Elizabeth Yin

Tactical fundraising advice

When is the right time to approach a VC?

My friend Brian Wang posted an interesting topic on Twitter recently — when should you raise money?

Brian Wang
@brianmwang

One of the hardest questions many startup founders have to figure out is "When are we ready to raise money?" Kicking off the process before you even have a reasonable shot is a sure way to kill your company.

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Like everything else, we hear conflicting advice on when is the best time to start meeting with VCs. Some VCs say that you should start building relationships early. Others say that you should only pitch when you are at the right point in your business. What's a founder to do?

A few thoughts on this:

1) Founders are not treated equally

I'm just going to go ahead and call out this inequality — there are a lot of VCs who are looking to fund people with a particular background. Such as founders who are based in the Bay Area, who come from product or engineering backgrounds, and did really well at a great tech company like Google or Facebook (or now Uber / Pinterest / AirBnB et al), went to a particular school, and perhaps, is of a certain demographic in terms of gender and race. For these founders, a lot (not all) VCs want to start building relationships early so that when these founders hit upon a great idea, they can swoop in and fund the deal.

If you fall into this category, I would definitely meet with many VCs early and start building relationships and then continuing those relationships with the people you like. "Hey, I'm testing ideas in the area of problem X, and I would love to get to know you and see if this is a general area of interest." VCs will give you lots of time of day if you fit this profile.

If you do not fall into this category — and most of us do not –unfortunately, VCs will really only give you one shot on goal to get your pitch right, and so timing is everything.

(Note: I'm not saying this inequality is right — it's definitely not. But, this is the state of affairs and I think it's important to just address that plainly and openly.)

2) Know which VCs fund which stage

If you are in the latter category, it will be really important to do your research on which VCs are funding which stage (as well as obviously verticals / geography / etc). If you are in the post-seed / mango seed stage, then you should pitch investors who fund this stage. We at Hustle Fund, for example, would not be a good fit. (We do pre-seed.)

Seed is a huge range these days — know where in seed you are and where investors are investing and target your pitch to that stage of investor.

3) Get the timing right

Within each stage, it's important to get the timing of your pitch right. At a high level, all VCs want to invest in startups that:

- Have a strong direction
- Have positive momentum
- Have a clear set of milestones for funding

It's important to have all 3 of these components.

A) Strong direction

VCs want to see a strong direction. It shows leadership and a goal. Now, you might be thinking, who doesn't have a goal? Who doesn't have a direction? There are lots of reasons a startup may not have a strong direction at a given time. For example, if you are still deciding what to build. Or if you are mid-pivot — i.e. you were working on one thing before but are exploring a new thing, that's not a good time to raise. It's ok to be in either of these situations, but these are not good times to be meeting with VCs.

If you pivot, you need to test quickly and have conviction to go all in. This is especially hard, because usually when people pivot they already have some momentum on something else, so it's hard to want to abandon that past work completely in order to take the chance in going after a better opportunity.

Strong direction also means having a plan. You need to do A, B, and C. This is hard in running a startup, because it's never really clear what you should do. It's your job to find that clarity and run with it.

B) Positive momentum

Obviously, you want to have positive momentum as well. So, meeting VCs when you are on upward trajectory — e.g. posted your best traction-month ever. Or received a lot of press recently. Or made some key hires. Or onboarded a marquee customer brand. Or are shipping quickly. All of these things are times of positive momentum and good times to be meeting with investors.

On the flip side, if your revenue is decreasing / flatlined, or your unit economics are getting worse or you are getting bad reviews, these are all bad times to raise.

You also need to be having *significant* momentum. For example if you are surveying customers and then you start designing mockups for a prototype, that would be momentum but not significant.

Courtesy of Giphy

C) Clear milestones

The founders I speak with often don't have a clear set of milestones when they raise. I often hear founders say they are raising X for 18 months of runway. Investors aren't interested in funding runway. They want to know what you will achieve or are hoping to achieve with this amount of money. Obviously you may end up missing the mark — and that's ok, but at least have a clear plan of what you are going after with this amount of money.

You'll want to paint a story around, "I am raising X because I will use the money to do A, B, and C."

Applying this to pre-seed, seed, and post-seed stages

Let's apply all of this more concretely to the various stages of seed.

The three stages of seed these days is roughly: pre-seed, seed, and post-seed.

A) Pre-seed

For pre-seed, you need to have a clear direction and understanding of the problem you are solving. You need to have built a product at a minimum in many cases and in some cases, done some level of customer validation — ideally with real users or revenue traction. (If you are in a regulated industry such as health / fintech or are building hardware, this is less applicable but you still need to show that you've done something rather than just thought up the idea yesterday)

If you are still surveying people or doing customer discovery, you are probably too early to be meeting with investors. Momentum — you need to be shipping fast and getting new customers or leads each week. You should really feel like the ball is moving fast at this stage. I'll give you an example of what fast looks like at this stage — I chatted with a startup founder in November of last year. They were working on an idea I didn't find interesting, but the founders seemed impressive. I was very candid and said that I didn't have conviction on the problem they were working on but if they ended up pivoting, I wanted to take a look at the new idea. The team ended up pivoting in the next month — going all in on their new idea and built the product quickly, and by end of January, they had gotten 2000+ users already. That is what speed to pivot and momentum looks like — new idea, new product, and thousands of users within 2 months. I invested.

B) Seed

For seed, you definitely need to have direction and momentum already. At this stage, investors are typically looking for 30%+ MoM growth (the numbers are small so sometimes even higher). And at this stage, you are starting to form a growth story. This is still a scrappy stage, but you should be focused on painting a picture around how a business is built around your product. Milestones: Based on whatever unit economics you have, can you paint a picture around how you can put money into certain customer acquisition channels and get customers profitably? I would try to get this answer before you meet with investors — even if it's on a small scale, you need to show the path to how this becomes a big business assuming the channels continue to work (which they won't).

C) Post-seed

Definitely, by this point, you should be able to articulate what your current unit economics are and in which channels you acquire users / customers and show how if you take X in investment, you can pour it into those channels and turn it into a $2-$3m net revenue runrate business, which are roughly typical series A metrics for a software company. If you don't have that level of conviction or knowledge on how to do that, then you need to figure that out before you pitch.

Unit economics also matter a lot on customer acquisition spend — if you are wildly unprofitable, you need to figure out how to get closer to the break even point in acquisition. Maybe you need to upsell more to make your customers more valuable. You don't need to be profitable, but you need have a clear story to growth and profitability before you meet with VCs.

Caveats

As alluded to above, if you are in a regulated area (fintech / health) OR are in hardware / non-software OR ad-based revenue models, then your milestones will be different. But, at a high level, this is still how I would think about whether you have a good raise story before you meet with investors.

After all, unfortunately, most entrepreneurs only get one shot on goal.

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One thought on "When is the right time to approach a VC?"

John Saddington

August 1, 2019 at 12:30 am

Good stuff, per usual (although you're missing a Featured Image and it's not categorized… but, whatever).

But, i'm struggling a bit… here:

>After all, unfortunately, most entrepreneurs only get one shot on goal.

I'm having a hard time with the "one shot" idea because I think it over-emphasizes something that isn't really true, outside of a pitch contest or show like "Shark Tank" perhaps — the idea that you only, really, have "one shot" and, to Brian's tweet, if you don't kick off the process "at the right time" you'll "kill the company," which is also not true as a single, isolated pitch never actually killed any company, ever (running out of money kills a company, for instance).

Even when starting to build a relationship with you all I felt like I was "pitching" multiple times over a matter of months (at least informally), and when we did formally sit down and chat I didn't actually walk you through the real pitch deck as I had a context-heavy (i.e. custom tailored) preso as my alt.

Now, a really good question would be whether or not I kicked off the process at the right time… but honestly, I have no idea if I did it "right" or "wrong" — it just worked out (and I suppose that means i did it "right"?).

Where this post shines, imo, is in the pragmatics and decomposing the ideas of momentum and direction into something folks can use — good shit there!

This arcane witchcraft of raising venture could be easier if it was based solely on calculable business primitives but… sadly, it is not. While one side of the table fights for objective metrics, the other is being told to work on the "narrative" and is sweating over how to maximize the "6 emotional arcs of storytelling" and some other mumbo jumbo. And then, the table literally flips and we all do the same dance except we've changed spots.

I think this is why HF has a real shot at cutting all of that nonsense out of the game.