Venture capitalists have a lot of secrets, including what types of companies they like to invest in, which entrepreneurs they like the best over the other ones, which partner they like better than the other ones. The biggest secret they have of all is the reserves. Believe it or not, when a venture capitalist invests in your company they're actually planning for a lot more.

Clint: What are reserves?

Jason: Reserves are the amount of money that we budget for future investments for our companies. Just because I invested $5 million in your company in the series A financing, don't believe for a second that's all I'm planning to do. Even if you're like "That's all the money we're ever going to raise." It never happens that way.

When we commit to a company we secretly on a piece of paper in our back office that only a few of us know say, "By the way, we put in five today but we're going to reserve $3 million to $8 million in the future to fund these companies because companies will take more money."

Clint: Is this something that's important for me as an entrepreneur to be thinking about when I'm picking my VC?

Jason: We'll very rarely tell you what the reserves are. Although, if anybody has ever asked me I've been pretty honest with them about what the number is. At Foundry Group we tell people, "We can vest up to $10 million pretty easily and between $10 million and $15 million you have to be doing very well." Simple math says ten minus whatever we have invested means we generally have that in reserves.

It is a good idea as an entrepreneur to ask your VC, especially if you have a selection of a couple, "Hey, how do you do reserves? How have you done?" If you mismanage reserves it can be absolutely cataclysmic for the venture capital firm.

Think of this. This happened in the dot com blowup. Companies that everybody was expecting to go public, to liquidate, to have a good acquisition; the markets crashed and suddenly there were all these companies that needed more money. Very few venture capital firms had reserved enough money in their portfolio and suddenly had to pick and choose between the companies they wanted to fund or not.

You had cases where half the portfolio was completely stranded without money. They had no reserves scheduled. They were cherry picking or trying to pick the favorites. Sometimes they picked right. Sometimes they picked wrong.

Managing reserves is an art not a science. We never know how much money is going to be needed. It really takes some luck but a lot of experience in doing this. What you try to do as VC is not try to really manage reserves on an individual company so much as a giant portfolio with some rough ideas that you want for a company.

At Foundry, we get together every quarter. We discuss them. Knock on wood, so far we've been very close over the 13 years we've been together as a group.

Clint: When I'm talking to a venture capitalist as an entrepreneur and I say, "I need this much money." How important is it for me to set expectations about how much additional money I'm going to need?

Jason: I think it's very important. I think if you don't agree with the venture capitalist on how your business is going to grow over the next three, four, or five years then that is an inherent problem. Part of this reserve analysis gets implicitly brought out in those discussions. I'm going raise $5 million today. We're going to run for another 24 months. If things go well we'll raise some more money then. It could between X and Y. Of course, we know these are all guesses and they may not be very accurate. It is important to have that discussion as soon as possible.

Clint: Questions?

Student: Does that mean that you'll sometimes not invest the whole fund because the numbers worked where you had too much in reserve? Maybe you'll invest $215 and not $225. Is that how that happens?

Clint: Technically, the answer is yes. What it means is you'll never invest the exact amount. If I had $100 million fund, I'm either not going to invest $100 million or I'm going to invest a little more and have to get permission from my investors to do so. I've never seen anybody actually line it up perfectly. Usually, you're within 5% or 10%, if you're good.

There are cases, as Brad talked about recycling. Think about how acute this problem can be. A $100 million fund, he talked about $15 million going into management fees. You only have $85 million to invest. If you've reserved on $100 million fund and you don't at least recycle back

$15 million, even you could have had the best reserved plan in the world and you're still $15 million short.

By the way, there are funds, including some well-known funds, that had to make the decision "Am I taking management fees to pay myself salary or am I going to take this money and put it in reserve for the company?" What do you think they did? It depended if they thought they were going to raise a new fund or not.

A lot of these firms were like, "You know what? We're out of business. We're going to take all the money and use it as management fees and we're not going to be able to support all of our companies." It gets very complicated.