High Resolution Fundraising

September 2010The reason startups have been using   
more convertible notes in angel  
rounds is that they make deals close faster. By making it easier  
for startups to give different prices to different investors, they  
help them break the sort of deadlock that happens when investors  
all wait to see who else is going to invest.By far the biggest influence on investors' opinions of a startup  
is the opinion of other investors. There are very, very few who  
simply decide for themselves. Any startup founder can tell you the  
most common question they hear from investors is not about the  
founders or the product, but "who else is investing?"That tends to produce deadlocks. Raising an old-fashioned   
fixed-size equity round can take weeks, because all the angels sit around  
waiting for the others to commit, like competitors in a bicycle  
sprint who deliberately ride slowly at the start so they can follow  
whoever breaks first.Convertible notes let startups beat such deadlocks by rewarding  
investors willing to move first with lower (effective) valuations.  
Which they deserve because they're taking more risk. It's much  
safer to invest in a startup Ron Conway has already invested in;  
someone who comes after him should pay a higher price.The reason convertible notes allow more flexibility in price is  
that valuation caps aren't actual valuations, and notes are cheap  
and easy to do. So you can do high-resolution fundraising: if you  
wanted you could have a separate note with a different cap for each  
investor.That cap need not simply rise monotonically. A startup could   
also give better deals to investors they expected to help  
them most. The point is simply that different investors,   
whether because of the help they offer or their willingness to  
commit, have different values for  
startups, and their terms should reflect that.Different terms for different investors is  
clearly the way of the future. Markets always evolve toward higher  
resolution. You may not need to use convertible notes to do it.  
With sufficiently lightweight standardized equity terms (and some  
changes in investors' and lawyers' expectations about equity rounds)  
you might be able to do the same thing with equity instead of debt.  
Either would be fine with startups, so long as they can easily  
change their valuation.Deadlocks weren't the only problem with fixed-size equity rounds.  
Another was that startups had to decide in advance how much to  
raise. I think it's a mistake for a startup to fix upon a specific  
number. If investors are easily convinced, the startup should raise more  
now, and if investors are skeptical, the startup should take a  
smaller amount and use that to get the company to the point where  
it's more convincing.It's just not reasonable to expect startups to pick an optimal round  
size in advance, because that depends on the reactions of investors,  
and those are impossible to predict.Fixed-size, multi-investor angel rounds are such a bad idea for  
startups that one wonders why things were ever done that way. One  
possibility is that this custom reflects the way investors like to  
collude when they can get away with it. But I think the actual  
explanation is less sinister. I think angels (and their lawyers)  
organized rounds this way in unthinking imitation of VC series A  
rounds. In a series A, a fixed-size equity round with a lead makes  
sense, because there is usually just one big investor, who is  
unequivocally the lead. Fixed-size series A rounds already are  
high res. But the more investors you have in a round, the less  
sense it makes for everyone to get the same price.The most interesting question here may be what high res fundraising  
will do to the world of investors. Bolder investors will now get  
rewarded with lower prices. But more important, in a  
hits-driven business, is that they'll be able to get into the deals  
they want. Whereas the "who else is investing?" type of investors  
will not only pay higher prices, but may not be able to get into  
the best deals at all.Thanks to Immad Akhund, Sam Altman, John Bautista, Pete Koomen,   
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