CHAPTER TWO

How the fundraising process works

Before you devote the next several months to fundraising, we must start with the most crucial question of all.

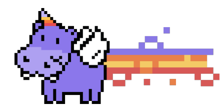
Should you even raise money?

Not every business should raise money.

Founders have to give up partial ownership of their company when they raise money. That percentage could be worth a ton of money when you go public or get acquired down the line. And once you start selling part of your company, these investors become your business partners. This means they will have opinions about how the business should operate, which may or may not align with your vision.

So if you can get away with securing money through bootstrapping, crowdfunding, government programs, banks, or even alternative lending models like Paintbrush… we actually recommend not fundraising to keep 100% ownership of your company.

I know this is a weird start to a book about fundraising, especially from a venture capital firm. But we want to be fully transparent on what's actually best for you, the hard-working entrepreneur.



So, what type of businesses *should* raise money? Typically high-growth tech startups that hope to:

1. sell their business for hundreds of millions of dollars, or
2. go public, also known as an initial public offering (IPO)

If your goal is to sell your company for a smaller exit, it may be ok in some cases, but it's likely that your investors will be disappointed. Because they're looking for a very high return for their capital – like 100x their investment – so they want to invest in founders that are aiming for a big success.

If that's you, keep reading. You're in the right place.

Fundraising stages explained

Founders typically raise money in stages.

1. Pre-seed
2. Seed
3. Post-seed
4. Series A
5. Series B
6. Series C
7. Series D-G (if needed)
8. Initial Public Offering (IPO)

It usually takes several months to start and complete a fundraising round. Since this book is written for early-stage founders, we're going to primarily focus on the **pre-seed to Series A stages**.

Pre-seed

The pre-seed stage is the first round of funding that founders raise. People also call it an *angel round* or a *friends and family round*. Teams at the pre-seed stage are just getting started. This is when founders quit their jobs to go full-time on their startup. Investors want to see you launch a minimum viable product (MVP), a basic version of your product that's designed to quickly gather user feedback and improve your offering.

They also want to see data around customer discovery that proves what you're solving is indeed a big problem and these customers are willing to pay to solve this problem. You probably don't have many (or any) real users or revenue yet. So investors who put in money are betting on your team and the market you're in.

These investment rounds are typically small, ranging between **$100k - $1M**. The money will likely come from your family, friends, angel investors, and pre-seed funds like Hustle Fund (that's us!). The goal at this stage is to get enough money to go full-time on your startup, build your product, and start generating some traction.

Seed

The seed stage typically happens when you've shipped your MVP and have feedback from real users. You could have a consumer app with millions of users. Or you may have a B2B business with some enterprise customers in your pilot program. This is the stage where you're validating the market demand for your product and making solid traction.

Seed rounds typically range from **$500k to $3M**. The goal at this stage is to generate traction and find product-market fit. The typical traction range is ~$10k+/month.

Post-seed

The post-seed stage (also known as "pre-Series A") is a gray area between seed and series A, kind of like the awkward teenage phase. You've made major progress as a seed-stage company, but not quite enough to raise a Series A. You may hear people call this round the *mango seed stage* or *avocado seed stage*.

Not everyone who plans to raise a Series A will need to raise this round. If you have enough runway from previous fundraising rounds, or from your earned revenue, you may be able to skip this round entirely.

Before you get to Series A, you may need to hit specific metrics around retention and engagement. Or hit certain revenue milestones, or acquire a certain number of users. The post-seed round is your opportunity to achieve these goals.

Post-seed rounds can range from **$1M to $5M**. This can be an extension of your seed round with many of your previous investors, or separate rounds with new investors. The goal at this stage is to provide more evidence/data that your company is ready for a big series A round. The typical traction range at this stage is ~$100k/month.

Series A

You know you're ready to raise your Series A when you've found product-market fit, that sweet spot where your product fits so well with what customers want. You have strong evidence that you can capture a decent share of the huge market. You've shown that you can recruit A-players and have a solid team that can execute your vision.

Series A rounds are more substantial than previous rounds, ranging from **$5M to $10M**. They typically involve a **lead investor**, the first and main investor in a funding round who puts half or more of the money into the round. This stage is also when you typically form a board of directors (outside of your co-founders), to whom you'll report quarterly on your progress. The typical traction range at this stage is $2-3M/year.

To sum it up

These numbers are the typical ranges that we've seen in the venture world. But just because a company has these traction marks doesn't guarantee it'll be able to raise money successfully. Factors like your location, type of business, business model and more will impact your fundraising strategy.

Angel investors vs. venture capitalists

What is an angel investor?

An **angel investor** is an individual who has accredited investor status. That means they have a million dollars of investable assets or a really large salary ($200k+/yr). Angels don't have to be techies or experts in your industry. They could be your dentist or a friend's mom.

One of the main reasons to work with angels is that they make decisions about where to spend their money based solely on their own preferences. They don't have investors to consider, business partners to consult, or office politics to deal with. They can write you a check after one meeting if they like you and your idea. It's their money.

Angels can help with things other than money as well. Many angel investors are experienced operators who can help you solve real problems. So if you need guidance on how to build a marketing team or how to create a product roadmap, an angel who has experience in those areas could be a highly valuable partner.

One thing to consider before raising money from angels is that they typically write smaller checks, between $1k to $25k. This means that if you're raising $1M, you'll have to close a lot of deals if you only stick with angel investors. Another downside is that angels might not be able to participate in your later rounds when the check sizes get bigger and the valuations get higher.

What is a venture capitalist?

On the other hand, **venture capitalists (VCs)** can write larger checks than angels, ranging from $50K to millions of dollars, with the opportunity to participate in their portfolio's later rounds. Here's how: a venture capital firm raises money from their investors called **Limited Partners (LPs)**. Then VCs invest all that capital into startups and divide the returns among all the LPs (and themselves).

VCs can be extremely well-connected. They often introduce their portfolio companies to other VCs, potential business partners, and even new hires. In later stages, VCs can also be great board members to help guide the next chapters of the business.

The fact that VCs have LPs is both a burden and a blessing. A blessing because LPs enable VCs to do their work. Without LPs, VCs wouldn't have the capital to invest in startups. But they're also a burden. Because VCs are essentially stewards of their LPs' money, they're obligated to invest only in deals they truly believe will give them a 100x return. This means if a VC invests in a startup at a $1M valuation, they are hoping that your business will exit or IPO for a $100M valuation.

The math of venture capital can be complicated. All you need to really know is that VCs invest in dozens of companies expecting the majority of them to fail. The 1-2 startups that give investors a 100x return will pull up the value of the entire portfolio.

For example, imagine a VC firm invested $50k into 100 early-stage startups for a total of $5M. Ninety-nine of these startups failed. But the one company that succeeded just happened to be Uber, a company that's worth over $100B today. The firm's $50k investment in Uber would be worth hundreds of millions of dollars, which more than makes up for the initial $5M investment.

This desire to show big returns to their LPs gives the VC industry a bad reputation. Some VCs put extreme pressure on founders to grow at a rapid, unsustainable pace. On the other hand, angel investors aren't generally looking for a specific ROI.

If they love you and your idea, they may invest even if they think they'll only get a 2x or 3x return. Since angel investors have no outside investors to consider, they can afford to be more patient in your company's growth.

However, to chase big returns, some angels may still pressure you to sell your company if that'll guarantee them a modest 2x return, or advise you to shut it down entirely.

So who should you raise from?

Any business that expects to exit and aims to provide its investors with a meaningful return on investment (ROI) should consider raising from angels… even if they also plan to raise from VCs. Here’s why.

Angel investors are more accessible, will give you money faster, and often roll up their sleeves to help your startup. They can make intros to other investors (which builds momentum during fundraising) and they’re likely not running a fund.

While any VC-backable business should strongly consider angel investors, several business models are not VC-backable. And those businesses might be great for angels. For example:

- Media companies
- E-commerce businesses
- Food and beverage businesses
- Hardware businesses/wearables
- Brick and mortar businesses

These are business models that VCs don't typically invest in because the overhead is too high to have a meaningful exit. Those types of businesses are more likely to see a 2-10x exit than a 100x exit.

VCs are looking for that one big winner like the next Uber or Instagram. If you’re aiming to be a billion-dollar company one day, VCs tend to be great partners in the later stages since they can provide you with more capital and direction when you're scaling fast.

But let's state the obvious: a 100x return is extremely tough to accomplish. Investors know this, and they only invest in companies that have the potential to scale fast. There are lots of things that make a business scalable. But since you don't have all day, here are the top three things we look for.

1. **Unit Economics** – the cost of acquiring and onboarding a customer compared to how much money you make from that customer
2. **Customer Acquisition** – your ability to acquire customers at scale
3. **Exponential Growth** – when your revenue is increasing at a faster rate than your incurring costs.

Both angel investors and VCs would love to invest in a startup with great unit economics, low customer acquisition costs, and rapid exponential growth. We recommend raising from angel investors first for speed. Then consider VCs if you have a business that can potentially scale to deliver a 100x exit.

Startups in the "vice" categories (think alcohol, cannabis, gambling) will likely have more success with angels than VC firms. This is because VCs usually have a "no vice" clause that they adhere to. Whereas angels can invest in whatever they want.

Incorporate your company in Delaware

Hustle Fund GP Eric Bahn made a huge blunder when he started his education startup: he formed a California LLC instead of a Delaware C-corp. When Eric later sold this business, his tax accountant told him that if he had switched to a Delaware C-Corp, he would have saved a *ton of money* on taxes upon his exit.

Learn from Eric's mistake and incorporate your company in Delaware. Here's why Delaware C-Corps are so advantageous.

Benefit #1: Delaware is business-owner friendly

Delaware has corporate governance laws that are basically simple rules around compliance and in cases of things like lawsuits. These laws were written to help business owners stay in business.

Delaware is a business-favorable state. So it's more relaxed and easier to do business in Delaware in comparison to other parts of the US.

Benefit #2: You'll save a ton of money on taxes

There's this thing called the **Qualified Small Business Stock (QSBS)**. If your business is a Delaware C-Corp and has been around for more than five years before getting acquired, you could potentially be exempt from paying federal taxes when your company gets acquired or IPOs.

That's a huge deal. If Eric had converted the business to a Delaware C-Corp, he would have faced a much lower federal tax bill when his business was acquired thanks to QSBS.

There are a lot of potential federal tax exemptions only available for Delaware C-Corp businesses. This benefit also applies to investors. They'll be exempt from paying taxes in many scenarios thanks to QSBS. So everyone gets to keep more money upon an exit.

We're not lawyers. Do your research on QSBS and read all the nuances on Delaware's official page.

Benefit #3: It's favorable to investors who are buying shares

Imagine Eric invests in a cycling software business and it's doing really well. Like $20M in revenue every year. In this hypothetical situation, Eric wouldn't need to personally pay any taxes along the way even though he's a part owner of the business. Eric would only pay taxes on the gains he makes when this startup gets acquired or IPOs.

Just one of many unusual and wonderful treatments of taxes that you can find with Delaware C-Corp structures.

It's super easy to flip to a Delaware C-Corp

There are lawyers and possibly automated legal services that can help you switch over to a Delaware C-Corp. So if you're running a venture-backed business, switch to a Delaware C-Corp and keep more money upon your exit.

Breaking down equity, SAFEs, and dilution

If you want to fundraise, you need to know what SAFEs are and how dilution works. Because if you don't, you may accidentally give away too much equity and be left with very little at the end.

Let's break it down using my favorite food. Imagine you have a pizza in front of you. In the beginning, you and your co-founder(s) own 100% of this pizza (aka your company).

Photo by [Vit Ch] on [Unsplash]

Now let's assume this pizza is worth $20.

Your objective is to grow the value of your pizza. It could be worth $20 now, but in 10 years, your pizza could be valued at $1B. So how do you grow the value of the pizza? You give away slices of the pizza to strategic people – investors, advisors, and key employees – who will massively help you.

Every time you give away a slice of pizza, you're actually giving away **equity** in the business. Equity means ownership in the company. So if an investor has 5% of the equity in your business, they own 5% of your company.

Now, it's unavoidable that you'll lose some ownership of the pizza as you raise money. But these strategic people that you gave slices to can help bring the valuation of the entire pie from $20 to $1M to $100M and hopefully to $1B. Even if you only own 15% (equity) of the pie (your company) by the end, if it's valued at $1B, then your slice will be worth $150M. It'll be easier to accept that you don't own the other 85% of the pizza because your small slice is so valuable on its own.

But you need to be careful about giving away your pizza slices. As you can see, one small slice in the beginning can be worth millions of dollars down the line. Every time you give equity away means that you (the founder) will have less ownership over your own business.

Equity will translate to dollars when you IPO or get acquired, so you want to maintain enough equity to stay motivated to keep working on the business. So here's the million-dollar question: How much pizza should you expect to give away when you raise money?

This will depend largely on the amount your startup raises and the valuation at which you raise. We typically see founders give away 10-20% of their pizza per fundraising stage. The gold standard is for the founders to still own the majority (more than 50%) of the pizza after their Series A round. It's common to lose the majority by the time you raise your Series B. But as I mentioned earlier, this shouldn't bother you if the value of the pie is high enough.

What SAFEs are and why you should care

SAFE stands for "simple agreement for future equity." SAFEs aren't slices of pizza directly, but think of it like a ticket for a slice of pizza. You give these tickets to investors, which gives them the right to come back to you later to claim their slice (assuming the pizza is still alive and edible).

In non-pizza terms, a SAFE isn't equity you sell to your investors, rather it's the promise of equity in the future. Think of SAFEs almost like an IOU; you're not issuing any equity yet… but once you have an equity financing round, an acquisition, or an IPO, that SAFE will get converted into equity. If your startup crashes and burns, the SAFEs are worthless.

There are two kinds of SAFEs: **a pre-money SAFE and a post-money SAFE**. When Y Combinator created the SAFE in 2013, it started as a pre-money safe. This is important – remember this.

These SAFEs were open-source documents that have become the standard for founders to use when raising money. Without a SAFE, founders had to pay lawyers to draft a new contract from scratch. This was expensive and complicated to manage. SAFEs made it easier and more cost effective for founders to raise their earliest rounds.

But it had an unintended consequence. Founders wondered, *"A priced equity round takes a lot of paperwork, negotiation, and legal fees, which can easily cost me $20k. Why don't I raise my entire round via pre-money SAFEs? I can just download it from the YC website and keep my costs low."*

So founders started raising $2-3M rounds via SAFEs. But once they were ready to raise a priced equity round, founders weren't sure how much of the company they'd actually sold. They'd sliced the pizza in all kinds of weird shapes and sizes and never kept track of who owned what because of the nature of pre-money SAFEs.

By the time all those people with pizza tickets come back to claim their slices, the founders may realize they have the smallest slice out of everyone… which can kill their incentive to grow the value of the pizza.

We know a founder who raised a bunch of money via pre-money SAFEs. He didn't realize his equity had been diluted so much until he tried to raise his equity round. This founder discovered he only owned 35% of the company at the seed stage, which is no bueno.

We'll share exactly how all of this works with some easy numbers later in this chapter. But for now, Eric offers this warning,

"It is really easy to mess up these calculations when you have so many different kinds of pre-money valuations stacking on top of each other with capital that you raised before your Series A, or whenever your post-money raise takes place."

Why founders are using post-money SAFEs instead

To rectify the unintended consequences, YC later introduced post-money SAFEs. They wanted founders to have clarity on how much of the company they're selling.

Here's the magic equation: (investment) / (post-money valuation)

- Example #1: The founder raises $500k on a $5M post-money valuation. $500k / $5M = 10%. This founder has sold 10% of the company.

- Example #2: The founder raises $1M on a $5M post-money valuation. $1M / $5M = 20%. The founder has sold 20% of the company.

The math of what you've invested at the post-money valuation is simple and clear. This calculation is better for both the founders and investors because you know the exact percentage of pizza you're giving away.

To sum it up

Focus on growing the value of your one pizza. Be strategic in who you sell your pizza slices to because you want to own as much of your company as possible.

If you use pre-money SAFEs, learn how to calculate and keep track of how much pizza you've sold. Instead, use post-money SAFEs to have clarity… and sleep well at night knowing you still have enough pizza in the fridge to enjoy later.

How to determine a valuation for your startup

A **startup valuation** is the financial value of a startup's equity at a given point in time. In other words… how much your startup is worth.

Unlike public companies – where the stock is listed on an exchange and fluctuates throughout the day based on trading activity – private startup valuations are agreed upon by the investors and the founder(s) when the startup goes out to fundraise.

This valuation is based on a variety of factors:

- How much revenue the business has
- Business experience of the founders
- Competition in the market
- Macro market conditions
- Investor demand

The last point on "investor demand" is one you should definitely pay attention to. While the other factors do matter, a startup's valuation is not actually about how much your company is worth, but about the **supply and investor demand of your round**. Let me explain.

Example #1:

Imagine your goal is to raise $200k at a $1M valuation. But you discover that you have a lot of investor demand. In fact, these investors are offering a total of $500k… $300k more than you're aiming to raise.

This means you have more demand in your company than available equity, so you can safely increase your startup's valuation and still secure the capital you're looking for.

Example #2:

Imagine your goal is to raise $2M at a $5M valuation. But no one is interested. Then your valuation is, well… $0. Because there's no investor demand to participate in your startup's round.

You can't raise money at a $0 valuation. But you can lower your valuation to a sweet spot where you'll get to investor demand. Alternatively, you could improve your pitch deck to try and convert more investors. Or you could work to grow the business and "earn" your desired valuation.

In practical terms, determining your valuation is less about your "actual" worth and more about what investors are willing to pay. So founders can set a value for their own startups, but VCs will also perform due diligence to determine a valuation they'd feel comfortable investing at. The two sides may then negotiate an acceptable valuation for both parties.

Still with me?

Because there are two different kinds of valuations that you should know: the pre-money valuation and the post-money valuation.

Pre-money and post-money valuation

The **pre-money valuation** is the valuation of the business before it receives any outside investment.

The pre-money valuation doesn't take into consideration the money the founder is planning to raise. So if a startup has a pre-money valuation of $2M, and she's planning to raise an additional $500K, her pre-money valuation is still just $2M.

This number is important because it tells investors how much they'll need to put in to purchase their desired equity stake. The pre-money valuation will usually change every time the startup raises a new round of financing.

For instance, a seed-stage startup might raise at a $5M pre-money valuation. After 12-18 months of growth, it'll return to raise its Series A at a $10M pre-money valuation. The increase in pre-money valuation would represent the additional value the startup has created by acquiring more customers, improving its product, building its brand, etc.

Let's take the example of the company with a pre-money valuation of $2M. If an investor wants to purchase a 20% equity stake, it means that the investor will need to put in $500k at a $2.5M post-money valuation. ($500k / $2.5M = 20%).

As the name suggests, the **post-money valuation** is the startup's valuation *after* receiving outside investment. Unlike the pre-money valuation, the post-money valuation is easy to determine: simply add the investment amount to the pre-money valuation.

A startup on a good trajectory should see its post-money valuation increase with every new financing round (i.e., investors should view it as growing in value). If the post-money valuation goes down round-over-round, it's called a **down round** and could signal the business is in peril.

High valuations aren't always a good thing

While high valuations leave founders with a larger percentage of ownership in their startup, there's more to consider.

Consideration #1: Investor incentives

We already know that investors can be really, really helpful. But with 24 hours in a day, they're only able to give meaningful help to their highest-priority investments. So if an investor has a 1% stake in your business and a 10% stake in another business, and you're at the same stage, which company do you think they'll dedicate more resources and time towards?

Consideration #2: Startups need time to grow into valuations

Let's say a founder generates interest in her idea or an early version of her product. She raises money at a $12M post-money valuation.

She uses that money to improve the product, acquire users, and hire a few people. After 8 months of working on the business, the founder doesn't see the traction she was hoping for. And she's out of money. She decides to raise another round of funding.

Only this time, investors have less conviction in her business. Since she hasn't proved that her idea is successful, they might recommend a lower valuation, but that can look really bad. Decreasing the valuation is a signal to investors that there is something wrong with the business. And since investors see anywhere from 10 to 1000 pitches every month, they're more likely to invest their money in a new company instead of writing this founder another check.

Ironically at the time of this writing (January 2023) where capital is really tight, down rounds are not negative signals. It's a sign that someone wants to invest. So this is the exception to the rule.

Consideration #3: Recruiting

Most startups don't have the capital to offer competitive salaries to high-quality talent. That's where the ESOP comes in. By attracting talent with stock options, founders are able to conserve cash while employees feel like they have ownership of the company. Those employees are incentivized to work really hard to make the business successful because if the business does well, their options will be worth a TON of money. Right?

Here's the problem: joining a team with a high valuation means that the price for the stock options is also high. Employees will realize that they can't actually afford to buy their options.

Couple that with the low salary and long hours, and they won't be incentivized at work. This can lead to ugly company culture and low productivity.

The savvy people who are smart enough to ask about valuation and exercise price will realize that the opportunity isn't as good as they thought. So if you have too high of a valuation, hiring those people will become very difficult.

How cap tables, shares, and vesting all work together

A cap table is a spreadsheet that lists all the people and entities that own pieces of your company. In the beginning, there may just be two lines for you and your co-founder. It'll list your names and how many shares you both own.

The shares in themselves are meaningless. But they are meaningful when you see how much of the pie they represent as a percentage. Every time you give a slice of pizza to an investor or a key employee, they will be granted shares and have some equity in the pie. Their name will then be added to the cap table with the respective % numbers next to their name.

Here's an example of what a cap table looks like. You can also make a copy of our template here.

	Company Valuation				
	Total Value ($)	Per Share ($)	# of Shares	% of Total	
Series A					
Pre-Money Valuation	$7,500,000	$8	1,000,000	75.00%	
New Equity Raised	$2,500,000	$8	333,333	25.00%	
Post-Money Valuation	**$10,000,000**	$8	**1,333,333**	**100%**	
	Company Ownership Cap Table				
	Capital ($)	Common Shares	Preferred Shares	Total Shares	% Ownership
Shareholders					
Founders	$0	800,000		800,000	60.00%
ESOP Pool		200,000		200,000	15.00%
Investor Tam	$150,000		20,000	20,000	1.50%
Investor Kera	$450,000		60,000	60,000	4.50%
Investor Eric	$300,000		40,000	40,000	3.00%
Investor Shiyan	$250,000		33,333	33,333	2.50%
Investor Elizabeth	$900,000		120,000	120,000	9.00%
Investor Janel	$200,000		26,667	26,667	2.00%
Investor Brian	$100,000		13,333	13,333	1.00%
Investor Haley	$150,000		20,000	20,000	1.50%
Total	$2,500,000	1,000,000	333,333	1,333,333	100%

In this example, our post-money valuation is $10M. New investors are coming in for $2.5M. That means they now own 25% of the business. The cap table also has an ESOP pool of 15% (more on what that is below). Which leaves the founders with 60% ownership after the investment round.

Founders get **common shares** while investors earn **preferred shares**. There are three main differences.

- Voting power: Common shareholders get to vote on important company decisions whereas preferred shareholders usually don't have voting rights.

- Dividends: Preferred shareholders get preference on liquidity when the company IPOs/exits. This means they get paid out before the common shareholders.

- Risk: Common shares are a bit riskier. If the company has to close down, founders will be the last to get any money back from what's left, whereas preferred shareholders may recoup some of their money.

Founders and employees earn shares by working for the startup, but their shares typically **vest** across four years. This means they don't get all the shares upfront when they start working at the company.

A typical vesting schedule is as follows:

- The employee earns 25% of their allocated equity after working for the company for 1 year
- Over the next 3 years, they earn the remaining 75% of their equity on a monthly basis.

Once a founder or an employee has vested some shares, that's technically just a right to exercise the option to buy those shares for a cheap price (in most cases). Once your shares have vested, you can exercise or buy your options – pay the cheap price to get your shares – at any time that you are still at the company.

Most people do not exercise their options as long as they are still at a company, because they want to wait and see as long as possible how the company is doing to decide whether or not to spend the money. People typically exercise their options when they leave the company, because once you leave the company, you typically forfeit any options that have vested that you haven't bought.

If the company is doing well, buying their vested shares is generally a good deal for the employee (especially early employees) because the price for each share is directly related to the valuation of the company at the time the employee joined. So an employee who joined a startup early could buy their fully-vested shares at, say $.05 per share, even if the current valuation of the company at that time is much higher.

Vesting prevents people who only stay with the company for a month or two from running away with tons of shares. Investors expect founders to have vesting in place for everyone. This includes advisors, whose shares typically vest over 1-2 years.

You might be wondering, "What if everyone stays on until their vesting schedule is complete and exercises all their options?" Then you'll have a **fully diluted cap table** where everyone who was allocated shares will indeed get all their shares.

If investors are investing on a SAFE, they technically do not own shares at that point. Remember the last chapter? Investors using SAFEs will have a ticket to claim the pizza later, but not actually own the slice in that present moment. So these investors will NOT be added to the cap table until their SAFEs/notes convert into actual shares.

This is another reason why founders don't realize how much of the pie everyone owns. There are investors who have invested money but aren't technically on the cap table yet. We recommend founders use Pulley (a plug for one of our portfolio companies), which makes cap tables super easy to understand even if someone invested through SAFEs.

When you raise money from investors, they will often ask you to create an **employee stock option pool (ESOP)**. This means setting aside some shares for your employees to incentivize them to stay longer and do great work. Investors typically expect founders to set aside 10% of the pie for ESOP but this percentage amount can be negotiated. 15 years ago, this percentage was typically 15-20%, and we may revert back to that if the markets get worse.

An ESOP can dilute the cap table faster than you might expect. For example, if you're being diluted down by 20% by the next round of investment AND you have to create a 10% option pool in the same transaction, you are actually being diluted down by 30%. If a departing team member doesn't use their vested options, the unvested and unused options will be forfeited and added back to the ESOP. But still, this is more dilution than most founders realize when they go to raise money.

Cap tables have been traditionally hard to organize just using spreadsheets, especially when you have many SAFEs and shareholders. It’s rare to see founders do accurate cap table math at each fundraising round. Even our team of VCs can miscalculate data.

This is why we recommend using a cap table management tool so you can have an accurate view on your current cap table, as well as compute different scenarios quickly and easily.

Be aware of the current market conditions

At the time of publishing this book, it’s the start of 2024. Fundraising right now is tough, especially for series A and beyond. The truth is that VCs aren’t investing as much in the later stages. Why the sudden change?

Well, there are a lot of factors.

1. VCs are having a harder time raising funds

Just like many startups, VCs have to raise money from their LPs (remember, an LP is someone who invests in a venture capital firm). Interest rates are high, and many LPs are opting to put their money into other assets like a savings account that earns interest there rather than invest in a VC fund.

This gives VCs less capital to work with, so they become more conservative with their cash. VCs will be extra selective about investing in new companies, or they'll focus more on reinvesting in and bolstering their existing portfolio companies.

2. Companies are valued less

If there are fewer investors (supply), there's more competition amongst startups to raise money (demand). This means investors can usually negotiate terms that are more beneficial for themselves rather than for founders. But it's not all sunshine and rainbows for investors, either.

Founders that do raise successfully tend to have lower valuations than in the last few years – when the market favored founders over investors. So a company that raised a pre-seed round at a relatively high valuation (say, $8M), is raising their seed-round at a relatively lower valuation (say, $10M). Some companies are having such a hard time raising, they might not see any increase in valuation from one round to the next. Or their valuation will actually go down.

When a company's valuation fails to increase, the VCs who invested at the earlier stages are left with a portfolio that's worth less than what they expected or planned for. A rough rule of thumb is that founders should aim to double their valuation every round.

But there is cash – this is not 2008

This section isn't intended to be all doom and gloom. The good news:

- Seed stage investors are less affected
- Deals are happening but all stages are just moving slower

The benefit of a less frothy market is that it forces you to think about how much cash you actually need. Elizabeth suggests thinking about your cash needs in two ways:

1. Stop the bleeding

Founders often say, *"I need to raise $2M."* Do you really? Probably not.

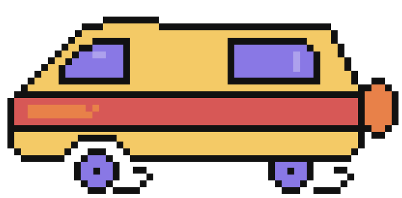
Instead, ask yourself: What is the minimum requirement to keep the company running? How can you reduce your burn rate? How can you cut expenses? Are there creative ways to generate revenue in the interim?

Remember: the Airbnb founders sold cereal boxes to keep the company alive in the early days.

2. Long-term planning

If you can stop the bleeding, then how much cash would help you with long-term planning? Think through your long-term vision, goals, metrics, product development, hiring, etc. How much capital would you need to hit those milestones?

Is the answer still $2M? Maybe. Or maybe it's a smaller number. You should aim to raise enough cash to cover both your short-term and long-term needs. However, if that's not possible, definitely prioritize the stop the bleeding strategy first.



Best times of the year to fundraise

When Eric was trying to raise money as a founder, he had no idea VCs were on vacation, like, all the time. VCs would auto-respond with OOO messages saying they're skiing in Jackson Hole. Or on a beach in Mykonos. Or "finding themselves" at Burning Man.

This might sound super weird if you're not from Silicon Valley. Why are VCs always on vacation? After lots of trial and error, we figured out the best time VCs are active to take meetings with founders.

Good: January – February

The first part of the year is a good window of time to start fundraising. However, there are a few important things to note:

- The first week of January is an extension of the end-of-year holidays. So if you raise in the new year, wait until the 2nd or 3rd week of January.
- Many VCs have kids in school who have mid-winter breaks in the middle of February. This is the perfect opportunity to take the family to Aspen or Jackson Hole for a mini ski vacation forcing them out of the office.

Best: March – May

Spring is the best time to fundraise. There aren't too many major holidays. The weather is amazing. Yeah, there's usually a spring break but most VCs are working.

It's normal for VCs to meet you in person outside at the Rosewood Hotel. Or take a walk with you somewhere on Sand Hill Road. Or grab coffee together at Coupa Cafe in Palo Alto. You know, Silicon Valley things.

Decent: June – July

School is out! VCs usually go on another vacation to spend time with family. But there is still some activity happening in both June and July. Besides the 4th of July holiday, VCs are fairly responsive.

All in all, the first half of the calendar year is a pretty good time to start the fundraising process.

Worst: August

August is the absolute worst time to raise money. VCs basically take the entire month off for summer vacation. They're somewhere in Ibiza, Mykonos, or Croatia enjoying the sunshine.

There's also Burning Man at the end of August. This is when VCs go off to the desert wearing ridiculous costumes and return after a week covered in dust. So you're probably not going to get any meetings with VCs in August.

Good: September – November

This is Eric's favorite window to fundraise. VC firms host annual meetings in the Fall to bring their LPs together and they also invite some of their portfolio founders to meet everyone.

Investors rush to do deals before the end of the year. There's great activity happening everywhere.

Bad: After Thanksgiving – December

In the United States, we have this major holiday called Thanksgiving. It happens every year on the 3rd Thursday of November. It's a pretty big deal. Schools are closed. No one really wants to work that week. But it turns out that the feeling of not working basically extends through the end of the year.

Of course, most VCs come back to work after Thanksgiving. But Eric has been in VC offices around this time. There's eggnog and snacks everywhere. Michael Buble's music is playing in the background. The energy is super low key.

VCs may take a few meetings here and there. But they're not doing that much. And VCs are off again for Christmas break until early January. Where the cycle starts all over again.

These are not hard-and-fast rules

We are speaking generally of the VC world. Getting a fast response from VCs depends a lot on the VCs themselves. The Hustle Fund team works year-round because we're young and hungry to make big things happen. Newer VCs are more like startups, so we're a bit different from other funds.

Outside of VCs, angel investors tend to be active year-round, too. Keep this tip in your back pocket if you're looking to close a round in a month when VCs are out of office.