around 90% profit margin.

**In today's business you need three products:**

**The product you market:**

Your brand, your mantra, your flagship product that everyone wants.

**The product that generates cash:**

This is a service business that pays the bills now.

**The product you build to sell as a business unit later:**

A SaaS business model that provides recurring revenue.

It can be hard to build a SaaS business when the only thing you are creating/selling is the SaaS product. The main thing to consider here is adding more products around it to make the business easier to grow.

# Crafting the Executive Summary

The executive summary of your business plan should contain the highlights of your project. Moreover, at the risk of stating the obvious, consider this: most investors won't read past this section unless you have something truly compelling.

Most entrepreneurs I know write the executive summary last after they've completed all the market projections and financial analysis.

When you're ready to write the summary, you should include the following items in one page:

1. **The Problem the Company Solves**—it must be a significant problem in the market place creating an excellent opportunity for you to sell widgets.

2. **Product/Service Offered**—a description of your product or service that solves this massive problem that you've outlined above.

3. **Competitive Advantage/Analysis**—and please don't say that you have no competition (unless you want an investor to discredit you and move on to the next plan immediately). Even if another company does not have a direct product that competes with yours, you're always fighting for dollars allotted elsewhere.

4. **Target Market**—this should address how large you think the market is (based on your research). This section should also contain your strategy to establish entry into that market (your beachhead).

5. **Business Model**—how are you going to make money? Investors are funding capital efficient deals only, meaning that you have a solid business model with excellent profit potential.

6. **Sales Model**—you should describe the channel, the sales funnel, and the metrics for selling your product or service into the market.

7. **Intellectual Property**—this includes trade secrets, patents, copyrights, and so forth that you own that have value.

8. **Management Team**—the team that you've built should show completeness and experience. Ideally, you have some people on your side that have experience raising money for startups, significant industry experience, or something that gets an investor excited that these people are involved with your company.

9. **Revenue, Costs, EBITDA Projections for Five Years**—a big section. Many investors are going to go right to this paragraph. Show the high-level revenue potential over five years

10. **Funds Sought and Use of Funds**—demonstrate how the dollars invested in your company will translate into business results.

11. **Exit**—show potential acquirers and comparables to your company.

Overall, the executive summary should tell **YOUR** story succinctly and highlight the values you've built into your company. Make extensive use of pictures, graphs, charts and keep word count to a minimum.

# Content-Based Marketing – Five Steps to Creating a Campaign

To gain attention in today's business world, you need to have something relevant, informative, and interesting to say. The days of banner ads are long gone. Content-based marketing will help you establish your name in the market. Here are the five steps to creating a content-based marketing campaign:

1. **Know your audience:** know their interests, problems, issues and what they care about.

2. **Create a Mantra and a Message:** boil your core message down to a few words.

3. **Create a list of topics:** these topics address what you found in step 1. Focus on what your audience wants to read or know.

4. **Write about those topics in your blog:** you need to write consistently over time to establish a presence in the market.

5. **Reformat the content for other purposes:** take the show on the road with presentations, articles, etc.

As you build out your content, you'll also find your niche, and your target audience will become more clearly defined.

# The Elements of Intellectual Property

Almost every entrepreneur has heard that it's essential to protect the idea and most have heard about patents. However, in addition to patents, there are other forms of protection that come under the name of Intellectual Property. They are:

**Trade Secrets:** the information about your product/service that is not publicly known.

**Trade Patents:** protection based on legal means through the US patent office.

**Copyrights:** a set of exclusive rights granted to the author or creator of original work.

**Trademarks:** a distinctive sign or indicator used by an individual, business organization, or other legal entity to identify that the products or services.

A robust intellectual property strategy for your business includes all the above. Some recommend you start with trade secrets and only move to patents if necessary. Using copyrights and trademarks, you can add additional layers of protection around your business.

For a software business many startups talk about their patents, but most angels know that patent protection is weak at best in the software world since there are many ways to work around a patent if someone wants to duplicate the idea. A better measure is to calculate the cost of duplicating the software including design, coding, build out, and most importantly data set build out.

# Negotiating the Terms Sheet

During the ACA Summit, Robert Robinson of the Hawaii Angels offered the following advice: there are three elements to understand in any negotiation.

**Commitment** – what have the parties agreed to?

**Verification** – how will we know that everyone fulfills their commitment?

**Enforcement** – what happens if a party doesn't fulfill his commitment?

Areas to negotiate include:

**Expectations**
**Process**
**Terms Sheet**
**Communications**
**Portfolio governance**
**Follow-on financing**
**Exit**

During the presentation, he brought up a key point of negotiation when he stated,

> *"Principles unite, numbers divide."*

As soon as someone starts using numbers conflicts begin to arise. At some point in the negotiation numbers must be used, but building a common base first goes a long way in helping to navigate through the possible numbers later.

Knowing the terms and what they mean is critical to the negotiation process. I've sat across the negotiation table with entrepreneurs who from time to time lean over to their attorney and ask,

> *"What does that term mean?"*

To that end, we've taken steps to provide more training to entrepreneurs in the form of special events like the Central Texas Entrepreneur Funding Symposium and Mock Terms Sheet practices sponsored by Andrews Kurth. For a tutorial review of Terms Sheet terms, check out this site.

# The Role of Patents in a Startup

In some cases, patents along with copyrights, trademarks, and trade secrets are crucial to securing funding. This is true in the area of medical devices and healthcare in particular. However, in the area of software, it is less so.

One begins by filing a provisional patent. The cost is relatively low (around $300). Later a full patent can be filed when some funding is secured. A competent patent attorney plays a key role in helping perform a patent search on prior art. Many patent attorneys will defer payment until funding can be secured.

Since software tends to be more of an execution play, patents may not be as relevant. The time it takes to litigate a patent can run from 2 to 3 years if not longer and among startups, there's often little money or assets to be seized and it's usually easy for competitors to work around patents to achieve the same goal.

# Keep NDAs Away from the First Conversation

Everyone once in a while I'll come across an entrepreneur who wants to tell me about their deal but before giving me any details wants me to sign an NDA which is a Non-Disclosure Agreement that requires the signer not divulge the details of the subject matter to anyone for a certain period of time (usually 2 to 5 years). To an angel investor, this is a **red flag**.

When an entrepreneur won't even show me their one-pager without my first signing a Non-Disclosure Agreement that tells me his deal is not protected and most likely is not protectable.

I advise entrepreneurs to have a one-pager ready to share with investors who show interest after a brief discussion. The one-pager should state what the business does but doesn't necessarily go into details about how the IP works. If the discussion goes far enough that it enters the due diligence phase and the investor wants to see the **"secret sauce"** then it's reasonable for the entrepreneur to ask the investor to sign an NDA, but **not** at the beginning of the first conversation.

While I understand the entrepreneur's concern about protecting the idea and subsequently the business, it's difficult to generate interest among the investors when you can't even tell them the basic concept. The entrepreneur should be able to inform the investor about what the product or service does at a high level and what performance advantages it has over other methods.

A rule for signing NDAs is that you should know precisely what is protected – the technology, the business model, the concept, etc. Signing an NDA without knowing this could mean the investor is signing away the ability to invest in any deal that is related to the entrepreneur's target market or application.

To carry out the conversation, I invite the entrepreneur to tell me about the non-confidential matters. This potentially keeps the conversation going. Of course, the first subject to discuss after receiving the one-pager is how can one protect the idea – patents, copyrights, trademarks, trade secrets, etc.

# Look Beyond Your Backyard

Recently there has been a lively debate about the lack of funding in Texas. It's not a new debate but rather an ongoing dialog between entrepreneurs and investors. Entrepreneurs feel that funding is scarce in Texas compared to other parts of the country. Investors counter that they would invest more and more often if the deals were further along and better prepared.

The debate is not new. It comes up every year. The solution is to change the way fundraising is handled. It's no longer in your backyard. You must have a national focus on your fundraise from day one.

When I was the director the Central Texas Angel Network we had just restarted the formal angel community in Austin. The previous group, the Capital Network, had gone out as they were tied to the dot com world and when that went away, they went away with it.

At that time, it was a significant boost to have a formal angel group in Austin so central Texas entrepreneurs could raise money in their backyard, so to speak. It worked for a while. When we started, we had 15-20 deals on each round of which four would receive presentation slots, and two would get funding on average.

As the years progressed, two things happened. First, the number of deals grew. Today it's not unusual to see 75 to 100 deals considering CTAN of which four will get to pitch to the membership and two will get checks. The funding rate is higher because there are more members involved, however, entrepreneurs looking for funding have a 2% chance of getting it from the group.

Daunting odds.

The second thing that happened is that crowdfunding came into its own. After several years of debate and government (in)activity, the rules are starting to change. It's now possible to raise from non-accredited investors as well as from accredited investors who are not in your backyard. At CTAN, we all gathered at the Headliners club in downtown Austin to see the live pitches. With crowdfunding, one can source angels from across the country if not further because the pitches are online.  The tools are improving, and the entrepreneur's ability to use those tools is increasing.

The world of angel investing is going vertical.  The chance that an angel investor interested in your particular application (mobile apps, enterprise software, consumer product good, etc.) is in your backyard is shrinking.  To reach an investor interested in your stage and type of deal, you much reach across the country.

Crowdfunding is how you do that.  By placing your deal, online angel investors can now find you.  You can now reach angel investors from a broader area.

It's helpful to have some support from your local area, but from day one entrepreneurs should have a national perspective on their fundraise.  If you have a real business (not just an idea), you probably have an investor out there who would be interested in your deal.  He's just no longer in your backyard.

# PART II: Working with Angels and other Investors

# Are you Ready to Meet the Investor?

Not too long ago I was contacted by an entrepreneur who wanted to raise funding for his startup. It was a compelling deal in a growing market space, but it was also a fairly complex one with a significant number of moving parts. So, I decided to send it to the investors. I asked for the usual docs and information. When only the business plan arrived, I pressed the request for more details– letters of intent, employer identification numbers, articles of incorporation, financial statements, references, etc. As it turned out they hadn't even filed for a company entity. The letters of intent were still being written. The reference request sent them scrambling to find everything. There were no detailed financial statements.

## The Importance of Key Documents

Without key documents in hand to validate the business, there was no reason to pursue investors beyond initial contact. If the investors are interested, they will move into due diligence and will want to see all the documents related to the business including patent filings, contracts, and financial statements.

As a company moves into fundraising mode, I recommend the entrepreneur compile key documents into one place, so there's no delay in the follow-up process by gathering materials. Moreover, if you say you have a contract, you better have something in writing to show it.

# Investor Questions You Should Be Prepared to Answer

Before you approach investors, you should know enough about your startup to answer these five questions.

1. **What is your value proposition?** The answer points out what your company provides and why people want it.

2. **Will customers pay for the solution?** Investors want to know if customers will pay for your solution. Free usage is not hard to achieve but paying customers is required.

3. **Who is on the team?** About half of an investor's decision comes down to believing in the team and knowing they will be enough to reach the goal.

4. **Why is now the right time?** Is there anything in the deal that suggests now is the right time to start this business. Why hasn't someone done this before?

5. **What is your exit?** This is one of the hardest questions to answer – how the investor will get their money back.

# Angel Investors and Why Do You Want Them?

Angels are high net-worth individuals that are seeking to make a return on an investment (not donations). However, they do usually have additional motivations such as:

> *"Do a little good, make a little money, and have a little fun."*

To invest in startups, they must meet the Accredited Investor requirement set out by the SEC which you can see at sec.gov.

Typically, they are not professional investors but have substantial business experience having started and run their own business successfully. Often, they are ex-CEO and VPs of large companies, and there are many different kinds (such as the fundraiser, the networker, the Jack of all Trades, the strategist and the industry specialist).

Each angel has their criteria for what makes a good investment. Some of the questions they may ask about your start-up include:

1. **Does the company have a strong management team?**
2. **How large is the market? Is it growing fast?**
3. **Does the company have strong intellectual property protection?**
4. **Does the company have a platform product that can produce many products?**
5. **Is there a clear exit path for the company?**

Angels bring expertise through industry experience as many have run successful businesses in the past. They potentially bring their network of experienced and successful people, and they often have a standing in the community - so if they lend their support to your start-up, it should help you in raising more funding and attracting support.

Assess the needs of your startup and look for angel investors who can bring more than just funding to your start-up. Even if they don’t invest, you may find some angel investors are good candidates to join your board of advisors. Angel investors typically know other angels that can be referred to your deal.

# What Angel Investors Look for in a Startup's Legal Structure

Most startups use an LLC structure when they form the business. This is okay for starting a company, but when it comes time to raise funding, it needs to be converted to a C-Corp. In general, angel investors don't like LLCs. Tax laws dictate that owners in an LLC must submit a K-1 tax form each year, which is a hassle. The other drawback is that there's typically not a proper board formed in an LLC, so the oversight by investors is not as robust it needs to be from the investor's point of view. S-Corps limit the number of investors and so doesn't work well in an angel-funded company.

The next question is should it be a Texas-based C-Corp or a Delaware C-Corp? If you raise funding only in Texas, then a Texas C-Corp is sufficient for most investors. If you plan to raise funding on the West Coast or East Coast, then a Delaware C-Corp is better. For those who are not familiar with company legal structures, Delaware provides the most favorable legal environment for companies.

# How to Find Angel Investors

Now that you have the idea, business plan, and (hopefully) a product that will change the world as we know it, all you need is a few thousand bucks—or a few tens or hundreds of thousands of bucks—to get it up and running. All that stands between you and your success is finding the right angel investor.

It's important to note that the rules for who is an angel investor were set in the late 1960s and have only changed once since that time, thanks to Bernie Madoff whose scandal forced lawmakers to make the recent revision (They declared that you couldn't count your house as part of your net worth for determining whether or not you were an accredited investor).

Because the term angel investor is rather broadly defined, we're going to talk mostly about the accredited investor or the professional investor that has some experience putting money into companies.

So, where do you find them? Here are some ideas for starting your search:

### Start close to home

Check out your family and friends, as your family members may qualify as accredited investors.

### Use your Rolodex

Many of your coworkers and acquaintances may count as potential investors, and you didn't even realize.

### Formal angel groups

The Angel Capital Association is the largest trade organization for angel networks and lists the groups that are members of their association.

### Informal angel groups

In your local community are investors who review deals. Individuals with experience in angel investor generally lead them and offer pitch sessions.

### Pitch sessions and funding forums

Other ways to find angel investors is through funding forums and pitch sessions which offer mentorship to practice in advance of pitching for funding. The mentors and coaches in these groups are angel investors or know those who are.

### Business plan competitions

These competitions draw mentors and judges who are angel investors.

### Your attorney and accountant

Often your attorney knows potential investors

### Social Networks

LinkedIn is one potential source of finding investors.

### Web-based

Several web-based sites offer to connect you with investors.

# Attracting Angels – It's All About Networking

I had the pleasure of speaking on a panel hosted by the Austin Business Journal and Fish & Richardson on the topic of **"Attracting Angels."** On the panel with me was Fred Stowe of Order Corner — a company in which CTAN invested, and Steve Vandegrift, a long-time member of the entrepreneur/investor community. Kin Gill moderated the discussion.

Steve vocalized what many in the investment community already know – VC funding in Austin is almost gone. The funds in the 1990s have invested their dollars and are now trying to make their portfolio companies work. Rudy Garza has G51, Brian Smith has S3 Ventures, and there is Austin Ventures, but that's about it. Most of the deals are now angel deals anyway. What used to take $5M to startup a company can in many cases be done with $500K due to the cost of business going down thanks to the web, email tools, outsourcing, and the like.

Angel investing is back in a big way. They run in five to seven-year cycles, and a new period was kicked off in 2006. I attended the Angel Capital Association meeting in 2006 in which there were 150 of us attending. This year, the same ACA conference had twice as many people. Across the board, angel groups are seeing a resurgence in membership and deal flow. Indeed, the Central Texas Angel Network is witnessing a surge in membership and deals. We get about 30 deals a quarter submitted to our site.

Fred Stow echoed the comments of Steve and highlighted the need to network to find funding. He also mentioned that in his experience the angel groups in Austin, Dallas, and Houston, each had unique characteristics. Dallas is focused on retail, Houston on energy and biotech with a leaning toward **"old money"** and Austin towards more eclectic deals with risk. Each angel group has its personality, which should be taken into account when looking for funding. An angel should bring more than just dollars to the table. An Angel should bring contacts and expertise as well.

# Focus on the Core Product or Service

Entrepreneurs are always excited about their marketplace solutions and want to talk about it to anyone that will listen. That enthusiasm is critical to start a business because that passion is the only thing that will genuinely carry them through the process (it's certainly not the money— trust me!).

Sometimes, however, that enthusiasm causes entrepreneurs to lose focus on what they are conveying as part of their product offerings.

For example, you might have ancillary services or spinoff products that are part of the plan. However, cluttering the business plan with numerous potential options for the company will appear diffuse and fragmented to an investor.

It's better to focus on the core product or service. An investor looks for purpose and clarity of focus in startups and even early stage companies

This also solves the problem for entrepreneurs who are concerned about protecting their intellectual property. You don't have to describe the **"secret sauce"** behind their product— merely focus on the benefits the product or service offers.

At this early stage, there's no need for a non-disclosure agreement, so put that away. Most investors won't sign one at this stage anyway, and it will only turn them off. Only in later stages will the investor need to learn more about the IP, and they will be glad to sign it at the due diligence stage.

# Have a Solid Go-To-Market Strategy

In your pitch presentation and business plan, it's important to describe your sales and marketing strategy— or in other words, your go-to-market strategy:

1. What is your channel to the customer?
2. Are you selling direct, indirect, through Original Equipment Manufacturers (OEMs) or channel partners?
3. Are you franchising or granting licenses?

Entrepreneurs should also explain why that model was chosen over others and demonstrate how leads are generated and converted into buying customers.

# Building a Solid Management Team

The key to the management team is experience in the area of the new business. First time CEOs need to have substantial operating expertise. In addition to the CEO, most startups have two other executives on board. Depending on the business, they could be financial, operational, manufacturing, scientific, technical, or other. Again, industry-specific expertise needs to be highlighted. Startups without a full management team could create an **"Advisory Board"** staffed with non-paid volunteers who provide advice. Typically, they have substantial industry experience and can augment the management team.

## Defining the Target Market with your Team

We've talked about framing a compelling customer problem for a potential investor—but to honestly get their attention, your target market must be sizable. In other words, there need to be many customers with that problem that are ready to pay for your solution!

It's wise to break the **"target market"** category into three pieces:

Available Serviceable Beachhead

The **Available Market** is typically anyone who could potentially purchase the company's product or service. Look for numbers in the billions to truly be compelling.

The **Serviceable Market** is the sub-segment that would most likely be a strong candidate to purchase the company's product or service. This number is usually in the millions of dollars.

Moreover, finally, there's the **Beachhead Market**, which is the first set of customers the company will pursue. The company should list beachhead customers that are in the pipeline which shows market validation.

Conveying these three items in your business plan and pitch presentation will show an investor that the market cap is sizable, that many companies are willing to buy your product, and you have a solid go-to-market strategy.

# Competition & Competitive Advantage

If you want an investor to stop listening to your pitch presentation or to stop reading the business plan, state how you don't have any competition, you might be surprised at how many entrepreneurs make this rookie mistake in their pitch presentations--we hear it regularly, and it's almost sure that you'll lose credibility instantly with investors.

I believe that entrepreneurs that say they have no competition are trying to convey a broad opportunity to exploit a market—the problem is that it has the opposite effect. The main reason is that the customer is solving the problem somehow now, even if indirectly in comparison to your solution. There's always another company competing for the same dollar, and even worse, If the investor finds out about a competitor from someone other than the entrepreneur, then it makes them look even more unprepared.

When researched thoroughly, the competitive analysis in your business plan demonstrates to potential investors that you understand the strengths and weaknesses of your business. It also gives them a better picture of the market opportunity.

When researching the competition for your plan or pitch presentation, you should focus on answering the following questions:

1. **Who is out there competing for the same dollars that you're going after?**
2. **Are they directly or indirectly selling products, services, or substitutes that compete?**
3. **What are their strengths and weaknesses in the market?**
4. **How are they currently positioned in the market?**
5. **What segments of the market do they operating in?**

6. **What is their go-to-market strategy and how does that differ from yours?**

7. **What threats do they pose that may impact your business?**

In other words, perform a SWOT Analysis (Strengths, Weaknesses, Opportunities, Threats) on each one of your competitors and compare them to your company.

When you go to present your findings in the business plan make sure you:

1. **List the key competitors with their strengths/weaknesses in comparison with your own.**

2. **Show specific competitive advantages of your solution.**

3. **Use numbers to make a comparison.** The more numbers, the more robust your company looks. Use numbers to show market share, your economic benefit, etc.

# Take the Investor on the Journey with You

I encourage startups to meet with investors well before they go out to raise funding to understand better the investor's criteria and to build a relationship. Many investors want to see how well the entrepreneur executes on their plan, so it's best to take the investor on the journey with you. By the time you go out to raise funding, you should have 20 to 30 investors whom you are keeping up to date on your progress.

# Keep Your Investors Informed

Keeping investors informed is a critical element in the ongoing entrepreneur/investor relationship. This section outlines the key reason an entrepreneur should send regular, informational updates to the investors. In a nutshell, it's to maintain the connection so the entrepreneur can ask the investor for follow-on funding later.

I remember my first angel investment back in the 1990s. This was before I knew you were supposed to set up an agreement with the entrepreneur on how, how often, and what they would communicate to the investors. After several months of hearing nothing, I finally called the President of the company and asked for a written update including financials. A week later he sent me a short two paragraph email along with a spreadsheet attached showing the financials. There are several items to point out here:

1. The two paragraphs by no means filled in the details of the business. To this date, there are holes in their explanation of what went on in the business.

2. The financials of any company should not be in an Excel spreadsheet. They should be in Quick Books. Excel has no audit trails, no security or validation. Anyone can change the formulas. Several of the columns of financial data didn't add up in the bottom row.

3. I only received this after I demanded it and I never received another one. After that experience, the entrepreneur wanted to discuss over the phone and found excuses not to send out the financials again.

These were all red flags indicating that things were not going well. Later the company went bust.

Here is a **list of best practices** for entrepreneurs communicating with shareholders along with why and what should go into the **report**.

# PART III: How to Raise Funding for Your Startup

# 5 Signs your Startup Isn't Ready to Raise Funding

1. **The vision is still fuzzy and hasn't come into focus yet**— if you're still sorting out the market and your position in it then you need to gain more clarity on the space and your company's situation.

2. **The team isn't in place yet**— if you still have significant holes in the team that you are seeking to fill, you need to find candidates for those positions before funding.

3. **You haven't identified the repeatable business model**— if you're still pivoting from one business model to the other, then you're not ready for funding. It would be best if you had a business model that is predictable at some level.

4. **You don't have your financials under control**— if you don't know how much to budget for expenses or what the impact of a sales increase on your bottom line may be, then you're not ready for funding.

5. **There's no clear path to profitability**— if you don't see how you can grow to a profitable position with your current business model, then you're not ready for fundraising.

# Timeline for Raising Funding

If you answered, **"right away!"** as many entrepreneurs do, you're probably not being realistic.

The benchmark is that for every million dollars you are raising, it will take you one year.

However, even if your fundraise isn't that large, it can still take many months of planning and executing to raise funding from Angel Investors.

Here's a rough outline of what you should be ready for when developing your plan:

### Month 1— Check readiness.

Assess your readiness for raising funding and be honest. Ideally, you have a product and have sold some units. You should also have built a core team. Communicate with your current team and investors you already have about raising funding. Also, don't forget to check with your attorney about the legal aspect. You may have to consider modifying your legal entity to allow for outside investment.

### Month 2— Prepare the company.

Planning your fundraising strategy includes assembling your key documents including, the Executive Summary, Slide Deck, Financials, and Due Diligence documentation. Take steps to fill out your board of advisors and build a set of email updates for monthly transmission to the potential investors.

### Month 3 to 5— Prepare the investors.

Identify potential investors to put on your investor prospect list. Start with ten investors you already know and have contacted and add ten new investors per month to your list. Set up meetings to introduce investors to your deal and tell them that you will start raising money in a few months. Ask permission to keep the investor on the list for updates you will be sending out.

Start sending monthly updates on your company's progress using personalized emails – not 'broadcast' emails. Customize the mailings to build a personal relationship.

Moreover, please don't send them your press releases. Demonstrate how you are achieving milestones.

### Month 6 to 9— Pitch the investors.

Follow up each potential investor and pitch the deal. Identify the lead Investor and close the first round with investor-friendly terms. Offer an incentive to the lead investor for the additional risk he is taking by going first.

### Month 10 to 11— Close the investors.

Invite other investors to follow on. Keep the relationship with all investor prospects--some may join in a future round.

### Month 12— Finish the round.

Oh, but you're not done at this point. Continue sending updates to investors AND the investors on your prospect list every quarter to prepare for the next round of funding.

# Understanding How Much Funding to Pursue

When I ask entrepreneurs how much they are raising the automatic answer is $1M. It just seems like the thing to do. Moreover, when I ask what they are going to do with it, many seem unsure. Alternatively, they provide generalizations like:

> "*We need it for marketing, or hiring key personnel, or developing products.*"

The response from investors (myself included) is usually along the lines of, **"No S!#t?"**

Before pursuing investment, one needs to consider how much to raise and how it's going to be used. Also, when you go to pitch investors, it should be clear from your financials as to exactly how you've come up with these funding requirements and exactly how you plan to put that money to work.

Of course, it's still an educated guess, but having these items researched and detailed in your business plan (and pitch presentation) will build more a lot more credibility with the potential investor.

Figuring out how much you need to raise starts with: How much do you need for equipment, inventory, contract services (such as legal costs, marketing, sales, and more.)? This financial model is a **MUST** before setting the fundraising amount.

I often recommend raising as little money as possible before you have customer sales because the valuation (how much the investor considers your company worth) is going to be quite low. Any money you raise in the beginning will cost a more significant portion of equity in your company than follow on investments down the road. In other words, the higher the risk, the greater the equity the investor is going to require.

It's also better to raise a lower amount (say $250K) to get the product up and running and sold to a few customers. You always raise a larger round of funding later, but at that point, it should be a much better valuation for the entrepreneur--with the product and customer risks mitigated you don't have to give away as much equity.

Also, for every $1M you are trying to raise you'll spend one year raising it and **NOT** doing much of anything else on your business. Raising only $250K will reduce the amount of time spent fundraising allowing you to work on your product, marketing, sales, and team building.

# The Fund-Raising Funnel

I spent some time at the World's Best Technologies Show in Arlington which highlights technologies from university and government labs moving through the commercialization process. In the session on raising funding the panel provided an interesting perspective on the "funnel" used to describe the fundraising process as follows:

1. **Self–fund** — 80% of the companies do this, and it will let you start a company that can grow at 20% a year max.
2. **Friends and Family** — Another source the can generate funding from an emotional investment as well as a financial one.
3. **Strategic Partners** — Sell your product in its early stages (even if it doesn't entirely work) and charge an NRE (non-recurring engineering) fee for it.
4. **Angel Groups** — There are 300+ of them throughout the USA.
5. **Individual investors** — Sign up the potential investor as a mentor first and then move to the investment stage.
6. **Grants** — Check out grants.gov which lists all the grants the US government has to offer.
7. **Early Stage Venture Capital** — There are 75 firms in the US operating today.

8. **License/Royalties** — You can generate cash for your startup by licensing the use of it to someone in exchange for a royalty stream. It takes $9M of funded research to create one license which will last on average for five years and generate $375K of cash to the licensee.

As an angel investor, one of the first questions put to the entrepreneur is what other sources of funding have your tried, and in the future, what you will consider. If you haven't put your own money into it, it will be difficult to convince others. If you're building a life science or cleantech product requiring a great deal of capital, then government funding is a must.

# 5 Golden Rules of Fundraising Success

1. **Know your investors**— it's important to know what kind of investor you are looking for and what those investor wants to see in your deal.  Many startups fail to understand what the investors are looking for and end up without a follow-up meeting after the pitch.

2. **Educate your investors**— after you pitch the investor, it's important to educate the investor through updates about your deal. It's often the case the investor is unfamiliar with your application or space.

3. **Build trust**— demonstrate that you can be trusted by showing examples of how you've performed in the past.

4. **Respect your investors**— show respect to the investor and don't take their time and advice for granted.  When investors see their feedback and advice is not followed up, they turn their attention elsewhere.

5. **Focus on current supporters**— make sure you keep your current investor and investor prospects updated on your startup. If you don't articulate progress in your deal, the investor will most likely not know.

# Best Practices for Entrepreneurs Seeking Funding

### Have ready the executive summary, slide deck, and business plan with financials

It helps to have the core three documents – executive summary (one-page only), slide deck, and business plan already developed and ready to go. As the entrepreneur meets prospective investors, he can use the relevant docs for each meeting.

### Publish a periodical email newsletter for interested investors

In the fundraising process, I see some entrepreneurs sending out email updates to highlight the progress of the company. Some come as often as weekly to show growth in sales, product plans, and other milestones. This shows the company's ability to execute.

### Find a lead angel to develop a terms sheet and start the funding round

By finding a lead angel and creating a terms sheet, the entrepreneur removes the most significant barrier to fundraising – the negotiation process. Numerous angel investors find the initial negotiation and due diligence process too time-consuming. By eliminating this hurdle, the entrepreneur opens up the deal to a more significant number of investors.

### Make the deal terms "investor friendly"

Of course, every deal must be negotiated. The harder the terms for the investor to accept the longer the time it will take to negotiate. By making the terms **"investor friendly"** through reasonable pre-money valuations, preferences, and other terms, the faster the process goes.

### Push all due diligence docs to a password-protected site so that interested angels can perform due diligence more easily

The due diligence phase can be sped up by having all the essential docs already available. I've seen some entrepreneurs put everything on a protected website and then give out the password to interested investors. This knocks down the hurdle of trying to send 600 MB worth of documents through the email system.

### Continue the quarterly email newsletter after funding, so investors stay with you

It's important to keep investors up to date even after the funds are raised since investors can help in other ways. Some investors bring a Rolodex of contacts while others bring experience and coaching. By keeping them informed of your progress and challenges, they may be able to help. This practice is also useful for when it comes time for follow-on fundraising.

# 10 Habits of Successful Fundraisers

Some entrepreneurs are quite good at raising funding. They know what to say to investors, and they do the right things. Here are five habits of successful fundraisers:

1. **Set goals**— understand what you want from the overall raise and break it down into stages. The entrepreneur who vaguely requests $1M has not yet thought through the use of funds, and most likely needs less to get started.

2. **Stick to budgets**— setup a time budget for raising funding and then stick to it. It's a daily/weekly exercise – not some one-time thing.

3. **Consider the calendar**— starting a raise in the middle of summer or just before Thanksgiving is going to be difficult. Plan the launch of your fundraise with the investor's schedule in mind.

4. **Know the target audience**— understand the target investor and what they are looking for. It's a good idea to see what they have already invested in and approach them from that angle.

5. **Spend time preparing documents**— make sure your documents – executive summary, pitch deck, and financial projections are ready to go so when an investor expresses interest you can provide them.

6. **Practice your pitch**— successful fundraisers know their pitch and have it well honed.

7. **Create a plan and then work the plan**— have a list of prospective investors and continually work investors through the process.

8. **Focus on metrics**— make sure you keep track of the numbers in your campaign. You should know how many prospects you have and how many you need to achieve their goal.

9. **Ask investors for feedback**— be open to feedback from investors and others on your pitch and campaign.

10. **Demonstrate appreciation**— show appreciation to those who help you in during your fundraising.

Fundraising is a skill just like most other aspects of running a business.  These skills can be learned and honed.

# The New Normal for Fundraising–It's Now Online

Fundraising like everything else is moving online, almost all of it. Traditionally, those who wanted to raise funding would meet everyone in their local area. You would pitch to the local angel network or investment group, meet with the local venture capitalist, and of course canvas all your family and friends. It was something the CEO had to do because investors wanted to meet with the CEO of the company.

It was time-consuming. You had to get introductions to investors you didn't know, and you had to keep the investors up to date with your progress. It was not uncommon to hear about 50+ pitch sessions before receiving the first investment. The investor side was equally difficult.

I ran an angel network in the 2000s, and I had many startups pitch to my investors in a dinner club setting. Ninety percent of the startups would go away, and we would never hear from them again.

We had no idea what happened to them.

Only about ten percent would come back and give us updates, reminders, and show some semblance of progress. Those are the startups we funded. Those CEOs built a relationship with the investor and provided enough information to the investor that one could see momentum and traction in play.

Today, there is a better way.

You can use online tools to help raise funding for your business. The key to fundraising is to build an investor prospect list and update them on your progress. It takes seven touches to close a sale – so it takes seven touches to close an investor.

To raise funding, you need to:

**Access a large number of investors.** You need to think worldwide-not just citywide.

**Use analytics to find the right investor.** Understand the different investor types – angels, VCs, family office, etc.

**Engage and maintain contact with investors.** You must demonstrate progress not just state forecasts and make promises.

**Prepare investor documents**. You need to come prepared with your pitch deck, due diligence box, and other key documents for investors.

**Prepare the campaign.** Know what you are going to tell the investor about your deal.

The rule of pitching is: if you don't articulate it – it doesn't exist. If you have revenue but don't mention it, you get no credit for it with the investors.

# Build a List of Investor Prospects

By now you probably have your pitch deck and financial projections ready, and your due diligence box (some call it a data room) is coming together. The first step in a fundraise is to build a list of potential investors. You've gone through your contact list, your LinkedIn connections, and you rack your brain for potential investors in your deal.

You've done a few Google searches and added a few local angel networks you know. The list stands at about 15 names.

Now what?

You know the fundraise is similar to sales– it's a numbers game. Only a small percent are going to invest so we need more names – a lot more. You can search Medium and find a few lists online.  Some have email addresses; most do not. You start asking around for lists from friends, and they share some with you.  Some of the lists are up to date, but many are over a year old.

At TEN Capital we have over 5000 investors in our network, so we can give you access to more investors. We can introduce your deal to those investors interested in your type of deal. That doesn't mean they will write a check for $1M in a few weeks, but now you know who you are targeting, and you can start the work of building a relationship with the investor.

# Run at Least 4 Mailers Against the List to Identify Who is Engaging

You have a good list. Next, you need to introduce your deal to the investors and demonstrate why it's a good deal. The operative word here is **"DEMONSTRATE."** Most startups tell the investor why it's going to be a good deal – great product, great team, great market, great future, etc. The key is you must SHOW them it's a great deal by highlighting the traction with customers, the experience and ongoing work of the team, and the improvements on the product.

Investors see dozens of deals every day. You can stand out by remembering one thing: Everyone promises – only a few deliver.

Every startup has a great future. Every startup promises the moon. So, what does the investor do? The investor looks for evidence of meeting milestones, a sense of momentum behind the deal. Your outreach to the investor is a campaign – not a one-time contact. You must demonstrate that you have traction. The team must be doing great things. The product must be progressing. If you can't do anything unless you have a $500K, then this is going to get tough.

You must show you can do things with little or no funding.

Your campaign mailers need to tell your story. Over the next four mailers, you need to showcase your story and how it works. Investors are busy, and they don't have time to read 5000-word emails. They'll read a half page, maybe a little more and that is it. It would be best if you told your story over a series of emails as we work our way into the busy lives of the investor. Break the story down into smaller pieces and schedule them out so the investor can see progress being made weekly.

# Educate the Investor About Your Deal

They say it takes seven touches to close a sale – so it takes seven touches to close an investor. Some startups pitch to a group of investors and if they don't see checkbooks coming out at the end, then in their mind it's a failed meeting.

I tell the startup that the investor doesn't yet know if they are interested or not – they're still trying to figure out what the deal is about. It takes four updates before the investor gets a sense of the deal and can start to form a decision.

In the end, the investor makes a decision based on team and traction.

In the introduction, you can talk about the market size, growth rates of the industry, and the promise of a great outcome.  After that first mailer, the investor doesn't care to hear any more about the market, or growth rates. They only care about one thing – what are you doing to achieve the promise?

Your mailers need to showcase the strength of the team and the progress you are making on sales, product, IP, and fundraise. To make your case, you need to include numbers in your deck and updates. It shows you know your business, your market, and your status.

I'm amazed at how many startups don't know their revenue numbers.

Come prepared to share those details with the investors in mailers and follow up conference calls.

One tactic I've seen used to good effect is to go to your investor prospects six months before launching the campaign. Tell them you will start your raise in six months and then ask if you can keep them informed of your progress.

This gives you six months to educate the investor about your deal and demonstrate progress so when you are ready to launch your fundraise; you have a group of educated investors prepared to go.

# Research the Prospective Investors for Fit

In a fundraise, most startups think it's the startups who pitch, and it's the investors who ask questions and run due diligence. The reality is that startups should be asking as many questions as the investors and should also be running due diligence on the investor. It's essential to research the prospective investors and qualify them for a fit to your deal based on their investment criteria and track record for funding.

In your analysis, you should separate them into A, B, and C, investors. With A being the ones that fit best and you want, B are the ones that have some fit, and C's are the ones that don't fit.

There are many venture capital funds, accelerator programs, and other forms of fundraising on the market. All claim to be **"founder friendly,"** have a great program, and talk about how they are the best.

How do you know whom to pursue? The startup should be analyzing the investors for their fit to the startup deal. Do they invest in companies like yours? Do they have expertise in your area? What exactly can they do to help?

There are tools available to help understand the funding landscape such as **Crunchbase**, which tracks venture fundings and make the results available to subscribers.

You can track what companies are getting funded, as well as sectors. You can see which venture groups are active and doing deals and which are not.

In your analysis, you should keep track of what investors are funding, and what valuations they are providing. This will give you some indication of what valuation you should negotiate for. The operative word here is "**negotiate."**

As the saying goes:

> *"You don't get what you deserve, you get what you negotiate."*

Moreover, knowing what to ask for is the first step to a successful negotiation.

# Develop a Rapport with the Investor

When I ran angel networks using the dinner club model, I had entrepreneurs come in to pitch my investors. Ninety percent of them would go away and we would never hear from them again.

We had no idea what happened to them.

About ten percent of them, though, would come back and give us updates and reminders about their deal.

By and large, those were the startups that raised funding from the group.

Building a rapport with someone starts with introductions and awareness, to ongoing communication, to a level of familiarity. It takes seven touches to close a sale – so it takes seven touches to close an investor.

For substantial fundraises, it may take even more. The key here is that you must build a relationship with the investor before the funding not after. If you already have investors, think about how much you know about them?

How long did it take to figure those things out? In most cases it will be the same with your investor prospects.

# Closing the Investment

After initial interest, the investor often proceeds through due diligence and will ask for documents on your business including legal entity filings, articles of incorporation, patent filings, tax returns, and so forth.

In any due diligence exercise, ninety-five percent of the documents will come from the startup any way; therefore, it makes sense to start building what is called a due diligence box or data room, from the very start.

There are many checklists on the web that you can download and use as a guide to building out your list.  For early stage startups, there will be many documents which just don't exist – for example, if you don't have a formal board of directors there are no board of director reports to include in the data room.

One final word about due diligence — it's for serious investors only.  A serious investor has had several discussions with you before asking for the due diligence, and there's at least a soft circled investment figure on the table.  If the investor is not that far along then, it's premature to hand over data room access. Continue discussing their interests and concerns before proceeding.

# How to Raise Funding at Every Stage of the Business

Crowdfunding can be used to raise funding throughout the life of a business. When the idea of a new business strikes you, and there's nothing built yet, then you should run a donations campaign—ask family and friends to donate $10K collectively. Make sure they understand that no one is getting paid back. The value of this step is that it establishes a network to support your business. The money can be used for some initial costs such as filing patents, building websites, and starting work on a prototype.

The next step is to use a Rewards/Prepay campaign to pre-sell 50 units of your product. It can be anything. The key here is that you start to build your customer network. If you can't presell 50 units, then you have a product problem that needs to be solved first before you go any further. The funding you raise should be enough to build the first version of your product.

With a successful rewards campaign behind you, you now move towards turning those customers into investor using the Texas Intrastate crowdfunding campaign. The Texas Intrastate law gives anyone the ability to invest in your business. Again, the funding helps, but building your network is the crucial point. If all fifty of your Prepay customers invested in your business, you now have fifty brand ambassadors supporting your business--not a trivial support by any means.

With support from your customers, and now investors in your business, you approach angel investors and start to raise funding to grow the business. Angels invest $250 to $2M to grow a working operation. When you arrive at the angel investors door, they are expecting you to have a product at some stage of usage and some revenue. The previous steps give you the ability to do that.

If you need more funding, then you can go back and raise revenue-based funding. The investors at this stage take a piece of the revenue as payment rather than an equity stake.

If you find yourself having trouble raising funding, it may mean that you skipped some key steps. You should go back and fill in the gaps of building your support network and your customer base before proceeding.

# Recurring Funding for Recurring Revenue Businesses

The rise of the recurring revenue business as a standard business model has implications for financiers. Just as it changed how customers made payment, so it changes the way funding providers are changing the way they fund startups.

Recurring revenue businesses don't necessarily need sizeable discrete funding rounds. Today we see funding ongoing throughout the life of the business. As specific business growth needs arise funding steps in to provide the resources. The funding comes in small amounts and when needed.  In this model the fundraise round is never closed – it's always open. Investors should continuously be monitoring businesses to see who is reaching an inflection point and for opportune moments to invest in the businesses.

I started my company under the name Texas Entrepreneur Networks about ten years ago after launching three angel networks in Austin. I built a network of entrepreneurs and investors now throughout the country using a recurring revenue model instead of a broker model.

Building out the business doesn't require large fundraise all at one time.  It takes some funding to bring on new developers here and provide for a marketing push there.

I see a new method of funding for recurring revenue companies in which the companies continually raise small amounts of funding from investors rather than large rounds periodically. This new model works for our entrepreneurs who find it a great way to increase funding. Rather than spend a tremendous amount of time raising funding for six to twelve months, we've turned it into an ongoing program in which the raise is always open but doesn't take too much of the CEO's time.

There are some key things you need to do to enable this model:

> At heart, it's an investor relations program.
>
> We use email, website, and social media to introduce the deal to the investor and then keep the investor informed of the progress.

A campaign is how you tell your story and convince investors you are worthy of investment. Investors are looking for a strong team and consistent traction. Your campaign should demonstrate both.

It would be best if you were consistent and persistent about it. The motto is the “Fundraise is always open.”

# How to Raise Funding – A Little at a Time

Traditionally fundraising takes a tremendous amount of time on the part of the startup CEO. Some CEOs drop everything to run the fundraise.  I advise against spending too much time fundraising but instead set up a system to help with the fundraise.

With the right use of online tools (analytics, CRM, Drip campaigns, etc.) the CEO doesn't have to let fundraising become a huge distraction. Building a list of investor prospects and keeping them informed of your progress, the CEO can reach out to ask for an investment at the right time. Instead of raising two years' worth of funding, the CEO can raise a few months, which is a great deal easier.

This type of funding works best for early stage, and those with recurring revenue business models. These techniques were popularized by crowdfunding but can be applied to accredited investor raises as well.

As investors see more and more deal flow, they need help in finding, qualifying and following up the deals. At TEN Capital we let the investor select the deals they want to see and then send updates only on those deals. We work with the startups to build upgrades to share with interested investors, and all of this happens online.

## About TEN Capital

TEN Capital Group provides funding as a service to companies anywhere raising venture capital. Its network of over 5000 accredited investors represents venture capital, angels, family offices, and high networth individuals.



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