TheBlox

Later-Stage Fundraising

Before We Start, I Want To Kill Santa Claus

- There is a badass argument for why this class is irrelevant to 99% of you, at this exact moment.
- Later stage angel investment and especially venture capital is only given to companies with high growth potential and a lot of traction.
    - By traction, we mean a ton of revenue (some exceptions apply to what type of traction is accepted, but rarely). We’re talking about millions.
    - And by high growth potential, we mostly mean software.
- Most of the people on The Blox are not technology ventures, or are at the level of traction required to even start these conversations.

Then Why Is This Class Relevant?

- Because those two things from the last slide could change.
    - As we grow, add technology to handle the demand, and build structures to scale properly we can massively alter the “growth potential” of our ventures. Is Starbucks a tech company? No, of course not. But it’s definitely fundable because it uses fantastic custom software stack to scale the unscalable. Each of you can do things like this.
    - Eventually you will have achieved the level of traction required to start the conversations. This is just a matter of selling more stuff, which is why you’re all here.
- There is a finite window between when you start to qualify for this type of funding vs when you’ve gotten too far along and even the investors can’t afford to buy-in. The only way this works for both parties is if it’s timed correctly. To time it correct, you have to:
    - Know when you qualify
    - Know how to fundraise before you start
- As entrepreneurs it’s important for you to understand all skill-sets that are or eventually will be relevant to you. Yes, this subject matter is early. But when you’re in meetings, podcasts, pitches, etc. - we want you to be able to speak to these topics at a very high level.

The Boring Tools That Are Actually Available To Us At Early Stages

- Friend and family
    - Pros & Cons of raising from family
    - The power of small checks
- Crowdsourcing
    - Presale VS equity-based
- Bartering
- Grants & pitch competitions
- Traditional accelerators
- High net worth individuals
- Credit cards

What Are Funding Tranches

- Founder’s Savings
- Friends And Family
- High Net Worth Individuals
- Angel Firms
- Series A (Smaller VC)
- Series B (Larger VC)

Why Are Tranches Used By Founders

- Pretend your company needed $5M to get from wherever you are right now to the finish line.

- Now think about what percentage of your business you'd have to give up to get that type of capital. It'd be almost everything lol

- Now imagine taking a smaller investment. Using that small investment to hunt traction, which raises your valuation. Then selling a little more, which buys more traction. Then getting father along again, thus increasing the valuation. Then selling a little more. Etc., until you've reached the finish line with a much higher percentage of your business leftover.

    - In the first scenario you would own like 5% of your business at the finish line.

    - In the second scenario you would own like 75% of your business at the finish line because you only raised (sold) what you needed, when you needed it.

- Funding tranches help founders remain laser focused on new milestones and basecamps that are right in front of them rather than constantly looking at the summit. It allows them to be more flexible with how they maneuver the hike.

Why Are Tranches Used By Investors

- It de-risks the opportunity by insuring that money is parsed out to the entrepreneur as traction is being accumulated and the business is being proven.

- It allows investors to specialize in certain stages. A high net worth individual writing a $100K check is doing so at an incredibly different stage of business, with incredibly different terms, than a $3MM venture capital injection.

- The earlier stage investors act as signals to the next stage of investors that something has been validated.

How Venture Capital Funds Work

- Limited Partners VS General Partners
- Thesis (stage, industry, geography, size of check)
- Rule Of Thirds

Let’s Discuss Angel Fund Setups

- Why these might be more relevant to us right now is they write smaller checks, to earlier stage companies than venture capital.

- Finding them and going through their process (discussed in second half of this class) is almost identical to that of venture capital.

- Two main types:

    - Pooled Money: this where high net worth individuals pool their money and then make decisions about what to buy into as a group. In this situation, one business name goes on the cap table e.g. Kansas Angel Fund 1.

    - Road Show: this is where the angels pay a fee to be in a club. In that club, on like a monthly or quarterly basis, entrepreneurs that have been vetted present to the group. The individuals make singular investment decisions. In this situation, each investor that writes a check is added to the cap table, e.g. Ashley Smith.

How Does This Structure Change The Dynamic?

- The actual money is not owned by the person you’re talking to. You’re essentially talking to an employee, who is emotionless about the deal.

- The LP and GP have a contract that stipulates the investment thesis, so they don’t waiver on that thesis.

- The Rule Of Thirds means that they will only be able to bet on you if you have a chance of getting them a 10/20/30X cus they have to make up for their losses. Even if God parted from the skies and said to the GP, you’re guaranteed to 2X your money but no more, they’d deny the deal.

The Lifecycle Of A Fund

- Months and potentially years where the GP is raising the fund. They might be recruiting during this period even though they have no money.

- Months and small amount of years to “deploy” the fund, meaning this is when they’re most actively recruiting and writing checks.

- Months and years of writing follow-on checks to their portfolio ventures to either add gasoline or oxygen. But it might appear like they’re actively recruiting, but they no longer have any money.

- Then months and years where they are trying to help their portfolio ventures liquidate. They might appear like they’re recruiting during this time, but again, no money.

- Then the whole process starts over, and it will still look like they’re recruiting - but…say it with me…no money!

9B. Gaming The Venture Capital Journey

Prepping Your Startup Before A Big Raise

- How much are you raising? This almost has more to do with strategy than it does how much you need.
- Proof of traction, quantified.
- Detailed executive summary
- Financials
- Budget for sought funds
- Cap table
- Valuation justification

Eyeing Your Targets

- Create a list of firms that you think you qualify for
- Prioritize these things:
    - Geography
    - Thesis

Making Contact

- Once the list is made, go after every single one of them at the same time. This is sometimes referred to as Blizkrieg. This will create a sense of urgency, keeps you focused on the fundraising task, and will ultimately get you back to work sooner (successful or not).

- Use LinkedIn, their portfolio list, or other research tools to see if you have someone that can make a referral for you.

- Don’t spam the whole partnership. Send a super short message to the most relevant partner at the firm.

- Keep your list of targets, who you’ve contacted, and any other notes to keep this process organized on a spreadsheet.

Your Only Goal Is To Get To The Next Step

- Short back-and-forth emails after contact
- Quick vetting phone call
- First in-person meeting with your contact
- Due diligence homework
- More formal in-person meeting with the partnership
- More formal due diligence

Best Practices For These Steps

- Show up alone for the first meetings and phone calls
- Make your answers incredibly short. Let their questions guide the conversation. A question is not an excuse to give a speech.
- They’re gauging management competitency. They’ll make you feel relaxed but every movement and syllable is being judged.
- Can you build a rapport with them? If you can, they’ll want to do business with you. And if they want to do business with you, it will signal to them - that others will also want to do business with you.
- Don’t focus on your exit unless explicitly asked.
- Don’t over-sell fundraising interest.

Term Sheet (sometimes called an MOU)

- A term sheet sets the basic principles of the contract: valuation, amount of funds sought, governance
- This is almost a napkin contract to get two humans on the same page before the mutant lawyers get their hands on it.
- The term sheet is not binding.

The Subscription Agreement

- The Subscription Agreement comes next.
- This is binding.
- Think of this like the contractual Lego piece that attaches to your Operating Agreement (OA) and discusses just the terms of the deal. Things such as:
    - Valuation
    - Shares bought
    - Distribution of power (voting, board seats, etc.)
- Your OA is then adjusted to mirror the terms of the Subscription Agreement. So things like your capitalization table are edited to include your new investors. The whole thing is signed, and a check is wired.