Why should a VC (Venture Capitalist) invest in you?

What is the purpose of this article?
1) Enable founders and investors to discuss and understand some of the VC (Venture Capitalist) investor process in early stage companies.
2) This understanding will help founders create and manage their VC relationship building and two-way communications' processes.

What are the critical learnings in this article?
1) A VC is focused on making a large amount of money from an investment, because most investments generate little or no return
2) The VC decision making process has many steps, with variety of criteria at each step.
3) When it's time to make the final investment decision, the team is the most important factor for the VC.

What is driving the actions of a VC?
The primary focus of a VC is to make money for the investors in the fund. A secondary focus may be to have a positive impact on society. The VC likely has a fund. The fund exists for a finite period of time and is expected to produce significant returns to the fund investors (e.g. significantly better than a liquid S&P500 ETF.
1) Often 10 year fund lifetime.
2) First 2-3 years investing in new companies.
3) Most of the capital invested within 5 years
4) Retuning capital to investors in the last 5 years and winding up the fund at the 10 year point.

What is the state of your startup?
1) You already have revenue from your solution. Few VCs invest in pre-revenue companies. There are exceptions such as new drugs and new technologies (e.g. fusion power).

Why is the VC looking for companies which can return 10 to 100 time the investment? [1]
Andreessen Horowitz, a U.S. VC fund with over $10 billion of asset under administration, has public shared their experience. They receive 3,000 startup applications per year. 200 startups are looked at seriously. 20 startups are funded. They commented that in the VC industry overall, 8% of investments generate the bulk of the economic return. The other 92% of investments are a loss or generate little return.

What are the VC questions and decisions leading up to the decision to give you cash?
VCs get many requests for funds (sometimes dozens a day). VC's also seek out desirable startups, often using software to create large databases of startup companies.
The foundation for many of the questions is based on:
1) What's the market size? How did you determine the number of potential cash paying customers who have urgent problems and needs they are willing and able to address?
2) What's unique about the team? What does the team know that no-one else knows?
3) What's unique about the solution? How easy is it to copy?

What are the three different routes to get VC funding?
1) Ask them for funding, either via cold call or introduction.
2) The VC reaches out, as a result of you staying in touch if the VC turns your down initially.
3) The VC proactively contacts you. This may occur because: the VC's software scanning and analysis of the internet has identified your startup, they've seen you pitch somewhere, they've met you and talked with your for 2-3 minutes,

When you ask VCs for funding, their questions include:
1) Why should they open (rather than immediately delete) your cold call email or introductory email from someone the VC knows?
2) Why should they read any attachments?
3) Why should they have a brief call with you?
4) Why should they have a meeting with you?
5) Why should they start a due diligence process with you?
6) Why should they start to negotiate terms and conditions with you?
7) Why should they decide to give you cash?

Each one of the above questions will have a number of detailed supporting questions and analysis

What are the key VC questions when they decide to not-invest but still ask your startup to stay in touch with them?

These include:

1) Did you email them (or update their database) on the schedule they asked for? (Most commonly monthly.)
2) Did you accomplish in the past month what you said you would, in an earlier update?
3) How much have customer interactions grown, month by month. E.g. number of cash paying customers, number of customers who signed LOI (Letters of intent), how many asked to be emailed once your product is ready, number and type of interactions on your website, number of signups to your newsletter, etc.

The VC will have different decision making criteria at each stage. VC don't all ask the same questions or have the same process.

What has the VC determined prior to their final investment decision?

1) Prior to the final investment decision, many VC questions will have been answered, especially in the due diligence stage, as noted above.
2) Few startups make it to the point where the VC makes the final decision on whether or not to invest.

What is the most important factor early stage VCs consider when it is time to decide on whether or not to write the check.

1) 53% of VCs believe the team is the most important factor in making the decision. Fit with the fund was 13% and the solution was 12%.[2]
2) 64%% of VCs believe the team was the most important factor in their startups' success[3]
3) 60%% of VCs believe the team was the most important factor in their startups' failure[4]

Why the focus on the team when it comes to the final investment decision?

1) The team needs to be constantly learning and unlearning about customers, their ecosystem, technology, etc.
2) Often the team must change direction as they learn more about their customers and the customers' problems. E.g. YouTube started out as a dating site and Slack started as a multi-player online game.
3) Incredible grit and perseverance are required.
4) If the team's initial assumptions about a large target market for their proposed solution prove invalid, a brilliant team will find out what the unmet customer problems are and create an appropriate solution.
5) A poor team will continue to create and sell a solution for which there is little demand.

What are your next steps?

As a founder:

1) Understand the different decision making stage each of your target VCs go through, including the final decision to fund you.
2) Design your VC relationship building and two communications processes to support the variety of target VCs.
3) You'll need a CRM (Customer Relationship Management System), and two up-to-date data rooms. The external data room will be visible to potential investors. The internal data room is used by the startup team, and not visible to potential investors. Some content will be in both data rooms.

Footnotes

[1] https://corporatefinanceinstitute.com/resources/knowledge/other/how-vcs-look-at-startups-and-founders/

[2] Paul Compers, Harvard Business School, Will Gornall, University of British Columbia Saunder School of Business, Steven N. Kaplan, University of Chicago Booth School of Business, Ilya A. Strebulaev, Graduate School of Business Stanford, "How do venture capitalists make decisions", April 2017, Page 42 This survey of VC firms included: 63% of all VC US assets under management, 9 f the top 10 VC firms and 38 of the top 50 VC firms.

[3] "How do venture capitalists make decisions", Page 53

[4] "How do venture capitalists make decisions", Page 54

Further reading

Touko Kontro & Ari Seppänen, "How to get your startup funded?", NewCo Helsinki, City of Helsinki, https://newcohelsinki.fi/app/uploads/2018/01/Fundingworkshop-2.2-1

Is your early stage startup planning to fail?
http://koorandassociates.org/the-startup-journey/is-your-startup-planning-to-fail/

What does the startup journey look like?
http://koorandassociates.org/the-startup-journey/what-does-the-startup-journey-look-like/