Raise less money

A posthaven user yesterday

4-5 minutes

Over the last few years, I’ve noticed that good companies are increasingly over-diluting themselves in their seed and A rounds. Counterintuitively, dilution seems to rise along with price. One would expect the opposite correlation. Strong founders who command high prices should be using that higher price to sell less of their companies in exchange for money to grow. As I’ve tried to understand what’s going on, I’ve tried several arguments.

Somewhere in the last week, I’ve come to understand an error I’ve been making when talking to founders about how much money to raise. I realized that the conversation about raising always anchors back to the idea of adding “months of runway.” That always seemed appropriate to me because it was a measure of the amount of time a company had to stay alive. Staying alive seemed good since it increased the time a company had to find product market fit and to grow.

But I now realize that this is the wrong framing because simply staying alive is an inadequate goal for a company. Founders start companies to find product market fit and grow. Venture capital is designed to speed growth, not to extend runway.

As a result, in recent conversations, I’ve started to ask founders: “How much could you get done in the next 12 months with the amount of capital you are planning to raise? If you’re a good company, you’re either going to raise your Series A - or Series B - in the next 12 months or have significant revenue such that you won’t need more capital.[1] If you’re doing badly, why would you want to keep working on this for 24 or 36 months? That’s a waste of your time.”

Founders who raise too much capital are acting out of fear rather than acting out of confidence. This fear made sense ten years ago when seed financing was relatively scarce. This is when much of the fundraising advice I read as a founder was written. However, the world has changed and so should the advice

Financing is more accessible to good founders than it has ever been.[2] Confident, competent founders should take the risk of running out of money vs. the certainty of over-dilution.

Good founders respond to this framework as it shifts the argument from one in which “winning” is about adding months of runway to the bank to one in which “winning” is fast and high quality execution - as evidenced by hitting milestones. It’s also easy to draw a straight line from this framing to the best companies. When a company raises a Series A nine months after launch - or Demo Day - with 80% of its seed funds in the bank, it’s apparent that those founders sold too much.[3]

A founder’s decision on how much money to raise in any given round is more art than science. It is a fraught decision since it necessarily forces founders to make predictions about the future. There is no perfect answer, and over-optimizing around any single factor is a mistake. However, it seems clear that shifting the goal of fundraising from adding runway to progress would limit both the amount of money companies believe they need and the dilution that founders take in the process of building successful startups.

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[1] And if this is true, investors will chase you anyway.

[2] Even during COVID. I did not expect this to be true, however, this market is one of the most active I've ever seen.

[3] Seeing this dynamic on a regular basis while running YC's Series A program is what led me to realize my mistake. Without fail, the founders raising the most competitive rounds have the most capital left, and thereby the most unnecessary dilution.

Thank you to Daniel Gackle and Michael Seibel for your thoughts and edits.