5 Steps a Founder Should Take Before Raising Capital

If you are a founder of an early stage company, the issue of raising money is likely top of mind and a material source of anxiety. My guess is that when you hatched your great idea and decided to launch your company, you knew that raising capital would be something you'd need to do, but you had no idea how time consuming and stress evoking the process would be.

Over the years, I've had the opportunity to work with a number of early stage companies during their initial capital raises. Almost invariably, founders ask the same questions as they embark on their capital raising journey – yes, journey. The most common question is this, "What should I be doing to prepare for the fundraising process?"

Below are 5 steps that I typically suggest my clients take before engaging potential investors about fundraising. Will taking these steps guaranty funding? Absolutely not. Will following this process help you (i) be prepared, and (ii) put your best foot forward? That's the goal.

CLEAN YOUR ROOM:
When you were little and guests were coming to your home, your mom probably said, "go clean your room." Your mom did this because when you go into an "unkempt" house – you start noticing everything and are on high alert for filth. The same concept applies when you invite an investor to take a look at your company (i.e., due diligence). If they see things that don't look clean (from a legal perspective), they go on high alert for risk. The more they find, the lower the valuation. You obviously want to avoid that. The easiest way to avoid this is to clean your "legal" room before investors start poking around. Have a conversation with your lawyer, or hire one, to take a look at things and fix what needs to be fixed. Among other things, your lawyer should make sure: (i) your formation documents are adequate and correct, (ii) your equity has been issued properly, and (iii) that employees and consultants have signed appropriate non-disclosure and assignment of invention agreements. Yes, you will have to spend a little money. It will be worth it.

KNOW YOUR NUMBERS:
Can you imagine going to buy a car (or anything for that matter), and having the sales guy say, "I'd love to sell you this car, but I don't really know who owns it!" It would be very strange and you'd probably hop in your car and find a new dealership. Same thing goes for your company. You need to have a firm grasp on who owns what, and ownership should be properly and carefully documented. This seems obvious, right? Time and time I ask the question about ownership, and time and time again I get unsatisfactory responses. Finally, you should understand how your target investment would impact your capitalization table (sometimes referred to as a "cap table," this is the schedule that sets forth all equity owners in your company). You must think about these things in advance.

PUT ON YOUR "SALES GUY" HAT:
When you start raising money, you need take off your CEO or CTO hat, and put on your "sales guy" hat. Being able to sell is a huge part of raising money – after all, raising money generally involves selling a piece (or a right to a future piece) of your company (and yourself in a way) for new capital. In my experience, founders

that are able to raise money with relative ease are those with sales experience. Common skills among founders with sales experience include (i) the ability to communicate clearly the problem that their product fixes, (ii) the ability to articulate clearly what their product does, and (iii) the ability to tailor their message carefully for the audience. To add a bit more gloss to item (iii), you must recognize that your message when pitching to friends and family will likely be different from when you pitch to an institutional investor, and which will likely be different from when you pitch to a strategic investor. All of these items require work – but will most definitely pay off.

BUDGET MORE TIME THAN YOU THINK YOU WILL NEED:
Have you ever tried to get loan from a bank? If so, you know that it always take a little longer that you think it should. First, you have to complete the application, provide a bunch of information and run a credit check. Then, the bank asks for more information, and more, and more. Finally, the loan goes through the approval process. It just takes time. Raising money is very similar. First, the term sheet will be negotiated. Next, there will likely be a due diligence period that may take a few weeks (sometimes longer). Then the deal documents will be drafted and negotiated. Finally, once the deal documents are finalized, they must be signed, appropriate filings must be made, and wires must be initiated. Like I said, these things take time – sometimes a few months from start to finish. Be aware of this when analyzing your runway and burn rate.

STRUCTURE IS KEY – UNDERSTAND YOUR OPTIONS:
When buying your first house there are many factors to consider, like commute, neighborhood, and schools. You then analyze all factors as a whole in order to make your decision. Picking the appropriate way to raise money is like buying a house in that you have a significant number of factors to consider, all of which need to be analyzed as a whole and before your decision is made. The most common ways to raise money include priced equity rounds, convertible notes, and SAFEs (simple agreements for equity), and each offers pros and cons. It is important to consider factors such as the company's likely desire to avoid an early valuation (generally not ideal for very early stage companies), transaction cost, and transaction time line (an analysis the pros and cons of each is a subject for a different day). Furthermore, the investment structure will often depend on the relative leverage of the company and investor, the type of investor, and the size of the raise. The important take away here is to have a working knowledge of the different options.

No two companies follow the same path when it comes to raising money. Unfortunately, fundraising success often depends on who you know, good timing, and luck. That being said, if you take the time to consider and educate yourself about the steps above, you'll be moving in the right direction.

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