

The 12 Fold Way to VC Funding:

A Roadmap For Technology-based Product Companies

Version 3.4

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Assumptions

- **Getting funded is among the most difficult tasks in the universe**
 - **Statistics show that few companies actually raise money from Venture Capitalists – 1 in 75 or worse depending on VC & market**
 - **They see a gazillion business plans and hear a bazillion ideas every year**
- **VCs are risk adverse**
 - **VCs look for reasons not to invest**
 - **Risk control and mitigation are key**
- **All the “go” items must be in place; problems readily fixable**
- **There must be no show stoppers; some examples:**
 - **Unfundable CEO – must have made someone money previously**
 - **Incomplete management team**
 - **Excessive rigidity – founders unwilling to part with an appropriate portion of equity**
 - **Excessive ego, disharmony – team players are essential**

The 12 Fold Way To VC Funding

1. **People and Board with the “Right Stuff”**
2. **The Elusive 10X Advantage**
3. **Service Providers On Board**
4. **Intellectual Property**
5. **Productization Roadmap**
6. **Market Validation**
7. **Market Entry Strategy**
8. **Business Plan**
9. **Funding Strategy**
10. **Research VCs [and Angels]**
11. **Investor Pitches - Plural**
12. **Prepared for Due Diligence**

People – Team Identified

- **Fundable CEO – someone VCs recognize as having done it before, deep domain knowledge, outstanding leader and people manager**
 - VCs fund CEOs and teams
 - If you don't have a CEO or the right CEO, some VCs may help
- **Management team identified – they have to be ready to join on funding if not already on board**
- **Specific roles may vary by business**
 - Chief Technology Officer / Chief Scientist
 - VP Engineering / Development
 - VP Business Development / Sales / Marketing
 - VP / Director Finance & Administration

People - Boards

- **Board of Directors**

- **Legal, fiduciary obligations**

- Typically 1 or 2 inside people plus 1 from each VC in the investor syndicate
- Investors effectively running the company – get used to it
- Not friends and family; usually not Angels

- **Advisory Board**

- **Depends on the nature of the business**

- May be all scientists and engineers with public visibility, positive reputation
- May include industry-relevant executives, leaders
- Some should be identified and on board before approaching investors – enhances credibility

The Elusive 10X Advantage

- **Best funding case demonstrates at least one important 10X advantage**
 - 6X to 8X may do fine, depending....
- **Price / performance advantage**
 - Often important because it reduces the likelihood that price competition will succeed against new product
- **Demonstrating advantages requires:**
 - Convincing cost projections
 - At least some engineering data / performance data
 - May require competitive benchmarking (if feasible)
 - Simulations and modeling may be helpful, depending...

Service Providers

- **Have Corporate Legal firm on board:**
 - Company formed in Delaware
 - Founders' documents signed, sealed, delivered
 - Employee stock option plan filed (if necessary)
 - Basic legal document “starter set” received
- **Have IP law firm on board**
- **Line up:**
 - Accountant
 - Examples: Deloitte, Coopers
 - Bank
 - Example: Silicon Valley Bank
 - Outsourced HR (if going that route)
 - Example: Administaff
 - Insurance

Intellectual Property

- **IP matters to VCs**
 - Asset in worst case scenario
 - Have at least one provisional or utility application on file before seeking funding
 - Find patent attorney with background in the specific technology or related field

- **VCs may request “freedom to operate” opinion**
 - Would product possibly infringe the IP of others?
 - Possible tricky question because of potential willful infringement issues
 - May want to seek advice of patent litigator with relevant experience

Productization Roadmap

(For pre-commercial technologies)

- **Working product prototype best**
 - Means that this is what you intend to go to market with investor's money and additional engineering
 - Sufficiently advanced to get a handle on component and manufacturing costs
 - Convinces investors that the idea is not a “science project”

- **Working key components good**
 - Better than “the drawing board”
 - Initial proof of concept
 - Need to have roadmap with engineering milestones showing how to get to a product prototype
 - Open engineering questions, problems, issues identified

Market Validation

- **Paying customers are best. Period.**
- **Otherwise:**
 - **Beta customers who will sing praises and say they are committed to paying the amounts in the business plan**
 - **Potential customers:**
 - **Letters of Intent saying that the product solves real problems for them and that on launch they will pay the amounts in the business plan**
 - **Reference letters indicating customers would buy if product were available commercially and that the price / performance is very attractive if delivered.**
 - **Customer as (potential) investor / partner**
 - **Provides validation BUT may entail strategically negative terms such as Right of First Refusal.**

Market Entry Strategy

- **Does not matter one iota that the Total Available Market is a bazillion bucks globally**
 - Your not solving world hunger or boiling the ocean
- **Realistic estimate of first Target Market**
 - Who is the customer? Who makes buying decisions?
 - Key value proposition
 - Sources of customer resistance? Substitution threats?
 - Referenceable potential customers / partners required
- **5-year market-share forecast has to be attainable**
- **Channel / Direct / Mixed distribution strategy identified**
- **Marketing / communications strategy**
 - Key messages for target market and how delivered and at what cost

Business Plan

- **Varies by business, but highlights may include**
 - \$60M-\$100M+ in revenue in 5 years
 - Cash flow breakeven in segment-appropriate timeframe
 - Margins appropriate to business, industry
 - 5 year financial P/L Pro Formas
- **Built month by month and bottoms up**
- **Short 5-8 page narrative Executive Summary**
 - People, product value proposition, market, technologies, financial highlights, financing desired, contact info
- **30 slide BP presentation, which is not the same as the pitch presentation**
 - Hold in reserve for follow-on meeting if invited back

Funding Strategy - Financials

- **Capital requirements driven by BP**
 - Series A, B, [C] round forecasts
- **Take as little money as truly needed to achieve Series A milestones**
- **Know projected capital to cash breakeven**
- **Have detailed Use of Proceeds (“UofP”) for Series A funding**
 - Tells investors how their money will be spent
 - Month by month, bottoms up expense projections
 - Include all costs
 - Explore equipment leasing options where appropriate
 - Bring people, equipment on board as needed
- **Expect VCs to own 40% to 55% of company at the close of the Series A**

Funding Strategy – Term Sheets

- **Investors get Preferred Equity, not common stock**
- **Preferences typically include:**
 - **Liquidation preferences – what happens if the company is sold or fails – for entrepreneurs, the most important term. Period.**
 - **Dividend rights – may only apply if declared by the Board [remember who controls the Board]**
 - **Anti-dilution – if the follow-on round is at a lower price, additional stock issued to participants in the prior round to maintain their proportional ownership**
 - **Voting rights – what items require approval by the Preferred investors**
- **Angel round frequently a Convertible Note financing**
 - **Loan to company that converts at the terms of the Series A**
 - **Typically with a 20%+ discount to the Series A price depending on the contribution of the Angel investment to risk reduction**

Research VCs and Angels

- **Find out who in your region is interested in your market, product, customers, etc.**
 - **What have they invested in previously?**
 - **What's their investment strategy**
 - **Seed? Early Stage? Middle? Mezzanine?**
 - **Which Partner made which investment?**
 - **Do they have any money left for new investments?**
 - **How did their previous fund(s) do?**
 - **Talk with a company or two they invested in**
- **Don't blast your Executive Summary to 40 VC firms**
- **Do identify 4 to 6 target firms in your region**
- **Find someone to introduce you to the firm, e.g.,**
 - **One of their investors – Limited Partners**
 - **CEO, Board Member of a portfolio company**

Investor Pitches

- Elevator pitch – one your mother could understand
- VC Pitch
 - 15 slides plus supporting material at the end
 - Sell the business opportunity – not the technology
 - Why is this a great opportunity for VC and their investors?
 - If they care about the business, they will look at the technology in detail
 - Practice the pitch with friendlies; someone role-plays VCs
 - Define everyone's role in the meeting, if you get one
 - Meeting discipline is absolutely essential
- Angel Pitch –
 - Company usually seeking a portion of the Series A from Angels
 - Pitch, Financing Strategy, Use of Proceeds adjusted accordingly

Prepared For Due Diligence

- **People**
 - Complete bios, references lined up for CEO, direct reports
- **Engineering**
 - Product definitions, specifications, requirements, documentation
 - Test data, performance data, competitive benchmarks
- **Market**
 - Third party market data if possible
 - Original market research plan / data
 - LOIs, testimonials from prospective customers, channel partners
- **Business Plan**
 - Details of the financial projections, UofPs
 - Confirmations of assumptions, sources, channels
- **IP due diligence**
 - Patent Office communications, Information Disclosure Statements, etc.
- **Corporate and IP Legal**
 - All the corporate paperwork neatly tied up
 - Employment agreements, NDAs, non-competes, etc.

Be Persistent – Good Luck

- May take 6 to 9 to 12 months from start to close

- *Be Churchillian:*

“Never give in. Never give in. Never, never, never, never--in nothing, great or small, large or petty--never give in, except to convictions of honor and good sense.”

Winston Churchill

How We Assist Entrepreneurs

- **Strategy assessment and strategic planning;**
- **Startup formation, launch, and preparation for Angel or VC fundraising;**
- **Business scope definition and planning;**
- **Strategic negotiations with potential investors, partners, and customers; and**
- **Pre-investment strategy and business evaluation,**
- **Technical (in selected areas) and business due diligence**

Contact Information

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