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Fundraising Risk

What is fundraising risk?

Many startup founders we meet say fundraising is the most painful part of leading a startup. They would rather be focused on their customers and their products, and not courting potential investors and funders. That said, when a startup needs funds, it is often urgent, so it is important that founders start building relationships with the right investors early - even when they're not raising. Otherwise, founders can waste a lot of time and energy chasing investment precisely when the business most needs their attention. In understanding fundraising risk, there are various levels to consider, from the leader's level of preparation to that of the business.

To be successful at fundraising, founders/ CEOs need to have a complete and detailed understanding of their business. Leaders that are not conversant in the ins-and-outs of their business, especially the financial side, are unlikely to capture an investor's attention. This can happen when a CEO is overly focused on one side of the business and neglects another, or when the team is poorly integrated across various verticals. More commonly, this happens when startups lack the data and systems to substantiate their business. Startups are often moving so fast that they don't take the time to establish robust systems and may struggle to access data points reliably. For example, the distinction between active users and registered users is often an obstacle for early-stage startup founders. This kind of gap in information can be extremely detrimental when courting investors.

With this detailed knowledge in hand, leaders need to work on developing and telling the story of their startup. It takes skill and practice to craft the story or pitch in a way that communicates passion as well as intelligence, market understanding and toughness. Many investors tell us that they can judge a startup within minutes of meeting the founders. In fact, this is the basis for startup pitch competitions, which are popular all over the world. To get to this level of storytelling prowess, founders need to practice telling and refining their story, and should consider their fundraising potential a significant risk without such practice.

Finally, startup founders also need to invest energy building their networks and relationships throughout the startup and investor worlds. Often, the personal background of the founder can be a defining characteristic of this network, often to the exclusion of minority, local, or women founders. Nevertheless, founders tell us that the best time to meet investors is when you are not fundraising. This may mean taking time away from the business even when fundraising is not an urgent priority. Without building and cultivating such a network, fundraising risk will also be considered high.

Key factors of fundraising risk

- Data room development
- Density of investor network in region and sector
- Personal networks of founders
- Public speaking abilities of founder
- Refined story and pitch
- Access to pitch competitions and practice
- Integration in a startup community and hub
- Access to acceleration opportunities
- Access to innovation hubs

Mitigation strategies

*This primarily applies to pre-seed startups and first time founders.

Understand your fundraising landscape

Just as founders invest time engaging in desktop research and stakeholder interviews to understand their customers, they need to also map out the universe of investors to identify which ones have a mandate that matches their business. Most funds, and even angels, have specific mandates around sector, stage, geography, impact, technology used, customer served, current revenue run rate, type of revenue earned (recurring or one-off), and more. By comprehensively mapping the relevant investors, founders can approach them systematically and understand how to focus each conversation to appear relevant and tailored.

Mapping also allows founders to identify avenues for warm connections from within their networks who might have experience with these investors either as a co-investor, an investee, an LP, or a partner. These connections will not only serve to build trust with the investor but also share valuable initial feedback as to the founder's fit for that investor's mandate.

Ensure clarity of vision, immediate action and key risks

Building a pitch isn't just about a strong customer journey story or punchy, well designed slides; these are increasingly becoming normal practice. What sets great pitches apart from average ones is providing clarity in:

- illustrating the market gap (including evidence to validate)
- how the team will approach filling that gap (with the evidence the team has the capability, experience, resources and networks to do so), and a picture of how the world (or the ecosystem of directly-relevant stakeholders) could change as a result of success.

Beyond this vision, founders also need to clearly articulate how funding will be used to accelerate growth by explaining how their immediate actions (with the cost of each tactics and strategies) will allow them to achieve the next milestones. Having a good set of clear, strategic milestones is key as they are your startup's launchpad to the next round of funding. Furthermore, a developed fundraising landscape analysis (as noted above) can help founders communicate how these milestones fit the criteria of specific investors who have been targeted for the startup's round.

Create a Series A data room for your Pre-seed fundraise

Detail and structure is everything when it comes to building a startup's investor data room! Even in early days, a startup should build and maintain financial statements with the same level of professionalism they would expect from themselves at their Series A raise.

Founders should ensure to comprehensively include all material contracts, registration and licensing documents, technical documents, marketing materials, partner pipeline, competitive research, team CVs, and other items in their data room; having them consistently formatted and labelled isa plus.

Why start so early? First, it is much easier to build these habits in your team's way of working from day one, and to begin building the systems needed to generate this level of documentation when complexity is still low. Once the business has grown and the number of transactions has skyrocketed, implementing such systems will be difficult. Second, having such systems demonstrates that your team has a firm grasp of the details of your business. Third, such systems leave less room for extrapolation and estimation work on the investor's end as information is readily available.

Engage early, regularly, genuinely

Just as relationships aren't built overnight, funding rounds aren't closed in a week. If founders are on mandate and impressive, many investors will be glad to begin engaging in exploratory conversations months or even a year before you intend to begin fundraising. Founders should establish early on how regularly the investor would prefer to discuss their startup and be genuinely direct in these conversations.

These conversations are a great opportunity to gather feedback, given investors' experience in the sector, and their networks. For example, founders would be wise to understand who investors turn to for additional insight and data. These could be advisors, venture partners, and LPs, but will also include founders of portfolio companies (past and present) who have relevant experience in the startup's space.

<u>Make the ask</u>

If the relationship is going well and founders feel that there is strong alignment on mandate, approach, and vision between the startup and the investor, it is smart to be explicit and make the ask. Don't be afraid to say: "We're planning to begin fundraising in three months and would love to have you on board".

Dedicate time

Founders need to drive business growth but they are also responsible for fundraising. Whether the team is actively fundraising or whether founders are just laying groundwork, founders must dedicate regular time to fundraising and commit a portion of each day towards this process, especially in the final two to three months of the process. There are many tasks a startup's leaders can delegate to the rest of the team but fundraising is one that needs to be led by the founders.

Roll with the punches

Founders need to be prepared to take rejections (a lot of them) and as with martial arts, it's all about how you fall.

The best response to these rejections is to take the time to understand why the investor was not a fit, and to ask for direct and honest feedback. Next, they could ask for referrals to other investors or advisors who could help bolster areas of weakness the investor identified. Most importantly, founders should never take it personally.

Resources

- Investment readiness check
- What to include in investor data room (list)
- Y Combinator's Series A program
- More investment readiness advice
- Pitch deck template