**Venture Capital Decision Making Process**

**Purpose of this article**
Provide startup founders and early stage companies with a broad understanding of the investment decision making process used by VC (Venture Capital) firms.

This article provides a broad generic framework. The actual process will depend upon the specific VC firm e.g. investing in pre-revenue startups or a $50 million revenue company. The company seeking capital needs to learn the decision-making process used by the VC firms they approach. Many VC firms publish on their website information regarding their process.

This article does not address the VC process regarding their existing portfolio companies. i.e. what happens after the deal is closed and the cash is in the startups bank account.

**There 8 steps in a generic VC process**
1) VCs are looking to say No as quickly as possible. They may be getting thousand of applications a year, thus the need for careful time management.
2) The VC may say No at any point and may not give the rationale. Recognize that decisions are often a gut-feeling.
3) After saying No, the VC may ask the startup to stay in touch via monthly updates. This often happens. The VC can observe through a number of monthly updates the achievements of the startup, what the startup has learned, and how the startup has dealt with problems and issues.

**#1 Sourcing Deals**
1) Most of the deals VCs end up investing in come from referrals by people they know and trust.
2) Many VCs also actively look for deals.
3) Some VCs use software to mine the web looking for startups. InReach Ventures in Europe has used custom software to create a database of 95,000 startups.
4) Startups directly apply to VC firms.

**#2 Initial Screening**
1) Most VC firms have a set of a few deal-killer criteria to immediately say no to most applications.
2) A VC will spend 3 minutes and 44 seconds reading a pitch deck, on average.[1]

**#3 Initial partner call or meeting**
1) Most VC firms will have a set of criteria to enable a fast No.
2) The key decision at this point is whether or not a VC is interested in learning more.

**#4 Quick Analysis by an associate**
1) Follow up with the startup regarding questions from the partner.
2) Assess the pitch deck and answers provided by the startup.
3) Assess the competition.
4) Recommendation on whether or not to proceed.

**#5 Due diligence decision made by a partner**
The partner makes the decision to devote a significant amount of associate time to due diligence, which includes:
1) Customer reference calls.
2) Founder reference checking.
3) Deep competitive analysis.
4) Drawing upon technical experts to assess the solution.
5) Drawing upon industry experts to validate analysis of customer problems and needs.
6) Compare the startups to others at a similar stage.
7) Legal due diligence to validate the startups current legal documents.
8) Financial due diligence to validate revenues and costs.
9) An investment memo is prepared with recommendation whether or not to proceed

**#6 Partner meeting**
1) The partner sponsoring the startup, presents the investment memo to the other partners.
2) The partners make a decision as to whether or not to proceed. The decision-making process is specific to a VC firm. E.g. sometimes a unanimous agreement is required.

DRAFT

**#7Term Sheet**
1) How much financing?
2) What type of financing?
3) Terms and conditions regarding the financing?
4) Clarity on how key decision are made and who has what veto powers. E.g. what decisions require shareholder approval? What decisions require board approval? This is often in a shareholders agreement.

**#8 Closing.**
1) A number of documents need to be signed.
2) Cash needs to be transferred into the startups bank account.

One startup told me that the deal fell apart at this point – the cash was not transferred.

**Your next steps**
1) Define what value you require from a VC. Is it only money? Their network of potential experts and customers? Etc.
2) Reach out to VCs well before you need the money. The best way is via referral.
3) Research each VC to understand them. When and how do they expect to exit?
4) While the VC is doing their due diligence, you need to do your due diligence regarding the VC. E.g. talk with other portfolio companies, both current and past, to understand what it was like to have the VC as an investor.
5) Start sharing your monthly update with the people who've agreed to receive it: your potential investors, your advisors.
6) The potential investor update is different from the update sent to existing investors and the update sent to customers (potential and existing).
7) Remember that potential investors may well read your monthly update on their phone, and only devote a few seconds to it.

**Footnotes**

[1]"What we learned from 200 startups who raised $360 million", Professor Tom Eisenmann, Harvard Business School, and DocSend
https://www.slideshare.net/DocSend/docsend-fundraising-research-49480890

**Further reading**

How does a startup communicate with potential investors?
http://koorandassociates.org/selling-a-company-or-raising-capital/how-does-a-startup-communicate-with-potential-investors/

DRAFT