Sunstone Business School
Accelerate career. Get Promoted

Everything you need to know to get funded
- for beginners

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Preface

You may hate it or you may like it, but you can't ignore it. The major newspapers hit you every other day with news of very large investments being done in relatively small and new age companies. If you are an entrepreneur or a wanna-preneur you can't help but wonder. Are these businesses really worth it? What made investors put this large amount of money into this thing? And if you an existing entrepreneur, you can't help but compare your own business. My business is better! I even make profits, I have such fantastic products. These investors must be crazy!

Maybe you are right, but here is a little more info on how investors thing. What catches their interest? Is there a method to madness? And most importantly, can you be the beneficiary of this seemingly generous handout that is being given out every other day.

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About the Author

Rajul is Co-founder and Director of Sunstone Business School. Previously, Rajul co-founded GlobalLogic, sold for $420M in 2013 to Apax partners in the largest deal of the year in India. Rajul built the operations of GlobalLogic from ground up in India and then expanded through global acquisitions, until 2008. He also consulted with top tier venture capital firms such as Sequoia Capital and Aavishkaar, where he got exposed to the education sector. Fresh out of college, Rajul founded Pine Labs, a leader in the Indian market in credit card transactions. Rajul serves on several Boards, including publicly traded S Mobility, a leader in digital mobility. He is an active mentor to several start-ups, a sought after angel investor and a participant in several industry bodies such as TiE, NASSCOM, IIT Mentors and others. Rajul is a 1998 Computer Science graduate from IIT, Delhi.

Chapter 1: You have to be in an investible space

Raising early stage equity investments is always tricky. When you read the newspapers, it seems like everyone is being able to raise early investments, but when you go out to raise, it seems very hard. Only a very small percentage of ideas are able to raise sufficient early stage investments to be able to fund their business. It's important to understand how early stage equity investors look at a business. Not all good businesses are investible. And not all invested businesses turn out to be good businesses. Early stage investors are looking to solve to making a certain kind of investments that fetch them very large wins. This is to counter the risk of many of them failing as well. Lets look at what is an investible space from an investor's perspective.

1. Large market size: This is by far the most important. Operating in a large space does not guarantee your funding, but operating in a small space pretty much guarantees that you will not get interest. It's among the first check boxes that an investor looks at. Lets analyze it a little bit in more detail.

Firstly, what is market size? Here you see concepts like total market size, and addressable market size (TAM). For example if you are selling children's furniture online, then total market size would be the total volume of children's furniture sold today "online". Not online and offline, but online only. The addressable market size would be based on your category (premium, affordable etc.), your channels of reach (different portals etc.) and so on. So overall children's furniture market maybe say, Rs. 2,000 crore online and offline. Your market size if you are selling online might be 10%, say 200 Crore. If you are selling premium furniture, then your TAM might be 20% of this, which is 40 Crore.

In the above example, investors will say that if you are super successful, you may capture 20% of this market and hence your business in the best case may be a 8 Crore business. It may have a margin of 2 Crores.

This is good business, but it's not investible. It does not have enough size to find an exit or to provide the kind of return that equity investors are looking for. You are better off growing this business organically, use some debt maybe and get to a strong and profitable business.

A good investible business in India should have a TAM of $1B or more. Then investors can believe that over time, you can keep growing and build a business, which is hundred million or more, and hence have a sufficiently large return. Even if it takes a lot of capital and a lot of initial losses to get there, this is a more investible business vs. the small and beautiful business above.

This is why we see E-commerce platforms, Medical Platforms, Real estate platforms, Food etc. attracting large amounts of capital since the markets are very large.

There are many ways of doing market sizing for your business – top down, bottom up, competition, analyst reports and you should use these. However, the key is to be specific and not be too generic. For example, the healthcare space may be humongous but if you are selling a small product to doctors, you have to market size for that. Some times you may argue that I will do this and this more after 2 years, however unless there is a clear articulation of that and it's a natural extension, you have no real leverage to do that. It's a balancing act – you can't lean too heavily on future expansions at the same time you can't slice it too narrow.

2. It's an issue of timing – not too early, not too late: Its important to ask yourself – "Why now?" What has changed that enables your specific business to be done at the current moment. Usually you have to look at macro trends for this. MBA calls this "PEST" analysis. Political, Economical, Social and Technological factors.

The point is that human needs don't dramatically change.

Only they can be better / differently serviced over period of time. Our need to commute has always been there, now we have taxi cab aggregators to make it cheaper and convenient. Our need for education has always been there, now there are new ways to fulfill that online.

Hence, one has to look at what has changed in the environment that allows me to “now” scale my business model, something that couldn’t have been done 10 years back. Otherwise, somebody would have done it 10 years back.

For example, as more people have Internet access, Internet can be used as a disruptor to enable commerce. As more people have mobile phones, even niche mobile apps can reach lots of users enabling a large enough business model. So earlier doing an Internet based portal for a niche category was not scaled enough but now doing it on mobile enables a wider reach and large enough business is possible.

Increase in computing power is a change that now enables big data and deep analytics. It could not have been done 10 years back. Increase in digital spends makes marketing much more data driven as well, thereby providing another boost to the whole analytics industry.

A political change may lead to a party coming to power which is more business-friendly and make it possible to build govt.-centric businesses. There may be privatization of sectors opening opportunities or new bills being passed which makes it possible for new solutions to come up.

While many of us worry about being too late to market, in my experience, the bigger problem is being too early. The first time I heard of mobile-based field force automation, it was 2001. We are still waiting. Internet itself had a first coming in 2000 and then a second coming in 2009 and now a mobile driven 3rd coming.

Hopefully it's for real today. Online education is probably still early. Getting the market timing right is critical but very hard to achieve. Many businesses fail because they are unable to get this right.

3. Same-same but different – existing needs are easier to fund vs. new ones.

As I mentioned above, human needs don't change that much. Only they are better served. As entrepreneurs, many of want to innovate, however innovation is also a fine balance.

Investors want to see a market existing today for those needs. Ideally you should be displacing someone, competing with some other players and so on. If you are standing alone in your market, it's very hard to judge whether it will work or not. It's a major leap of faith.

So ideally you should be able to explain how a need was being earlier met, where was that money going and how yours is a better value proposition for the same spend. This is easy for investors to understand. This is why we see so much transaction commerce. Aggregation of existing spends. We are seeing this in cabs, retail, fashion, laundry, whatever you can think of. These are places where consumers are already spending and companies are providing them more value for their money.

All content products ultimately compete with media – TV, Newspaper etc. Hence they are called social media. They compete with TV time and hence are monetized by media spends. This is a very large category as well since marketing spends are huge.

B2B plays are always RoI driven. You look at existing spends, optimize them or you give businesses a way to get more customers. In India, there is a lot of activity right now to help SME's get more customers and we see a lot classified kind of businesses for the same. Large enterprises focus on systems and automation and that is always a play. Outsourcing etc. is a clear cost arbitrage play. Same services at a lower cost.

However, it's good to have some differentiation as well. My experience is that entrepreneurs try to differentiate too much and make a product for which there is no need. One can differentiate in many ways using product, business model, segment and so. One does not need to differentiate in everything. Pick 1-2 key differentiators that give you focus and you can execute on those. Same same but different.

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Chapter 2: You need to have a great team

Investors want to invest in large spaces with potential of large businesses being built. At an early stage, the business itself typically doesn't speak for itself. Hence, the fact that it's a good team takes gigantic proportions. I can't emphasize enough on how important this is for investors. Investors don't want to run the companies they invest in, they need the entrepreneurs to. This means that the entrepreneurs have to be the ultimate champion for the vision, raise further capital, build awesome teams, compete fiercely and basically just execute, execute and execute. All this is a big ask. What is the expectation a team is judged on and what are the attributes?

The expectations mainly are to execute. However, not just execute, but also execute at an unbelievable pace. Given the extremely competitive nature of the industry these days, most businesses come down to superior execution. And fast is considered to be superior. In this day and age of agile development, its all about iterating more and more number of times at an early stage. Your product may be quick and dirty in this iteration, but will get better with the next. In executing at pace, there will be some mistakes and there will be some in-efficiency, but things will get fixed also very quickly. As an investor, I have been amazed with how fast some founding teams execute. Apps and technology gets created in days and operations expand at a pace, which can only be called crazy. This one team grew from 3 people from 120 people in 3 months. The founders used to conduct 20 interviews each every day and built a fantastic team. On the other hand, some teams just crawl and take months to execute. They lose steam, run out of money and run out of time. When they make mistakes, they are very expensive since they run out of time to iterate one more time. This can easily be the difference between life and death of the venture.

So investors try to judge this super charged execution capability. Some of the attributes that teams are typically judged on are as follows:

1. Number of founders and the dynamic between them: No investor wants to invest in single founder companies. You may have seen some exceptions, but they are rare. It's just too hard for a single founder to build a company. How much can one person really do at a very early stage? There is usually too much to be done. 24 hours are not enough. It's also risky since there is no backup.

2-4 founders are usually good. 2 works, 3 are probably perfect and 4 works if the founders have a good relationship between them and the business is such. More number of co-founders means more people are convinced about an idea and there is greater bandwidth to execute. They can do much more within themselves.

Camaraderie between founders is also seen as very important. Hence, investors like founders who have some history. Maybe they studied together, have been friends or have been in the business for a year or more together. Maybe seem through a rough patch. All this tells investors that they are going to stick together. When times get rough, founders often fall apart and this is very disruptive for the company. Investors have had these experiences. Hence, it comforts them that the founding team has some history between them.

If there is a leader of the pack, a CEO, it's very useful. A CEO has to be picked eventually and if all founders are equal, it can be painful at a later date to elevate one. Egos get bruised and can de-motivate certain founders and put the business at risk. A leader also helps in consensus building when decisions need to be taken.

If the different founders can play different roles in the company, that's a big positive as well. For example, if one can handle technology, one can handle marketing and one can handle operations, you have great coverage of key functions right upfront.

2. The age factor – Youthful or experienced: Investors have experienced that younger founders execute faster. There are multiple reasons for this. Firstly, they are typically more energetic. They have the ability to work late into the night (or the morning) and get things done quicker. Secondly, they have less baggage and are more experimental in nature. They have a tendency of trying out things and go by data. They think less and do more. They make mistakes but learn quickly. Thirdly, younger founders can go longer, they have lower opportunity costs. They persist longer and eventually find a way. And fourthly, a lot of technology plays are targeted towards a younger demographic of consumers. Younger founders relate to this consumer set better.

Experienced founders gain an edge as the business grows. They have more management experience and are worldly-wise. However, at an early stage, a certain irrational exuberance is required, which younger founders have. If you are an experienced founder at an early stage, you have to carry an extra burden of proving to investors that you can unlearn, you can be free from baggage and you can execute just as fast. We see many US companies being successful with young founders and as they become bigger they hire professional CEOs. This has not yet caught up in India, however its only a matter of time before it does.

3. Tech vs. business founders: For the same execution reasons, investors have found that tech founders learn business / domain better than business founders learn technology. Business founders continue to struggle on technology for a long time. I have had more than 1 investor tell me that they would not invest in a team unless there is a strong tech founder in the team. Tech founders may make mistakes, but they will code all night, do more iteration and eventually inch ahead. Additionally, tech founders tend to solve operational and business problems using technology rather than operations, which is a more scalable solution.

Many founding teams ask me if it's okay to outsource their core technology. In real terms, it slows you down significantly. On one hand there would be teams that are producing gallons of code every night and a product release every few days. On the other hand if you outsource it, you will spend your days negotiating specs, prices and so on. For the outsourced vendor, you are just another customer; their life does not depend on you. At early stages, it slows you down significantly.

4. IIT or other premium degrees / appropriate company experience: This is one that hurts people a lot. I have heard number of founders say – we don't have one with IIT stamp and hence we are not getting attention. Unfortunately, their complaint is not without reason. I have seen more than a couple investors ask me about some of my investee companies if they have anyone from IIT. You can replace IIT of course with any other top name college or if you are from a top name company / celebrated startup company. The investor rationale is that firstly, these founders have proven an ability to work hard. Secondly they are expected to have a normal intellect at the very least and thirdly, they would have the network to build their teams later.

If you are from IIT though, it's not that you will get funding for sure. There are many other factors and they have to fall in place. You have an advantage, but its not enough to carry you over. There are plenty of unsuccessful entrepreneurs from top colleges around the world.

If you are not from a top college, you should know that there are scores of successful entrepreneurs who have not come from top colleges. Strategically, you have to try to motivate yourself in a positive manner rather than being bitter about it. You should basically focus on building a good business and build the networks and relationships to give you access to meetings. Many have done this before, so it is do-able.

5. Other factors: An investment process at an early stage at the end of the day is about liking people. It's like an interview process. It's hard to invest in a company if you don't like the team. Its not just physics, but also chemistry. Good founding teams hence invest in building relationships, not just with customers but also with prospective investors. They cast a wide net and cultivate these relationships ahead of time. It's nearly impossible to meet you one time and cut a cheque. They need to get to know you a bit.

Good founding teams also tend to find the balance between optimism and realism, between irrational exuberance and cold rational execution, between aspiration and pragmatism. It's a lot to ask, but it takes a lot to build business.

Chapter 3: Product Market fit and early signs of demand

Most entrepreneurs and investors will tell you that the biggest risk in any new venture is some thing called product market fit. Let me give you an analogy from the movies. However big the banner or however big the star, when a new movie releases on a Friday in theatres, that's where its acceptance in the market gets tested. That's the product market fit. Everything before that is theory.

Product-Market fit indicates the following:

- There is a need for such a product in the market by a certain Target Group (TG)
- This target group is able to discover the product and engage with the product. This may be through a direct sales channel, or through a marketing channel such as ad etc.
- The TG is taking a decision to try out this product and adopting it. Even paying for it.

The final test is that you are able to make money as well while doing all this, but that's my next chapter.

Product Market fit is simply that whatever product you have created, there is a real market for it, meaning there is a demand for that product. While this idea seems simple, but company after company after company is not able to achieve this simple thing to the satisfaction of investors.

Lets look at and assess some typical situations companies are in:

We have completed the development, all we need now is marketing: Only if I got a penny every time an entrepreneur said it to me! This statement or other variants of this statement - "We have that feature too!" OR "Our software is configurable – we can provide everything" is a sure shot red flag for investors. It indicates that you have never entered the market and never validated the product.

You may have spent a whole lot of engineering time but you have very little understanding of the market. You are not even at the beginning of the journey.

We are looking for a sales head to sell our product: Early product sales have to be done by the founders. It's very hard to believe that if founders are not able to sell, a professional sales person will. Professional sales people can scale the sales operations and bring that experience to the table. However, looking for a sales person right at the beginning again points to lack of validation and is a big red flag for investors.

There is no competition in our market: Investors look for better substitutes to existing products that are servicing existing needs. If you are the only product in your category, that is a scary proposition for investors since it points to un-validated need. It's much harder and takes much longer to create a new category from scratch and its very risky too. Ideally, as an entrepreneur you want to latch on to some existing need and serve it better. This would typically mean that there is some competition too and perhaps you can are focusing in a certain territory or demographic to establish your beachhead.

There are many ways how entrepreneurs demonstrate product-market fit. Lets look at some kinds of ventures:

In **consumer products**, adoption and usage are key metrics that prove product-market fit. A commonly used method to demonstrate product market fit is called cohort analysis. Early stage companies in consumer spaces live by their cohorts. For example, if you were doing a weekly cohort analysis, you would basically study the usage pattern of all new users acquired on a week to week basis and observe that over the following several weeks. An improvement in retention numbers would demonstrate that the product is going in the right direction and achieving better product-market fit. Deterioration in numbers or if most of the users stop coming back to the product after a few weeks, would show a week business. Investors ordinarily ask for cohort analysis while evaluating such a business.

In **enterprise software**, the best way is to have beta customers. I remember experienced entrepreneurs in the US, and they would only start building enterprise software once they had a beta customer. As an entrepreneur, you want to go on Day 1 with a PPT to sell and lock-in a customer. That ensures that you have product-market fit from Day 1. Traditionally people who had deep domain knowledge started these companies. So for example, you may be working in the collections department of a large Telco, you understand the need gap very well, you come out of that and start a company. But if you are coming from outside, there is very little chance that you will understand the needs well and hence its crucial that you sign-up early customers. They will sign up with you because firstly, you will give the product to them for very little cost, and secondly, it will be built to their specifications.

In **Cloud software**, these days the key metric is user adoption. Cloud software companies build simple key features instead of building large software and directly try to target users vs. going through an enterprise procurement process. Google Apps and LinkedIn have done this really well and now the newer companies such as Zenefits and Slack are doing the same. They seep into the user base with freemium offerings and then start selling. Even the more traditional Cloud companies such as SuccessFactors, WorkDay, SalesForce.com etc. have focused on 1 key function and incrementally built software over a period of time. A cohort analysis, just as in consumer markets, becomes very important too.

In **Services space**, such as IT services, healthcare, hotel, education etc. these tend to be more driven by execution. Most services have a clear need more driven by location more than anything else. For example, outsourcing has a clear need – staff augmentation / specialty skills and offshoring has a clear cost arbitrage need. When you combine the two, there is a significant value to the customers and hence the industry has become so big. Similarly other services such as health care and education are clear needs and play into existing spends.

In these businesses, the idea is to focus on execution. However, many of these businesses are not investible, since they do not have any leverage to scale. They have product market fit however they are not considered in an investible space, especially early on. As these businesses become big, they become more investible financially. This is more balance sheet and financial financing vs. risk financing. However, if you have a services idea at an early stage, it does not typically garner venture financing.

Product-market fit, combined with a large market size and the right timing is a fantastic combination and allow for rapid value creation, the kind venture investors are looking for. It's a hard thing to achieve and most entrepreneurs achieve it through constant experimentation and pivoting. Smart entrepreneurs are quick on their feet today and keep looking for true market validation vs. just falling in love with their own ideas. They engage with their potential customers early, learn from that and keep tweaking their products. This fitment and early demand goes a long way in getting investors interested.

Chapter 4: Business model is the second sign of traction

If you are in an investible space, IF you have a great team, and IF you have achieved some product market fit, the next question is – “Can you make money?” It’s useful to think of this question more consciously only after the first 3 questions are answered, however you have to have this question in the back of your mind all the time. Confused?

Every business has to ultimately make money. However, many entrepreneurs are forced to think too early about this. Especially when an entrepreneur is unable to raise external capital, they are forced to solve to making money too early even before they have achieved product market fit. This results in a growing orientation towards a more “custom”, service oriented model that rarely scales and ultimately the entrepreneur is not able to product-ify. This is a classic problem that I have seen many entrepreneurs face.

If you are able to raise capital, and you have a good chance if you have the team, space and product market fit right, then the business model follows next. There are many ways to measure the viability of a business model and many ways to make money from a product. It’s not something that is tightly linked with your product. It’s a pricing thing. It has an impact, but it’s also independent. In MBA-speak, there are 4 P’s. Product, Positioning, Pricing and Place (Distribution). The Product-Market fit is about getting the Product and Place right. Pricing is linked to getting the Economics right and Positioning is about getting the longer term strategy right, it has less of a role at the beginning.

The most traditional (and admittedly, the ultimate) way of measuring the success of a business model is the bottom line – net profit. In India, it’s called PAT (Profit After Tax) and in some other markets is called Net Profit. However, in entrepreneurship, net profit is not a good measure since its too early. One has to make a lot of investments in product creation, which have not been amortized over a large enough base. Hence, to understand the viability of a business model, you have to strip down the “scalable” part of the business and put the spotlight on that. Different businesses measure that in different ways. **Lets take some examples:**

IT Services businesses: The simplest unit that an IT service business is based on is 1 FTE (Full time engineer) or 1 person who you are billing for. If the billing rate of an average person > all the variable costs associated with a person, then the business is viable. The variable costs may take into account the costs associated with making this person do their job – for example, office costs, computer costs and any other overhead costs associated with it. If you have a decent spread between your rate and your costs, then it’s all about multiplying this unit. The more you multiply it, it will start consuming your fixed cost base, and over a period of time, your Net Profit will keep coming closer and closer to this spread. If you are at the scale of TCS with 300,000 engineers, there is very little difference between this spread and the Net Profit - mainly its tax.

The other key metric for such a business is your ability to sell efficiently. Given the competitive nature of the market and lack of differentiation, sales are difficult. One has to build relationships and cultivate a client over a period of time. Hence, the other key metric is sales productivity. So if your sales person costs $100 in fixed costs, is he / she able to sell enough to recover costs in margin over a reasonable period of time. The higher the sales efficiency, the better the business.

Hence, an early stage services business (Consulting, IT service etc.) can be measure on 2 key financial metrics:
- Gross Margin on Labor
- Sales efficiency

If these 2 metrics are good but the business is not profitable overall, it may still be a good business. Now we know that services businesses are not investible from a venture perspective, but they may attract other forms of patient capital.

E-commerce companies: Now this is a debatable space, which has attracted so much ink, especially in India. And so much capital too. The key metric that these companies observe is the CLTV (Customer Life time Value) on an acquired customer and keep studying cohorts over weeks, months and years. Now, CLTV is basically customer life time value measured as “Acquisition Cost” minus “Cumulative margin made on a customer over years”. So for example, say, you are Krishna. Lets say, an E-commerce company made you do a first transaction on their site by giving you a Rs. 1,000 coupon, i.e. their acquisition cost is Rs. 1,000. If over the following years, you bought enough goods from them to pay back this Rs. 1,000 in margins, then you are a viable and profitable customers. If they can prove that most of the customers they acquire become profitable over 1-2 years, they are a viable business. The problem may be that if they are growing very fast and acquiring a lot of customers, then the cash burn may be very high in early years and at a P&L level, they will look massively unprofitable. Investors believe that E-commerce is fundamentally viable over longer term as the existing customer base becomes larger than the new customers acquired every year. I am certain these metrics are closely watched.

Classified businesses: Lets look at a job listing site. Now, this is a little tricky since the money all comes from enterprises. You sell this database to enterprises and are making subscription money. However, the source of value is the fresh resumes that are on your website. If you look at incremental margin for the business, its close to 100%. To serve every new customer, you don’t need to incur any cost. However, to get every CV, you incur a cost – acquisition cost, branding cost etc. So source of revenue is from 1 side and cost is incurred on the other side.

I am not exactly sure what the correct metrics for this business are at an early stage, but if I had to venture a guess, it would be:

- Sales efficiency – How much revenue a sales person is able to generate by selling these databases to a corporate. A large amount of money would indicate a large value to me as an investor.

- Total CLTV to sales ratio: Basically take the total cost (since its not possible to take a per CV cost) of keeping the resume database fresh and see it as a ratio of margin made from the corporate customers. Compare these numbers to industry benchmarks.

Several other classifieds businesses in property, marriage, restaurants, and general services follow a similar trend.

Media / content businesses: There are businesses, which don't have any underlying transactions. All the social media is like this and these are some of the most valuable companies on the planet. All these media businesses basically compete with traditional media such as TV and newspapers and the key metric for these businesses is ad spend, which is directly proportional to time a consumer spends on these properties. So some of the key metrics these businesses use at an early stage are:
- Daily / Weekly Active Users (how many active users are there)
- Ratio of Daily to Monthly Active (how many of the active users are daily regulars)
- Time spent / week by average user.

These ratios can be compared with the same ratios for traditional media and one can gauge how valuable a business is. We have seen that ad dollars follow.

Retail businesses: These are businesses like hospitals, schools, shops, coffee chains and so on. They typically have a "store model" where you open certain kinds of stores, in a particular format and if it works, you keep on opening more and more. Over a period of time, you get brand leverage. In early stages, there are 2 key metrics these businesses are evaluated on

- Return on Asset (RoA): Imagine, it takes you Rs. 100 in setting up a new store in terms of capital expenses and working capital losses. At study state, what is the profit produced as a % of this initial investment by each of these stores. If it's Rs. 20, for example, then the RoA is 20% and so on.

As investors, one can compare RoAs across different kind of assets and chose how attractive a business is. If you are an entrepreneur in such a business, you may have to demonstrate attractive RoA for the first few stores before attracting investment.

- Same store growth: In store businesses, if you look at a specific store, and it keeps on reporting growth over years, then one can extrapolate that others stores will also follow a similar trend. Hence, same store growth is closely watched since it dramatically affects RoA as well.

We can keep going and there are several types of businesses and no framework can cover all such businesses. One has to look at each business individually and report the right kind of metrics.

As an early stage entrepreneur, one has to first identify the right kind of metric and then present it to the investors so that a more appropriate evaluation can be done. If the investor insist only on bottom line, that's probably not a good investor for an early stage company. Of course, ultimately, over time, all this starts reflecting in bottom line.

Positive key metrics influenced by the right business model can be a major confidence booster for investors and very likely to fetch you strong valuations.

Chapter 5: Funding is a continuous process - not a discrete event.

I have heard entrepreneurs say that we will do this or that post funding. Many believe that the round of funding they will raise will be the last they will ever raise. In my view, this is like saying that he next customer we will sell to will be the last we will sell to, or the next employee we will hire will be the last, or the next innovation we will do will be the last.

Raising capital for a business is not separate one-time function for any company. It's an ongoing process like all other processes such as sales, marketing, engineering, R&D and so on. Going public is just another large fund-raising process. Raising debt as a company becomes bigger another way of raising capital. Apple Computers, the most valuable company on the planet with over $600B in equity, and one of the most cash rich companies with over $100 billion in cash pile, has another $50B in debt. They continue to raise pile on cash, and they continue to re-finance and raise more debt.

In MBA-speak, there is something called WACC – "weighted average cost of capital". All businesses need capital and they have different ways of raising capital and they all come at different costs. The more risk you subject your investor to, the more expensive this capital is going to be for the business. Not surprisingly, early stage equity capital (angel, seed, venture etc.) is the most expensive form of capital you can ever raise. These guys are looking for 10X (or more) returns! However, you are also subjecting them to a lot of risk, and many of their investments die an early death. Hence, they look for very large returns on the ones that succeed so that as a portfolio, they can make a good return.

I want to make sure that I am conveying the right message, so I am not lamenting about the high cost nature of this kind of investment, just stating a fact.

It's absolutely fantastic as entrepreneurs that this option is available. Only because such capital is available, we have seen some outstanding innovations and companies become big. Google, Apple, Youtube, Cisco, WhatsApp to name a few. Imagine a world where such risk capital was not available, it would dramatically slow down the entrepreneurial eco-system. In fact, the dramatic growth in the entrepreneurial eco-system in the last 15 years can be attributed to the availability of this risk capital. Kids coming out of college in 1995 were no thinking of being entrepreneurs, today they are. Successful investors in this category deserve every success they get. You should also know that venture capital as an industry is filled with pain too. As a class of investment, over 80% venture funds don't even return par. Which means if they invest $100 in total in different companies, they return less than $100 in total. Of course, some investments and some funds have done exceedingly well over a period of time through their ability to gauge the market and pick winners.

As an entrepreneur, your job is to minimize your WACC over a period of time. At an early stage of business, you raise high-risk, high cost capital. As the business starts succeeding and risk reduces, you have the ability to raise lower cost capital both as equity and debt. As you become more and more stable as a business, you start re-financing your older liabilities and they all get cheaper and cheaper. You are always solving to a healthier balance sheet and a lower and lower WACC. Capital itself as a resource de-risks you more and more. Lets look more closely at some of the early forms of capital.

Seed Capital: As a new entrepreneur, you are at your riskiest at this point and hence raising seed capital gives you confidence and dramatically improves chances of success. Seed Capital in India can range from $10-20K to as much as $1M depending on the track record of the entrepreneur, the nature of the venture and so on. The source of this capital can be individuals, also known as "Angel Investors", or Incubators, usually run by individuals / corporations (Like GSF, T-Labs etc.) or Institutional Funds, like India Quotient, Seedfund, Blume and so on. There are also some collections of angels who invest together some times in a structured way, and sometimes in an informal way. For example, IAN (Indian Angel Network) is a structured format and so is Mumbai Angels, Hyderabad Angels and Chennai Angels. I think there is also something called Chandigarh Angels now.

The stage at which you can raise Seed Capital can vary a lot. In “hot” spaces, with solid teams, you can sometimes raise it very early. In other cases, you have to really demonstrate some traction, early signs of product market fit to raise this capital.

My guess is that over 500 such investments would have happened in India over 2015. A good friend of mine, a prolific investor, makes 8-10 such investments every year for the last 4-5 years. Lot of them are not even announced. Some of these are joined in by family offices, corporates, foreign individuals, family and friends.

For the 500 investments that must have gotten made, there must be at last 10-20x pitches so there must be 5,000-10,000 companies that would have made pitches in 2015.

Series A capital is usually the first large institutional round of capital that entrepreneurs raise. In India, it ranges from $1.5M – 5M. There are about a dozen funds which invest this kind of capital. On the more prolific side are funds like Sequoia capital, SAIF capital, Accel Partners etc. and then there are several others such as Nexus, Helion, Kalaari, Orios, Lightspeed and so on. There must be around 20 such funds who are making these investments at any point of time and my guess is that over 50 such investments would have happened in 2015. Some of these funds also make Seed investments in addition to Series A investments.

So if you do the math, my guess is that only 1 in 10 companies that raised Seed Investment would have raised Series A investment.

This does not mean that the rest would have failed. Some of them must have raised other forms of capital, some may not have needed capital, some of them may have gotten merged into other companies. My guess is that at least 50% of them would have shut down or will eventually shut down.

While there are always exceptions, Series A investors generally look for very solid product – market fit and some validation of business model / unit economics. Many times unit economics may not be favorable at the time of investment but its viewed that it will turn favorable at scale.

Growth Capital: As businesses look to scale, they look for growth capital and this is in form of Series B / Series C investments. Private investments these days can keep going for a long time driven by the large availability of capital. At this stage the businesses are expected to have a solid business model / unit economics and some may have even reached profitability as a business. The expectations of these investors as a return also reflect the lower risk in the business. These investors generally look for 25% IRR on their investments. May services companies which don't get interest at Seed and Series A level start getting interest here because of their interesting margins and continue abaility to grow at 20-30%.

My guess is that from the 50 that would have raised Series A investment, 15 would eventually go on to raise Growth Capital. Some would raise follow-on internal rounds, some would get acquired and there would be a few which would not make it. However the mortality rate post Series A is significantly less than pre-Series A.

The use of this capital is usually to capture market share. Your business model is proven out and you want to acquire as may customers as possible in as less time as possible. Elbow out any competition and establish a solid position.

Public Market Capital: Only 3-4 out of this set would eventually be expected to "go public", i.e. raise public money. This indicates that the business has reached a certain size. Many others will get acquired by larger players. This is a relatively newer phenomenon in India but well-established in more developed markets. A fertile acquisition eco-system is critical to the success of an entrepreneurial eco-system.

Very little mortality is expected at this stage, though there can be a few. This money is used many times to retire existing investors, provide liquidity to promoters and also for large scale market development.

Debt: They say that you can only really raise debt when you need it the least. You need a strong balance sheet, collaterals and what not. Thankfully, there is some innovation in debt now a well and companies are able to raise something called "Venture Debt" after Series A investments and it becomes more and more available after Series B and do on. As a company becomes bigger and bigger, debt becomes a serious option since it significantly brings down the WACC. Equity of any kind expects north of 20% as return while debt, even in India can go as low as 10%.

For entrepreneurs, at early stages of business, fund-raising is not just about funds, but also about validation. The way you constantly valid your products with customers, you also validate your business with investors. Investors get to take a look at a lot of different businesses and have some sense of businesses that are more likely to succeed. Of course, this also has a big problem that some entrepreneurs start "playing to the gallery", basically only work on stuff that investors are funding and stop applying their own mind.

So like everything else, there is also a balancing act here. Same same but different. You can't be too same but its also risky to be too different. You have to heed to the sensibilities of the market but you also have to apply the first principles to make sure you solving real needs. Did I ever say that entrepreneurship was easy?

Afterword

The investment market is always topical. It changes with changing times. This book is a result of my own experiments with entrepreneurship and investments. 2015 has been a heavy investment year for me, with 9 new investments. Whether its through entrepreneurship, or through investing or as a deep advisor, I have been involved now closely with over 20 businesses over the last 10 years.

If this text has been useful for you, I would encourage you to learn more. Entrepreneurship is a fascinating topic and has lessons not just for startups, but also for professionals and even life lessons for everyone. Every story, whether its that of stupendous success or abject failure has lessons in it. If you are a fan on the movies, every entrepreneurship attempt is like a movie. Some stories of the underdogs producing massive successes and sometimes the mighty fall.

If you are an entrepreneur or a wanna-preneur, I hope this book can serve as a mirror to you – as how investors would view your business. Sometimes it's a useful view, sometimes distracting. Make your own call, the way entrepreneurs do!