Five myths of pre-seed investing – TechCrunch

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Pre-seed has risen in prominence in recent months due to the growing gap between what founders are seeking at the seed stage and what the market is offering, yet conversations around pre-seed come with preconceived notions and false assumptions about the companies and investors who care about early stage funding.

To break down these misconceptions, we've assembled a list of 5 common myths about pre-seed and share what's behind our passion for feeding the ideas of tomorrow's next great companies.

Myth 1. Pre-Seed Investors Invest in Ideas (and Little Else)

The term pre-seed investing brings to mind a simple transaction: the founder with a great resume has an idea, the investor writes a check, and it's no big deal if things don't work out because it's just an experiment.

The misconception is that because companies don't have traction data, pre-seed investors don't have much to investigate and thus can't evaluate deeply. This kind of zombie-like trade is far from reality.

Institutional pre-seed funds such as Afore believe that pre-seed is just like any other kind of investing, with risks inherent to its stage that can be successfully mitigated. Beyond assessing founder authenticity and market opportunity, we focus on two specific areas: product and distribution. We care about unique product insights and novel distribution approaches and want to know how both will work in the short-term. We'll learn about what experiments the founders have run to-date to validate their hypotheses, and we keep probing until we hear "I don't know." While pre-seeds may not have traction in data, there's plenty of traction in thought.

Myth 2. Pre-Seed Companies Couldn't Raise a Real Seed Round.

It's assumed that companies seeking pre-seed investment simply aren't good enough to raise a seed round, and must pare down their pitches and expectations in order to raise a smaller round. This misconception discourages investors from pre-seed opportunities, delivering the wrong message that there's adverse selection at play because the company knows it's not good enough to seek a bigger round.

Raising pre-seed funding helps build and distribute the product, providing early traction with the least amount of capital. Founders are increasingly realizing that seed investors do not write the first check—with most seed capital coming 2.4 years after a company's founding. Afore is part of a new class of pre-seed investors funding pre-product/market fit companies. Startups that lack product/market fit and the ability to scale aren't ready for seed capital.

These investors supplement the friends and family round, providing institutional capital previously available much later. Pre-seed founders should raise $500K because it's better than bootstrapping, and eliminates the potential for the high valuations and dilution inherent with raising large seed rounds.

Myth 3. Pre-Seed Investing is All About Creating Optionality.

Another myth is that backers in these earliest-stage companies are casual investors who don't actually know what they're doing or care about their investments. Similar to an option bet, the idea is that investors have little to lose by placing money across a multitude of opportunities.

No founder likes to be an option bet or should choose an investor who doesn't make them a priority. Funds like Afore are active investors exclusively focused on pre-seed who live and die by the success of their portfolios. Pre-seed investment isn't an option bet to preempt the seed or Series A; it's their bread and butter.

Pre-seed is a burgeoning segment comprised of deeply thoughtful, committed institutional investors that includes pre-seed capital firms like Bee Partners, K9, Pear, Precursor, Notation, Wonder, and many others. Further highlighting marketplace need, PitchBook and the National Venture Capital Association revealed that funding for companies of $1M or less is at its lowest point since 2011.

Myth 4. The Pre-Seed Category is a Fad.

Rumblings persist that pre-seed investing is a flash in the pan that will collapse into standard seed investing soon enough. This is an idea based on the inaccurate belief that pre-seed only cropped up due to a bullish investing market.

Pre-seed stage companies look very different from seed stage companies in that they don't have much traction, revenue, or product/market fit. And seed investors are uncomfortable with that level of risk. It's hard to invest in companies without traction or revenue when compared with companies that possess cohort analysis, accurate LTV/CAC ratios and a strong grasp of their sales funnel. In this apples-to-oranges comparison, seed investors cannot also invest in pre-seed.

Another factor is the increasing size of seed funds. As fund sizes scaled, seed investors were forced to write bigger checks, pushing seed rounds closer to $5M. Given that the Partner time does not scale with fund size (that is until Elon Musk invents the 30-hour day!), there is no easy way for seed funds to write pre-seed sized checks for $500K then dedicate the time and attention they deserve.

As long as institutional investors have the appetite, experience and ability to take the "first check risk" well ahead of product/market fit, there will always be a need for the pre-seed round.

Myth 5. Pre-Seed Funds Couldn't Raise a Real Fund.

Misconceptions about VC funds that focus on the pre-seed stage are also numerous. You may hear: pre-seed firms brand themselves that way because they can't raise larger funds; they'd actually like to raise seed and series A funding but haven't been successful; or it was never their true intention to invest in such early stage companies.

Experience tells us otherwise. Our peer GPs all saw the venture trends early as well as the emerging gap in early stage funding and, being entrepreneurs, they took advantage.