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## Raising VC Money: How Much Do I Need, and How Much Do I Ask For?

When deciding how much money to ask for, your first instinct is probably to determine how much you need. But, should these amounts be the same? In short, rarely.

How much *should* you ask for, then?

While some experienced entrepreneurs and investors have a simple, straightforward modus operandi here, most will probably tell you that the “proper” amount to ask for depends on a host of variables. Certainly there are popular schools of thought and some basic guidelines one can follow (which we’ll discuss below). However, at the end of the day, every company has its own idiosyncrasies and subjective considerations. Just as each company will have a unique capital need at any given time, each should have a correspondingly unique (but not necessarily parallel) capital ask – therefore, it’s difficult to point to any universally applicable formula. But, let’s begin by looking at the big picture.

### Fundraising vs. Building a Business

Before all else, it’s critical to think about whether it makes sense to pursue venture capital in the first place (at this particular time *and* in general), both from your perspective and from that of potential investors (a point often overlooked). Is the money and strategic value-add worth the time, money and energy diverted from working on the day-to-day of your startup? Given the product/service, industry and market size,

business model, stage of development and so on, is your company truly VC-investable?

I certainly don't want to discourage any entrepreneurs from seeking venture capital, but I *do* want to emphasize the importance of fully thinking through the decision before jumping into capital-raising mode, for two main reasons: 1) raising money isn't for the fainthearted – to do it well requires a significant amount of focus, hard work and perseverance; and 2) as Brad Feld alludes to in a clever 2011 blog post, it is easy sometimes to forget that fundraising, be it VC or other, is simply a means to an end (building a business) and not an end in and of itself.

The point is this: venture capital can be a life-changing catalyst for some entrepreneurs and startups, but it's not for everyone. Pursue venture capital because it's the best path to grow your business, not because it can be a sexy headline. But, I digress; you've done your homework, you've thought long and hard, and now you want to start your raise. So let's discuss.

## 3 Rules for Thinking About Your Needs

1) The most fundamental principle to understand when projecting your budgetary needs, and subsequently raising money, is the concept of **milestone-based thinking/planning**.

Milestones differ from a company's general goals in that they are specific, tangible, value-creating inflection points. They are well-defined

markers in a company's history, such as a key hire, a beta launch, user metrics met, regulatory clearance achieved, or reaching first revenues.

Demonstrating the ability to map out and achieve meaningful milestones, on time and on budget, can serve as a powerful track record and help compensate for other perceived weaknesses (e.g., lack of previous startup experience for a first-timer). Inevitably, every startup has its rollercoaster moments, but being able to show consistent achievement trends and produce positive momentum is critical for fundraising success. It is an indication of an entrepreneur's ability to plan and execute, and like it or not, 99% of investors that you'll encounter believe, as Jeffrey Garten put it, that "A vision without execution is a hallucination."

In relation to determining your budgetary needs, each time you achieve a specific milestone, regardless of how big or small, you turn guesses into facts by gaining knowledge and experience – some question marks behind your numbers begin to fade away, and slowly your estimates start to become actuals. Following this iterative learning process, the more the individual numbers reveal themselves, the clearer your entire needs picture becomes for the next phase of your business and the more de-risked the venture becomes for yourself and potential investors alike.

2) Anyone can plug in numbers – it's all about the **logic and assumptions** behind them.

Related to the milestone and execution-related thinking above, a VC will inevitably poke around your financial model (among other things), asking questions and looking for holes. Essentially, what VCs are doing is taking an inventory of knowns versus unknowns; they're assessing and weighing what risks have or have not been mitigated at that point in time.

Consider two widget companies (A and B), perfectly identical in every way except that A has recently hit the milestone of producing its first batch of products. A was able to produce its widgets for $X/unit, which is exactly the same as what B is projecting its cost to be; however, B won't produce its first batch for another three days still. While this is a seemingly trivial difference, an investor will look at this and categorize A's cost of goods sold (COGS) as a known, and B's as an unknown; therefore, A's projected needs are more predictable (that is, less risky) than B's.

Obviously there will always be a certain number of unknowns and risks, especially with early-stage companies. When figuring out how much money you need, the key is to determine which question marks are material, and back up your best guesses for them with solid assumptions and reasoning. Every entrepreneur will have projections with some numbers plugged in to show the (in)famous hockey stick, because that's what a VC wants to see and believe. However, a sophisticated investor will undoubtedly dig into any significant unknown

variables, and it's critical that you can support and defend the numbers you picked with clear-cut, grounded logic.

This practice of recognizing holes and defending key assumptions is an important exercise that you and your team should also go through internally – not only to better anticipate investor questions, but, more important, to better estimate your true and full funding needs. Besides, when dealing with investors, it's best not to drop any major after-the-fact surprises on them – intentionally or unintentionally. When that happens, then the trust and the relationship tend to be pretty short-lived.

3) **Plan for the Uncontrollable**.

Notice I didn't include "plain bad luck," "freak occurrence," or any other generally uncontrollable circumstances in the above. When determining how much money you need, be sure to **build in buffer room** for the unforeseen and unanticipated (reasonable, not excessive, buffer room).

Despite what is reported, investors are humans too – we know that even the best-laid plans can go awry, and we understand that sometimes things just happen.

**Developing Your Ask Amount and Thinking About Why Versus What**

As mentioned in the beginning, some investors have a clear and simple rule of thumb when it comes to the relationship between need and ask. For example, assuming they agree with your needs assessment, the basic thought process is this: calculate the company's expected monthly burn

rate, decide on a critical value-creation milestone in the next 12-18 months, and then ask for enough capital to create a runway for a short time past that point (both as a timeline buffer and also to sustain your company through the next fundraising period).

Sometimes it really is that straightforward, especially if you are pitching to a well-established, institutional firm with which you or your founding team already have a previous (and successful) history of working together. In this case, the parties know and trust each other; there's an established relationship.

Usually, however, it's a bit more complex than that. More elements end up coming into play, and it becomes much more of a give-and-take. As such, it's important to understand what a few of the most common variables are, and why they can (and sometimes should) cause a divergence from the simple guideline above.

*Ownership*

From the entrepreneur's perspective, with every equity investment there exists the fundamental tradeoff between raising enough money to reach the next critical milestone and minimizing dilution. VCs, on the other hand, need to be incentivized by a large enough ownership stake in a company to make it worth the level of risk and investment of their time, money and energy in the company. There is a natural tension at play that can lead an entrepreneur to request less than, and can lead a VC to insist on investing more than, what might otherwise be an optimal amount of capital for the raise.

*Cash-Flow Management*

Even for experienced entrepreneurs, fundraising almost always takes longer than expected, and startups almost always require more money to get off the ground than expected. Therefore, it is critical that a company manage its cash flow appropriately from an operational standpoint – and also pay close attention to cash flow from a personal standpoint. Sam Hogg lays out a great explanation for why a team's and a founder's personal cash-flow management is important to think about during the fundraising process as well.

Some investors will always want to provide extra capital for troubleshooting any unforeseen cash-flow issues. Yet, other investors, like Fred Wilson, prefer to see startups operate as lean and low cost as possible – so the companies move quickly and stay hungry. In general, the data does not overwhelmingly support one approach over the other, as there does not appear to be a direct correlation between amount of money raised and startup success. Nonetheless, each VC you pitch will surely have an opinion on the matter, and that in turn will impact your fundraising.

*Supply and Demand*

Finally, when developing your pitch and ask, it's essential to do your homework thoroughly and know whom you're dealing with. Every investor and firm has some sort of reputation. Do yourself a favor and

use specific search criteria (profile, preferences, policies) to measure potential fit before meeting with investors. Read up on their investment theses, talk to their portfolio companies, follow their tweets; collect as much knowledge as possible and incorporate that information into your raise strategy. Once you determine the amount of money you need, your investor "intelligence" probably won't change that number; but, the amount of money you decide to *ask* for may evolve daily depending on whom you are approaching and what the market environment is like at the time. The basic law of supply and demand will always come into play, so at any given moment, one side will usually have more negotiating power than the other.

At the end of the day, the simple "ask guideline" described above is just that…a simple guideline. Again, most of the time there will be a departure from this basic relational logic, and it can be caused by either one or both sides equally. When these departures do occur, they can lengthen and complicate an already long and difficult process, but it is by no means necessarily a bad thing. In my opinion, the best way to either leverage or counteract the variables noted above when they appear is to identify, understand and communicate the major "why's" from each side that are the driving forces behind any tension points or disagreements. Ultimately, the "what's" themselves are usually positions that are hard to move, but when you examine the "why's" behind them, they usually prove to reveal good workarounds for resolutions.

## About the Author

**Matthew Bloom** is an investment associate at Connecticut Innovations. You can contact him at matthew.bloom@ctinnovations.com.