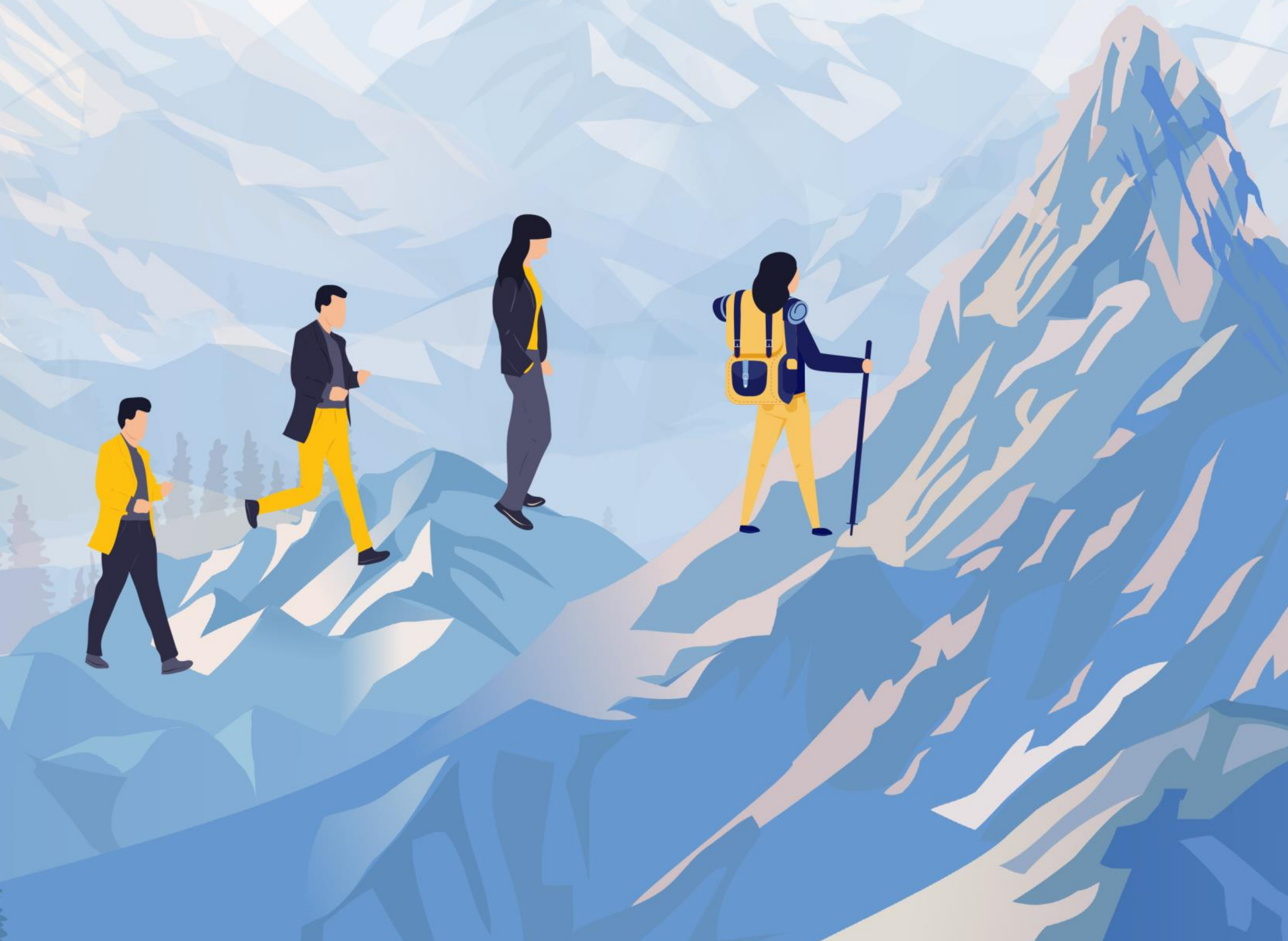
Venture Finance 101
Basic Masterclass
User Book



Welcome, and congratulations for taking the first step on your journey to investment readiness.

If you are a tech founder, CEO, or somebody focused on innovation, science and technology and you've raised less than $1 million, you know that raising capital isn't that easy. And because you're probably pre-revenue, you also know that if you don't raise it, you're not going to get where you want to go. So it's important that you understand how to navigate through this – that you have that foundational knowledge to help you get the best terms and conditions from the best and most suitable investors. That's what you're going to learn in this course.

This course is structured as an introductory level survey in which you're going to learn the essentials of what you need to know to get the money you need to go where you want to go, including:

- The foundational building blocks of venture finance
- How to get your house in order
- Creating a compelling offer
- Investing in successful sales and marketing

UNIT 1: FOUNDATIONAL KNOWLEDGE

What we're going to do in this unit is go through the basic tools in the toolkit when thinking about the corporate form of an organization, a company – whether it's incorporated in the US or whether it's incorporated in other jurisdictions. There are some common types of securities and instruments that can be used to help finance a company.

1. Common securities and instruments

1.1. Common stock

This is the most basic option. It's called common stock in the US or ordinary shares or voting shares in Europe. It's the basic thing that's issued to founders and to, say, friends and family when you're trying to raise money.

1.2. Convertible debt

The next type of instrument that is frequently used, starting about 20-25 years ago and continuing to the present, is something called convertible debt or convertible notes. This, as its name suggests, is truly debt but it converts at a later date into equity.

1.3. SAFE notes

Some people decided, "Hey maybe we come up with something that's like convertible debt but isn't debt." And so clever lawyers, of course, came up with a new kind of security, the SAFE note or the safe agreement: Simple Agreement for Future Equity. It's not convertible debt; it's not common stock; it's a simple agreement for future equity. And then there are different versions of that.

1.4. The KISS

The accelerators over Silicon Valley came up with a different version of the SAFE note which is called the KISS or the Keep it Simple Security. And that has two different versions: an equity version or a debt version. These are important because the idea here is that you'd be able to raise money without spending a ton on lawyers.

The standardization of the documents means that both the investors and others in the community who want to know "What is it?" see that there is some common language around what this instrument is.

1.5. The SAFT

More recently, with the advent of ICOs and STOs, there's an agreement called a SAFT, which is a Simple Agreement for Future Tokens.

1.6. The Series Seed

The idea here is that you simplify the traditional form of a venture capital financing with a set of open-source documents that everybody can download and presumably you don't need to spend as much time or money on lawyers. The Series Seed is one that is frequently used and versions of it exist in other jurisdictions besides the United States.

The innovation ecosystem and the legal system in the US, in many cases, is setting the trend and coming up with these sorts of instruments but it's important to understand every jurisdiction has its own laws. Those forms cannot just be duplicated – they need to be actually modified and localized.

1.7. Preferred stock

To stick with the traditional ways, there's also preferred stock. As its name suggests, preferred stock is a preference over the common stock. This doesn't mean that it's necessarily better; it just means that in certain circumstances, the preferred stock gets paid out first and that can be really useful for a variety of reasons when you're accepting money from third-party investors. The preferred stock can be convertible into common stock and we can get into how that's structured and why a bit later.

1.8. Revenue-backed notes

It's important to understand that there are other ways that you can do it. You could try and maybe give somebody, what is effectively a royalty in your future revenue and those are called Revenue Backed Notes. So instead of giving somebody ownership, you basically say, "Hey, if you give me some capital, I will pay you back as a percentage of future revenue." Maybe up to a certain amount, maybe 5x, and then you can eliminate that debt instrument.

1.9. Venture debt

There are ways to buy equipment. A lot of fast growth companies can't get financing from a traditional bank, and that's not because banks are bad; it's because banks have lending criteria and a lot of these companies don't meet those criteria in a highly regulated environment. As a result, special-purpose types of bank or non-banks, or financial institutions, will essentially loan money for different kinds of equipment. And because those debts are riskier, they frequently come with some kind of an equity kicker such as a warrant or similar. This is called venture debt or venture leasing.

1.10. Tokenomics

1.10.1 Initial Coin Offering - ICO

When you think about the toolkit and that how the toolkit has been evolving, we may have hit an inflection point in the last couple years in that there is a new way to engage in venture finance. It's based on a business model – blockchain and tokenization – and it started to become quite popular around 2015/16/17 as the ICO model, which is now largely dead. But it rose and fell and it was a massive boom-and-bust cycle up through about the latter half of 2018. Over $20 billion was raised through the end of 2018.

I first heard about this when I was working at an innovation center down in Australia and people were saying, "Hey Brad, you should check out this ICO." I was like, "ICO, what is it?" And when it was described to me, I was like, "It sounds a lot like getting a gift certificate to buy pet food at pets.com before pets.com has even built a website."

These tokens were saying, "Here's my white paper which is just a description of this great thing that I'm going to do, and if you back my project we're going to give you this token or coin. And that coin is going to allow you to participate. Maybe it gives you a discount on future pet food purchases or maybe it gives you access to a network that has certain features which might actually, by the way, be a really good project, but we haven't actually built it yet. And so we want you to give the money now, and then later when we build it you'll have these rights."

It's pretty innovative and a lot of money was raised – like I said over $20 billion. But unfortunately, a lot of the projects haven't materialized. There have been a lot of scams. People didn't do what they said they were going to do in many cases. Turns out the governance models often weren't that great, so what happened was, as you would expect, there was a kickback from the regulators all over the world.

In the United States, they said these look like securities, and you need to comply with securities laws. And you don't solve the securities problem by just incorporating in Gibraltar or Malta or Switzerland or Liechtenstein because the securities laws which are based in whatever country the investor resides dictate what you've got to do. Those securities laws unfortunately are not harmonized at this point so it's pretty hard to do a one size fits all. It can be quite complicated.

1.1o.2 Security Token Offering - STO

Having said that, it's a big deal. This new breed of STOs are exciting from my perspective and will unlock illiquid assets. Actually, this is revolutionary and it will change the world. You will be able to open up and unlock and basically securitize or tokenize all sorts of things.

Could you do an IPO of your house? If you live in Lithuania, can you own real estate in London by simply investing in some kind of real estate token? I think you could. What about art? Let's say you want to own and sell and trade art or maybe you want a fractional interest in a piece of art. Could you own a Monet? You could, absolutely.

These security tokens are going to unleash a lot of illiquid assets and it's important to recognize that this is a new way for companies to try and raise money. It's exciting and it's probably the most innovative period over the last two-three years and over the coming three or four that I've ever seen – and maybe in world history.

2. Key Economic Terms and Conditions

2.1. Liquidation preference

There are different ways that an investor and a founder or entrepreneur can allocate things that matter to them. There are ways you can control the economics, depending on how concerned you are about control, creative control, and how to make sure that people get the benefit of the bargain.

In a traditional sort of professional angel or venture-capital backed deal, there's something called a liquidation preference. What the liquidation preference says is that one class of security, namely the cash investor, has a preference in connection with a liquidity event –
a sale the company for example – to get their money back first.
Now, you might think, "Well that's not fair – why should the vulture capitalist pig get their money back first when all the real value has been created by the entrepreneur?" It has some intellectual appeal, except in a circumstance where maybe the entrepreneur didn't create any value.
Think about an entrepreneur who raised, say, $5 million and sold 50% or 20% of the company. And then, after using the money, the company's sold for $5 million. So the investor, in the best-case scenario, is going to get a zero return.

Why didn't the company create value? You could come up with a lot of different reasons, but the economic bargain that was struck at the beginning was, "Hey, you (the entrepreneur), and your team told me that you were going to take the five million and create something that's more valuable and it didn't happen."

That's how liquidation preferences come into play. It's just a way of making sure that the investors essentially get their money back first before everybody else gets to participate in the gain – the value creation.

2.2. Pay to play

This is a way for different investors to encourage other investors to play along. It's a tool that essentially says, "Look, if, at a future date, the company needs additional financing and you don't pay your *pro rata* share, then you're going to lose some of the preferences that you had previously negotiated."
It punishes those investors who refuse to continue to support the company in the future and it really exists among the investors as opposed to between the company and the investors.

2.3. (Reverse) vesting

In addition to reverse vesting on shares that are already outstanding, there's obviously vesting on equity incentives so stock options people are familiar with that. It's another way to ensure that you get the benefit of the bargain.

Another thing that you will see commonly is reverse vesting on founder stock. Everybody knows that starting a company is hard and it takes time, and frequently people who are involved in it go through a lot of pain and suffering. Sometimes, for a variety of reasons, one or more of the co-founders decides to leave. Maybe they've got to get a job. Maybe, for whatever reason, their spouse wants them to move to a foreign country.

The bottom line if that happens is that the founder didn't earn the equity. There are periods – in Silicon Valley it's typically four years – that if somebody leaves with or without cause for whatever reason, it's not uncommon that a portion of those shares will be repurchased at cost. And because the cost is low at the beginning of the company's formation, basically they have to give some of that back.
Is it fair?
If you have to go out and find somebody else to do the job, and get them as motivated, you don't want to pay twice for the same thing.

2.4. Equity

In Silicon Valley (and in other places that are trying to build a tech community), it's very common to have a stock option or equity compensation pool. That pool needs to be big enough to attract, retain and motivate people from now through some time period. That is essentially an economic thing because it impacts the value of the company in terms of the price per stock.

2.5. Anti-dilution

Another thing that you'll see in these deals is something called anti-dilution. That is a mathematical formula which asks, “Okay, if we're buying shares at a dollar a share and later the company sells shares for 50 cents a share, then what happens?

Does everybody share equally in that pain? Or, because it looks like the earlier investors might have paid more than they should have (in this case 50 cents more), is there a way to re-price that earlier round?

That's called the anti-dilution adjustment. It's very common and there are lots of good arguments why that does make sense.

3. Key Control Terms and Conditions

3.1. Protective provision

Everybody who has ever been in a relationship knows that there are certain issues regarding control: who's going to do the grocery shopping, what you're going to cook, where you're going on vacation. Those are important things.

In the corporate context, the relationship between the investor and the entrepreneur also impacts the control: the creative control and the financial control over where the company's going to go.

On one hand, the investor wants to give the entrepreneur the liberty to do what he or she thinks needs to be done. On the other hand, how crazy can they get with your money?

There are different ways you can do it, and you can do it by putting contractual restrictions on what they can't do, unless they get your consent. Those are called **protective provisions**.

3.2. Board of directors

Alternatively, you can do it through the board of directors.

Here, I'm giving perspective of somebody who's lived in many countries. Corporate governance in the United States has a board of directors which has control over hiring and firing the CEO, issuing new securities – basically general policy making. You will typically see that the CEO is almost always on that board of directors.

In other countries, in Scandinavia for example, you typically see boards of directors split between management boards and non-management boards. Down in Australia, there's different corporate governance.

Being on a board not only gives you rights, it also gives you fiduciary responsibilities. As a result, you need to ask yourself if you want to be on the board and how much they've got to pay you to be on the board. But, ultimately, being on that board of directors is important.

Entrepreneurs who are worried that they're going to lose creative control will fight hard not to lose control of that board. This control can also impact the economics. An example:

Imagine a situation where you agree that the founders need to have reverse vesting for four years. How do you get rid of a non-performing founder? Well, since the board gets to hire and fire the CEO, and the CEO typically gets to hire and fire everyone beneath him or her, it could be that two years into the journey the CEO gets fired by the board. Then they are not only out of a job, but they've also given up some of the economics. These are important things and they work in unison.

3.3.The drag-along

Another important element of the control feature is something called a drag along. It sounds like you're forcing somebody to do something they don't want to do and it comes into play when somebody wants to sell the company.

When you sell the company, that's a liquidity event for some but others might not be in favor of it for strategic reasons. They may say, "Hey, look, why would we sell the company now just when things are getting good? We should go and try and turn this into a $1 billion enterprise or a $10 billion enterprise" Or maybe it's 100 million. You're not at that goal yet.

Others may have a completely different view. They might say, "Hey this is a fair deal. We should get out now." And so the question is: can you force people to do it?

A drag-along provision is an important one, especially for investors that maybe didn't sign up for a 20-year commitment. If it turns out in the future that there is an opportunity to exit the investment, than they can force those who might not otherwise vote in favor to do it.

4. Other Negotiable Terms and Conditions

Other terms and conditions that are often a part of venture or seed-stage funding include:

4.1. Dividends

Will there be any dividends and if so how much and who gets to declare?

4.2. Redemption rights

Can you force the company to redeem your stock at some point in time?

4.3. Conditions Precedent to Financing (Including Milestones) / Drip financing

Conditions on future financings include drip financing. It’s where you just continue to drip money into the company on an ongoing basis. Is there some kind of milestone where maybe you have to provide the financing? Those are milestone based or drip financing.

In venture finance the idea – frequently over in America – is: give them a big chunk of change, let the dogs loose, and see what happens. That's not necessarily the case in other jurisdictions. Living in Europe, I find it's not uncommon to do more of what I guess I'd call drip financing. In other words: “We'll give you X to get to Y and if you get to Y we'll give you another round.”

Basically, you're doing periodic financings based on the achievement of milestones. That's something that can be negotiated.

4.4. Information rights

What have you got to do to keep your investors informed? Is it once a month, once a quarter, once a year? What kind of information are you going to give them? Are you going to give them financial information and audited financials? Those can be negotiated.

4.5. Registration rights

Another feature that you will see in venture financing is a vestige of an earlier era, where the idea of doing liquidity event through an IPO seemed like a pretty realistic possibility.

Registration rights consider what rights you have to force the company to include your shares in the registration statement if the company goes public. This is that is less important than it used to be because it takes so much longer to go public and fewer companies do it.

4.6. Right of first refusal

If the company is selling securities at a later date, do you have some right of first refusal to participate? In some states that's called pre-emptive rights, but it can be contractually negotiated and called the right of first refusal.

4.7. Voting rights

This is a little like drag-along rights, but the question is: do you have, for example, the right to vote one for one, or does some class have special voting rights and do you have agreements with different shareholders to vote in a certain way? These are negotiable.

4.8. Restrictions on Sales

If you want to sell your securities how do you do so? Do you have to offer it first to the company or to the other shareholders?

A co-sale agreement asks if you do sell to a third party does anyone else get to tag along on that?

4.9. Proprietary information and inventions assignment

This is very important especially within tech companies to make sure that the company does in fact own all the IP that it thinks it owns. It can be a deal-killer if it's not cleaned up. A recent example:

I was approached as a potential angel in a deal where the founders had something that they thought was really valuable. They had applied for patent protection on it and they were out pitching to try and get people to invest in the company.

When the due diligence started and the question arose, "Has everybody signed a proprietary information and inventions assignment agreement?" the answer was no. Which meant effectively the company didn't own anything. It was just a shell.

The founder said, "Well, I'm not going to do that until I know that the company's got at least a million bucks in the bank, because otherwise, hey, we could lose the IP."

For anyone who's thinking about being part of that first $999,000, you would effectively be investing in nothing, so that's a problem.

These proprietary information inventions assignment agreements need to be well drafted and they need to be actually signed.

4.10. Co-Sale Agreement

Another negotiable aspect can be restrictions on the sale to third parties. If somebody does negotiate a sale to a third party, can you tag along? Can you get some liquidity?

These are usually highly illiquid. How long you have to keep your money in the company is an important consideration and sometimes there's a desire to get partially liquid on it and maybe just keep a little house money on the table but take the original investment off.

4.11. IPO Shares Agreement

Co-sale agreements are a way to do that. And for those companies that do go public, there are ways to participate in the IPO. That can be a sweetheart deal if and when it pops up, and those kinds of things do sometimes matter more in late-stage financings.

4.12. Founder’s Activities

Is the founder full-time or part-time? Are they allowed to engage in other activities? Things that might compete with the company or otherwise distract them? That's a negotiable item.

Obviously investors like people who are fully committed. It's a hard job to be an entrepreneur, and it's probably not a 40-hour a week job.

4.13. Indemnification

We mentioned a board of directors. If you do agree to serve on the board, do you get some kind of an indemnification for your service in the case of a third-party lawsuit? That could be important.

4.14. No-shop agreement

In terms of traditional venture finance or seed finance, it’s worth mentioning the no-shop agreement.

Within a term sheet, just as the company can't shop it around third parties, the investor can't assign their right to a third party. When you have this agreement, it's important to know who you're dealing with and it's typically not allowed to take your signed term sheet and flip it to some other investor because that would be a different relationship.

5. Sweat Equity

This is when you do your very best. You put in your blood, sweat and tears to build something in order to create value. For those who are fortunate enough to be part of the founding group, that's great because they get in at the very first stage and so theoretically they benefit the most. But what about others who want to join your team at a later stage.

5.1. Stock Options

My experience is starting out on the West Coast of the US and this is huge. This is the way the big tech companies: the Googles, the Microsofts, the Facebooks were able to attract the very best and brightest people. And if you were fortunate enough to be on that ride, you got rich. That's the truth. Even if you were the cook.

The sad thing for me is, having lived in other countries, it's not as easy. Those West Coast- style incentive stock option plans don't always work in other jurisdictions.

Some big companies in Denmark learned out the hard way that they didn't work. And when I was living down in Australia 2014-2017 this was a huge issue. The share compensation scheme that the Australian Government had, in effect, made it really expensive and hard not just for the company but for the recipient, so it was kind of sad.

But if you are interested in that – basically compensating people without paying them cash – you're giving them a share on the upside.

These are really important issues. If you don’t get them right, it can be a nightmare. A nightmare situation would be where somebody grants you, for example, a stock option, in a company and let's say you earned it. You spent four or five years at the company and you helped them get to this event where the company is worth a lot more and your shares, theoretically, are worth a lot more, but now if you want to exercise those shares, you have to come up with a huge cash amount in order to pay the tax bill. So what you may decide to do is not exercise it and walk away, and it's kind of sad because people don't get the benefit of the bargain.

Among the various ways that you can compensate people through equity is using, as I mentioned, stock options – restricted stock, phantom stock – which really is just giving them the value without actually issuing any kind of security.

5.2. Restricted & Phantom Stocks

Restricted stock is one that I like because at least in some jurisdictions like the United States, if you grant restricted stock you get the benefit of starting the clock for capital gains purposes. And if there's a big difference between the tax rates between ordinary income and capital gain, then that's a pretty big deal.

If you don't get it right – again just sticking with the US – and if you fail to file what's known as an 83(b) election within 30 days, that can be a tax nightmare. Because now the shares that are issued to you are taxable income and every time there's a vesting event, you have more income. And so it just gets worse and worse and worse. Frankly, it can lead to bankruptcy and you didn't even get any value out of it.

Can you unwind it? Can you unring the bell? The bottom line is: it can be complicated. It can be great and lots of people have gotten really wealthy and shared almost a socialist vision. If you're a part of this value creation and you participate in it, it's a great thing. But if you get it wrong, it's a nightmare.

5.3. Securities, Tax and Employment Laws

I lived in Denmark for four years and it's the world's happiest country. My kids loved it. We enjoyed living there. But there is something about it that to me is a little strange.

Even though it is a socialist nation they have certain laws that don't allow and don't motivate or incentivize companies to grant stock options. So let's say you happen to be working for one of Denmark's greatest companies Novo Nordisk. Do you get to participate in the value creation of Novo Nordisk? And the answer is really no.

They pay well and they have very generous compensation schemes, but one of those is not stock options. So had Novo Nordisk been maybe a Silicon Valley based company, you would probably have tens of thousands of millionaires who made money by participating in Novo Nordisk growth over the last 15 years.

Instead what you have are very well-paid, happy people, but they didn't participate and the ones who gained by Novo Nordisk's wealth creation are the owners, which is a foundation, and Novo A/S, and public shareholders.

So it's ironic to me that a nation that is sort of socialist has put in place things that don't really give the people who are part of the team the opportunity to share in a socialist sort of way. Unlike the US, which obviously is more capitalist.

If you do happen to be part of the Facebook or the Google or the Microsoft story then you do benefit. All boats do rise with that rising tide.

5.4. Labor laws

As a securities lawyer and just as an entrepreneur, I’m interested in labor laws. There are some companies that thought that they could just employ a one-size-fits-all strategy by having an omnibus plan that's sort of a US-style plan and then using that and they were granting options to employees who were resident in Denmark.

In Denmark, when somebody is terminated mid-year, there's a concept under the labor laws that you're entitled to a *pro rata* portion of the bonuses that you earned during that year, and that's just the way the law works, which is great. It's very pro-worker.

The question in this case was that the stock option plan said unless you were employed as of a certain date you didn't vest. So litigation looked at the question of whether under Danish law you get a portion of the options that you "earned" even though you didn't hit the vesting date. And the big companies said, "No. This is obvious – no."

But that's not what the court ruled. Actually I know the lawyer who argued the case. He was very proud of it.

And so they won the battle in the sense that this particular individual was entitled to the vesting of his *pro rata* percentage, but, I would argue, lost the war because now the companies are like, "Great we'll solve that problem by just not granting options."

So if you don't understand the local laws and regulations, you're not going to be able to just come in with a one-size-fits-all. And a lot of companies, big companies, sophisticated companies, have learned that the hard way.

6. Unit summary

In this first unit, we’ve looked at the Periodic Elements of the Venture Finance Table.
These are the basic building blocks that any company, your company, could use to help you get access to third-party financing to grow your business.

However, the foundational knowledge alone isn't going to get you there.
The next step is Unit 2: What it takes to Get Your House in Order.

UNIT 2: HOUSE IN ORDER

As the founder, CEO or leader, owner of an innovation startup that hasn't yet raised at least $1 million in capital, you may not have gone through a due diligence process yet. The good news is there's probably not that much to clean up.

But if you're going to get access to capital from more sophisticated investors, sooner or later you will have to go through some kind of a due diligence process. That's what we are going to look at in this unit.

1. Does your story and appearance align with reality?

What do I mean by "Getting Your House in Order?"

Well, imagine you're trying to sell your house. Would you have the kitchen clean? Any dirty dishes? Got dirty laundry laying around? If the person's really interested in buying your house, they might be interested in knowing if you've got any skeletons in the closet or maybe you've got ghosts in the attic, or God forbid, you have any bodies buried in the backyard.

I'm serious – it's not a laughing matter. If somebody's serious about buying your house, they'll be looking for these sorts of things to see whether it's a good investment or whether they need to walk away. And that's what having your house in order is really all about.

It reminds me of *The Wizard of Oz*, one of my favorite movies growing up. You've got this great vision of Oz and people want to come and learn from the Wizard. And the Wizard makes a lot of noise. He's a good pitch person. But when you really look behind the curtain, what's there? That's what it means to get your house in order.

1.1. Investors in Europe

Getting your house in order in Europe is a little more complicated in my experience than it is, for example, in the United States – in part, because Europe is just more complicated. There are a lot of different countries. Each one has its own tax, regulatory, different languages.

Accordingly, there are opportunities to get creative and the big companies, the big tech companies, have taken advantage of it. But entrepreneurs can do it, too. Maybe you live in one country and you decide you want to incorporate in another, and maybe that didn't work out the way you liked. So you end up incorporating another entity in the third jurisdiction, or even a fourth, which is all well and good, if a little messy.

When it comes to financing, investors want to know what they're investing in. Where are the assets? So a kind of shell game can occur. It’s like cleaning your garage. It's something that a lot of people avoid doing until they have to do it.

When you start raising money, you need to represent exactly what it is that you're selling. And if you're selling a security in this company, you can say what this company has and you don't make false representations such as, "Oh yeah, we're doing something over here and sooner or later we'll get it over here." Those kinds of things are deal killers.

I've seen it happen a lot in Europe. I think Europe's very creative. And Google, Microsoft, Facebook and those guys have figured it out, too. So we can talk about why cleaning this mess up is important.

1.2. What is due diligence?

A worst-case scenario is when somebody really puts you through the ringer and does what's called a full-scale due diligence on your company. And by the way, this actually happens if you do get a real institutional investor such as a venture capitalist. They actually do organize a full-scale due diligence.

When you understand how that due diligence process works, then you can ask yourself whether or not your company would be able to withstand that kind of a process and come out smelling like a rose.

So first of all, what is due diligence? It's a term that goes back to the US Securities Act of 1933. The question is what level of care broker-dealers – the people who help market (sell) securities to the public – need to give in company statements in order to avoid liability for securities fraud.

The term became known as due diligence and today due diligence is used in a lot of different contexts but fundamentally within the concept of venture finance. It's about doing your homework.

So before you enter into a deal, what kind of homework do you have to do to make sure that the appearance is in fact aligned with reality? That there is alignment of the words and the pitch with the substance and the truth about the company? What do you need to be concerned about?

From an investor's perspective, there are three different kinds of due diligence: market diligence, business diligence legal diligence.

1.3. Market Diligence

In a nutshell, market diligence is just looking at how big the market is.What's the total addressable market? Assuming that this company does succeed and gets to the top of the mountain, are we talking about a small mountain or are we talking about Mount Everest?

It's also about the competitive landscape. Who else is trying to do the same thing?

1.4. Business diligence

This is really about character references. So if you were to say "We have happy customers and investors," in the due diligence process are probably going to want to talk to them and ask, "Are you, in fact, happy? Will you do more business?"

What about background checks on the founders, the officers and directors? Are there any problems there? Bankruptcies, criminal proceedings, those sorts of things.

1.5. Legal diligence

On the legal side there's a very long list of things that you would look at. Does the company essentially know who owns all of the capital stock?Have there been any promises made to people that maybe haven't been documented? It could have to do with ownership of the company.

Has everybody signed all the appropriate agreements that they should have signed? Does the company, in fact, own the IP that it says that it owns?

Those are the kinds of things you cover in the legal due diligence.

In the venture finance context, due diligence would look like: there's a term sheet that gets agreed but it is subject to satisfactory completion of due diligence.

Remember, however, that if you go through an audit, you'll probably find something that needs to be fixed. It really depends on what needs to be fixed. If it turns out that there are structural problems with the company, it could result in very expensive, extremely expensive, legal fees and other fees associated with trying to correct those past mistakes.

It kind of reminds me of an air filter commercial from when I was a kid. There is a company called FRAM, and their basic pitch was, "You can pay me now or pay me later." (Essentially, the sooner you clean up any mess, the easier and cheaper it will be to fix. The longer you wait to clean it up, the more expensive and harder it is to fix.)

And that's why getting your house in order is super important.

If it turns out that there are problems that can't be fixed, consequences could range from something like, "Hey, you need to send me more information – no big deal," to a very expensive process of trying to fix it. Or just a busted deal.

If it turns out that the company isn't what everyone thought it was, obviously the investors are either going to substantially renegotiate the terms or frankly they're more likely to just walk away.

1.6. What documents do you need?

In terms of the amount of due diligence that may or may not be requested, it’s really a question of who the prospective investor is. Different types of investors are going to want different kinds of assurances. It's not one size fits all. The deeper you go into the sophistication level, the more likely it is that you'll have to undergo a more thorough investigation.

I can say that in my experience the ones who will typically ask for the most information are the most sophisticated equity or debt investors. We're talking about the corporate charter, possibly copies of all of the board and shareholder meetings, agreements among shareholders, the by-laws, and making sure of the intellectual property.

Has everybody signed the proprietary information and inventions assignment agreement? Do we have signed non-disclosure agreements with everyone we should? Have all the employees and contractors entered into the appropriate agreements? Have we made the appropriate patent and copyright filings and registrations?

Other things would include whether management and employees have everything documented? Are there any promises that haven't been documented? Does the company have long-term commitments like real estate leases?

The form in which these due diligence requests are typically made can be a long-form due diligence document request. That's how it would be done in a venture financing.

With angels, the due diligence might be quite a bit less. It could be just a real subset of that. And frankly with certain kinds of investors who are investing more in the relationship they have with the founder, such as friends and family or fools, they might not even do any due diligence.

But remember: if you can get your house in order now, it'll be easier and cheaper. Or you can wait and try and fix it later.

UNIT 3: CREATE YOUR OFFER

In this unit, we're going to look at the 10 most common profiles of people that you could get access to and think about how you can start to create one or more compelling offers to help you get to this next stage in your growth.

1. First Who, Then What

Creating a compelling offer is the fun part. It requires some creativity.

One of my favorite authors, Jim Collins, wrote the book *Good to Great* and in it he did some research. The conclusion was: "Who first, then what."

It's just like trying to build a great company. First you need to assemble the team: who first. Then you figure out where you're going to go with that team.

I would argue that in venture finance, you should keep that in mind when you think about who you want to raise the money from. You need to think about what's in it for them: why would they want to part with their money to help you achieve your dream?

It's important to recognize that although money is theoretically a fungible commodity, it's not true that all money is equal. Actually, some money comes with value-add, some money comes with strings attached.

As you think about where you're going to get money and about the strategic value and how you're going to convince that person or entity to share it with you, that's the first question: the who.

So what we're going to do is look at some of the more common types of investors. We're going to review the different profiles of investors that typically provide funding in the venture finance space. Think of it like a jungle. Which of those species, which animals, which beasts are we going to focus on? Then you try and structure a deal that we know a particular type of investor wants to participate in.

It's hard to sell somebody something that they don't want.

2. The most common Profiles of Venture Finance Investors

2.1. 3F`s: Friends, family, fools

Everyone knows that when you're starting a business, the people who love you the most may think it is a crazy idea and may try and convince you not to do it initially. Once they get over it, they may say, “Okay, actually I do support you.”

Friends, family and ‘fools’ are typically first outside capital source. ‘Fools’ would be people who, for whatever reason, want to throw money in at this early stage but aren't really professional investors.

And all of these have one thing in common: they're essentially supporting the entrepreneur because they like the entrepreneur. They're supporting the entrepreneur because maybe they love the entrepreneur personally – has a relationship with him or her.

This money tends to be the least sophisticated in general.

2.2. Crowdfunding

Equity-based crowdfunding is now legal in many countries. And/or debt. So you could do equity or debt. And those are the four buckets for crowdfunding, putting aside STOs and ICOs which are a separate category.

2.3. Business Accelerators

Other parts of the ecosystem that have become pretty big are business accelerators and business incubators. Some people say that the difference is that an incubator is like incubating a little baby, whereas an accelerator is like a rocket ship. In my view the difference is that an accelerator typically is part of a cohort, a program – maybe it's 90 or 120 days – and it comes with a host of services: mentorship, a little bit of capital (20,000-150,000 among the most generous ones). Some of that, by the way, could be in convertible debt or something similar.

2.4. Business Incubators

An incubator is more of an ongoing commitment. Maybe there's no defined beginning and end. You come in on a rolling basis and those incubators can provide a range of support, cash and non-cash support. Sometimes they have shared services. Usually, incubators don't take an equity interest. But they are important players for early-stage companies in the ecosystem.

2.5. Angel investors

The next step is professional angel investors. These are individuals investing their own capital. It's not institutional money; it's personal money. Typically, they get involved in the pre-seed, seed, or even maybe early VC money.

2.6. Super angels

Professional angels are motivated by a number of factors, one is just pure economic return: they are investing money with the hope of a return on investment, but also because they think it's fun, it's interesting, it's an ability to sort of stay involved with entrepreneurship. In fact, most business angels are successful entrepreneurs themselves and they like that.

There's a different breed – the super angel–who takes it to a different level. A super angel is also not a micro VC and not an institutional investor. It's somebody that just can operate at a higher level. Usually they are capable of writing bigger checks. They can lead deals, and as leaders not only can they negotiate the terms and conditions, they frequently have a following of other angels because the super angels are perceived to be the super smart ones. The ones that follow are the sheep angels, who say, "Hey, if so-and-so is in the deal, I know they are smart and savvy so I'll follow along."

2.7. Micro-Venture Capital Firms

Micro VCs are a sort of a hybrid. They're actually structured like a regular VC in that it's institutional money, not their money. They're investing on behalf of limited partners.They may in the past have been like a super angel but now they want to move it up a little bit.

These micro VCs have become quite common globally. Usually it's a VC fund that has $50M and maybe up to $100M. They're operating in the early-stage market but they're an important player.

Within the local ecosystem, it's important that these micro VCs survive and thrive because they are the ones who can add additional capital on top of angel capital. They're also important to the extent that the global VC funds who want to venture into new markets feel more comfortable if there's a micro VC who's got boots on the ground and who can help them manage the investment.

2.8. Traditional Venture Capital Firms

With the rise of the micro VC, the traditional VC has moved further up the capital structure so that you're looking at more Series A and beyond. These traditional VCs, again, are institutional money – management fee, carried interest. They're investing other people's money and they're essentially a fund manager.

In partnership with both micro VCs and angels (particularly super angels), more and more of these traditional VCs are more comfortable operating beyond their home base. So you're starting to see more international deals getting done with a sort of a partnership between traditional VC players providing growth capital and maybe some of the other players that are providing the seed capital.

In the current market, companies that don't already have product/market fit and aren't already at a point where they're legitimately growing on a proven business model are pretty unlikely to be interesting to the VCs.

2.9. Corporate Innovation and Corporate VC Funds

Another important player in the innovation ecosystem and with possibilities for access to venture finance or non-cash or non-equity based support is corporate VCs or corporate innovation. Corporations know that there is potentially a start-up somewhere that's going to make them irrelevant, and so corporations want to be part of the ecosystem for strategic reasons more than financial reasons.

Accordingly, they sometimes set up innovation challenges where they'll put up some prize money for companies that want to come up with innovative ways for new products, new ideas or new collaborations. It could be that the corporation has some kind of an accelerator or a corporate accelerator.

It could also be that the corporation has a VC fund. I was living down in Australia and I remember when innovation became the new black. All the banks decided, "Oh well, we do corporate VC. Yeah, we've got a 50 million dollar fund."

These are important players that can be extremely valuable. On the other hand, it can present dangers if not structured correctly.

2.10. Venture Debt and Venture Lending

For companies that have serious venture funding, or at least seed funding, there are not traditional banks but maybe non-bank financial sources that will provide what's called venture debt.

In the US, there are actually a couple or three banks that do this but I would say it's more of a non-bank bank financing and it includes upside. It's a great way to extend your runway to finance equipment and capital goods, that kind of thing.

2.11. Innovation Finance

Tokens

The most interesting and most innovative form of venture finance over the last three or four years is clearly tokens.

Tokens started out a long time ago. I guess it would now beyond the 10th anniversary of Bitcoin. A lot of people think of Bitcoin as, "Oh yeah I've heard of ICOs. I've heard of crypto assets." And Bitcoin clearly is a coin. It's a token. But it was just the beginning.

Bitcoin may go to zero, who knows? But it doesn't really matter because that's like saying, well, Altavista, one of the first search engines, failed. But it's not like all search engines will fail.

ICO's and STOs

In this token space there was a bit of a mania from 2015 through the summer of 2018. I think over 20 billion dollars was raised in ICOs. The ICO is just an initial coin offering, and the idea behind it is that this coin is a token that gives the holder access to some benefit. It may be, "With this coin you can get access to cloud storage or you can get access to some other utility." It's a little bit like airline points or gift cards.

Those coin offerings were conducted in ways that were, in retrospect, fraudulent in many cases. The securities regulators don't like that. Securities regulators are generally trying to protect investors from making stupid decisions – and, like I said, over 20 billion dollars was invested in it. Maybe not 20 billion dollars of value was created.

Having said that, it is an important innovation. In the current market, the new black is STOs: the security token offering. A security token is really a token that's backed by some kind of an asset. It could be a hard asset. It could be a shares certificate. It could be art. It could be real estate. There's really no end to things that could be tokenized, but in the case of a security token, it need not have any utility other than the fact that it represents an investment. It could have a utility but it doesn't have to have a utility.

My prediction is we're going to see a lot of companies using this STO method to attract risk capital and venture finance.

3. Creating a compelling offer

3.1. What it is the compelling offer?

It’s my view – and it's been my experience – that you need to create a compelling offer that targets your specific investor. It's not a 'one size fits all.'

If you decide, for example, that you want to focus on corporate VC because you think the corporate VC can get you access to channels and customers that you couldn't get in some other way, then you create an offer that appeals to the corporate VC's interest. That may not include equity. It may be they don't care about equity because they don't know even where to put it on their balance sheet.

On the other hand, if you're going to try and convince your Uncle Joe that he should invest $100,000 in your business, you might not need to invest too much in creating an interesting offer because maybe Uncle Joe just loves you and he's going to give you the money anyway.

If you lean towards, say, a seed fund, if it's a real VC, keep in mind they're managing other people's money. You do have to be prepared to go through some kind of a diligence process and give them the kind of security that they would want, which in this case would be at least a series seed offer.

So you've got the type of security, which is important, but you also have the valuation. I mean if you go to somebody and you're pre-revenue, and you say, "Hey, we're looking for a million dollars and we're going to give up 5% of the company," my guess is that not many people are going to find that very interesting. Who knows?

You could be a great salesperson. But if you've got some real traction, a product/market fit, the offer might not be ridiculous.

When I say compelling offer, I mean not only do you have to create the kind of security that those investors want, but you also have to structure it in a way that the valuation is reasonable, or in the ballpark.

If different people have different views on this, are you supposed to take the lead in creating the offer and presenting it? "Hey here's the offer; take it or leave it?" Or are you supposed to be passive and say, "Well, I don't know – you're the expert, why don't you give me an offer?"

In my experience, you need to be respectful of the investor and put yourself in their shoes. If it's an investor that's in the business of negotiating and valuing companies, then obviously they want to have some discretion and they want to take the lead in making that first definitive offer.

If it's somebody that really isn't in the business like friends, family, and fools, they're not really in the business. You're putting a lot of pressure on them to come up with an offer.

The harder you make it for them to say yes, the less likely it is that you'll get a yes, which is kind of intuitive, right? But I find that a lot of entrepreneurs have a tough time coming up with any kind of a compelling offer that's actionable within a reasonable time period. You probably need a lawyer – a securities lawyer – who can help you make sure that your offer makes sense before you present it.

3.2. Getting it wrong

Over the last 18 months, I've looked at over 1,000 deals. I'm a curious, open-minded person. I'd like to think I'm easy to talk to. And in that time period I've been asked to be part of the investor group in many different ventures.

I'll give you an example of something that for me, as an angel investor, is not compelling. It's when an entrepreneur says: "Hey, do you want to invest in my deal?"

That's not good enough.

I'm like, "Well, what is the deal? Do you have a term sheet?" No. “So how do I even know what it is?”

I've had people come and visit me where I live in Basel, Switzerland. They take a train, a three-hour train ride, and they come to me and say "Hey, would you be an investor?" And I'm curious and open-minded and I listen to the story.

I ask, "Well, what is the offer? What's the deal?"

And they answer: “Well, you're the professional; you should make me the offer.”

I say, "Well, really, I mean you want me to do the homework? Is there anything we can look at? Do you have a lawyer?"

Not yet.

"Well, I'm not saying no but I'm not saying yes, so why don't you get back to me?"

I have seen this person several times since then. I've had emails, "Hey do you want to invest in the deal?" My reply is the same: "What's the deal? What's the offer?" I ran into this person in Davos. He was up on stage pitching this great vision . . . and still no offer.

That is putting the burden on me as the investor, that I'm supposed to come up with the offer. That's really not fair. If I really wanted to do the deal, I suppose I could do the homework, but keep in mind there's also due diligence.

Somebody who's trying to get angel investors needs to do the work on the front end, not just get the house in order, but actually create an offer that's reasonable. If you go shop your offer and your offer is unreasonable – something like "Oh, I'm pre-revenue. I'm trying to raise a million bucks and I'm selling 5% of the company" – my guess is that people will probably not jump at that offer.

Is this real or are you just out there fishing? Because a fishing expedition when you don't have your house in order and you don't have something that's actionable is likely to be a bad day of fishing. It could go on for months. A good offer does require
you to be organized and to have something that's actionable.

3.3. Getting it right

Whatever it is that you're doing, figure out whether your offer is in the ballpark of what similar companies at a similar stage are doing and then go to people who finance those kinds of ventures and present them with something that's actionable.

When you're done with the meeting, the lunch or the pitch or whatever, if somebody says they're interested in your company, what have you got to give them? Can you back it up with a term sheet, with a subscription agreement? Do you have a due diligence locker that people can look at to make sure you have your house in order?

Let's look at which deals I have invested in. Last year, I did eight.

In each case the company was well-organized, had a due diligence locker and already had the legal agreements in place. And at that point, honestly, all I had to do was get comfortable, sign the subscription agreement, and wire the money.

That's a good offer, that's a compelling offer. That is what you've got to do. I'm not saying that you don't need to negotiate as well. Different types of investors may want to negotiate – venture capital firms in particular might want to control the negotiation. But that's what a compelling offer is. You need to figure out what the deal terms are.

With these corporate VC things, they probably don't know what exactly they want to get out of it. They just have some person assigned to run the program who may have no prior experience in innovation or a venture, but they're creative. They want to get some value. In those cases, who knows what you need to do to be able to get value out of it?

Those kinds of deals are typically set by the corporation and then you just need to comply. Some of those are great opportunities.

In summary, creating a compelling offer is really about empathy. It's about putting yourself in somebody else's shoes and saying, “How can I make it easy for them to say yes to work with me?”

Depending on who is on the other side, depending on the profile of that investor, it may mean you need more than one offer because it may be that you're talking to more than one profile.

Somebody who's really organized needs to think with empathy and create an offer that enables the other side to get to yes quickly.

UNIT 4 – MARKETING YOUR OFFER

So you have the foundational knowledge, your house in order and you know how to create a compelling offer. You also know that there needs to be a sales and marketing strategy in order to maximize the likelihood of success.

In this unit, we're going to focus on fishing where the fish are, and helping you get the fish that you want into your boat.

1. The essential toolkit

1.1. Minimum viable finance offer

What will you need in order to effectively present yourself to the market? It is my hypothesis that you would be well served to have a minimum viable finance offer: something that you're comfortable with, something you believe is reasonable and in the ballpark as a talking point.

1.2. One pager

You definitely are going to need to have the basic marketing materials, which include the one-pager. The one-pager sometimes is two pages, which I know is weird, but everybody calls it the one-pager.

1.3. Powerpoint pitch deck

You are going to need a PowerPoint pitch deck, preferably 10, no more than, say, 15 slides that you can present in fewer than 20 minutes – preferably 10-15 minutes if you really need to power through.

1.4. Three paragraph written synopsis

You should have a three-paragraph written synopsis that you can use to tee up the meeting with an email.

1.5. Professionally made video

You should also have a video, three to five minutes – a professionally produced video, something that's pretty compelling and that can tell the story.

1.6. Post meeting follow up

You should also have a post-meeting follow-up. So some kind of a short synopsis. These are the next steps to continue the discussion or to close the deal in a best case scenario.

1.7. Strategic action plan and CRM system

You need to have a strategic action plan and you need to have a CRM system because you're going to be talking to a lot of people. You need to be able to effectively sort them, rank them and move them through a pipeline.

That is the basic toolkit. Obviously you might decide you want to have a few more things, but I think it's hard to be effective if you have anything less than what I just described.

2. Mindset and resources

In addition to the toolkit, maybe the most important thing is the mindset. How committed are you to doing what I takes to get this done? It's very time consuming. It's not a walk in the park. It requires a lot of focus.

It's probably going to require travel. Unless you live in one of the tech or financial centers where they have access to deep pools of capital, it has been my experience that you probably will need to take this on the road. You need to be willing to do that, especially if the profile of the investors that are your ideal investors actually live in a different place. You can't expect them to come to you.

You should also invest in high-definition video conferencing capabilities. If you do that, you can get a lot done over the phone. But video conferencing is quite important with screen sharing.

You need to invest in a team and if you're serious about trying to raise real amounts of capital in addition to getting your house in order, you should have a professional team that's experienced in the type of financing. That includes a securities lawyer.

So realistically, in addition to investing your own time, you need to invest upfront in getting the right professional advisors (and some of them aren't cheap) and all of the other kit and equipment to enable you to be successful. So think of it as if you're going to climb Everest. You need the kit, you need the team, and it's going to be a journey. It's going to take some time and it's not easy.

3. Fish where your fish are...

3.1 An advisory board

Capital raising is a little bit like fishing. What I've learned about fishing is: you fish where the fish are. I found that when I go fishing in places where there are no fish, I come home empty-handed. If you want to improve the probability of catching the fish that you're trying to catch, you need to first know where they are. So you need to research.

If you're looking for a particular source of capital then you've got to figure out where those people are. Then you've got to figure out how to access them? This is where having an advisory board helps you. If it turns out that you know that there are particular species of fish and you know that there are people within your group of mentors or advisors that swim with those fish then maybe it makes sense to form an advisory board and start to present your dream, your vision, your pitch deck

You can ask, "What do you guys think?" and that advisory board may be able to get you qualified leads. Having a referral from somebody is a much stronger and better way to get in the door than doing it through any kind of a cold call.

With the advisory board, the advisory board can play a very useful role, particularly if you assemble the advisory board together. There's nothing like a meeting where people can ask questions and receive answers and ideate and argue and debate. That's much better than just one-on-one communications.

So if you can assemble this advisory board and present what you think is a compelling offer, and if there's trust in the room and among the board, people will probably tell you whether or not what you're pitching is real or whether it's going to get traction. You're a lot better off within that environment to practise the pitch and to build confidence and credibility before you go out and actually start to pitch it to your best prospects.

3.2. Visualize it

Now, in terms of who you want to go after, visualization is something that a lot of athletes use to achieve success. It can be used in this context.

So envisage your situation and say, "If I had my pick of anyone in the whole world, who would be my partner, my financial partner. Who would provide this capital?" Who would it be?

Then start to say, "Who is most like that person and how can I sort of navigate through and hopefully find somebody who, even if they aren't the ideal person, the rockstar Hollywood A-lister, maybe they're somebody who actually isn't that dissimilar. Maybe on more local level?" I found that's a pretty good way to try and target your ideal investors.

4. Common ways to secure leads

4.1. Sourcing leads

In terms of how you figure out how to source leads and get qualified leads I don't have a one-size-fits-all answer because it's going to depend on who it is that you're trying to target.

But in general this isn't rocket science. This is just like any sales and marketing exercise. Imagine yourself trying to sell a product or a service to your target customer then ask yourself, "How am I going to target those people?"

In this case, you are selling a product. You're selling the company and the company's equity or debt securities. That's a product. And so the way you do it is the old fashioned way.

4.2. Free databases and social networks

You go to databases, you use LinkedIn, you join relevant trade associations where those people participate. You write a blog, you build a social media presence, you ask your advisors, the professional advisors who work for you, and say, "Hey, can you introduce me to the right people."

It's not about just getting on a plane and going to conferences and hanging out and hoping that you might meet someone . . . although it's possible that you might. It's about being much more strategic at figuring out how to get in front of the most fish – the kind of fish that you're fishing for and presenting your story to.

The best people that I've met who are good at fundraising are always ready. They might be on a plane and they happen to meet somebody and they can give that 30-second pitch to see if there's any traction there. And if there is, they can move into a five or a 10-minute pitch – not in an annoying way but in a "Hey, I'm passionate about my project and I'm always looking for people that can help me" way.

That's how you build momentum, and frankly it's a numbers game.

Let's be honest it's a certain breed of people that like startups. You've got to be a little bit crazy to do it. You've got to be crazy to be a founder. You've got to be a crazy person to go work for an early-stage company, particularly one that's under capitalized. If you're an investor, you've got to be a little crazy because there are other ways to make money besides investing in unproven startups.

4.3. Co-working spaces, accelerators & incubators

The places where these people hang out are co-working spaces and the accelerators. They have established cohorts and they have mentor groups and incubators.

4.4. Trade associations

Most governments, local and national, have some kind of enterprise network where they've got a whole base of people who are literally paid to help you with your business plan, with your networking. So you just try to maximize the likelihood that you're going to collide essentially with people who like the idea, and who are are willing to invest time, energy and reputation to help you get where you want to go.

4.5. Deal lawyers & accountants

I cannot stress enough: it's a numbers game. One of the best ways to get access to the kind of people that you're trying to get access to is through referrals from people that are already working on your behalf. So: deal lawyers, people that see a lot of deal flow. Accountants see a lot of deal flow.

4.6. Advisory board

If you're in a market that has some kind of a venture debt institution, they see tons of deal flow. Advisory boards, can be extremely valuable, particularly in the early stages. If you assemble an advisory board that's diverse, from different industries, you can incentivize with options – doesn't have to be a lot. But give them some upside, and then you respect their time.

For example, you call an advisory board meeting and you have a defined schedule. You circulate information beforehand, give them a free lunch, give the presentation and ask for constructive feedback, including an opportunity for the advisory board to debate.

I'm not saying your advisory board is like a Trojan horse in the sense that you would expect them to necessarily be angel investors in your company, but it's not uncommon to be honest that the advisors, as time goes by, start to fall in love with the idea.

It has been my experience that not only do advisory boards frequently participate in early-stage financing, they also lead to other investors to participate in that. So if you pick your advisory board wisely, you can not only get invaluable strategic advice, you also frankly may be able to get access to your first round of funding or introductions to later sources of funding at a later point in time.

4.7. Finders

One of the things that I see a lot that's an issue is the concept of finders. Sticking with the fishing analogy, let's say that you want to fish where the fish are. It's not uncommon for fishermen to employ a fish finder or guide – somebody who knows where the fish are.

Is that a good idea? It depends.

In the US the answer is probably no, because for the SEC it used to be kind of a grey area. But honestly it's not that grey. It's pretty much black and white. If you are not registered as a broker-dealer you can't accept any form of compensation for introducing somebody in connection with the sale of securities. It doesn't matter if you try and hide it and call them something other than a finder. The reality is, that's the law.

If you do it, what are the consequences? In the old days it was, "Well, it's just an unenforceable contract and maybe we don't have to pay the fee." The SEC says, "No, it's actually worse than that." It can result in the loss of the exemption under registration, which means that you could be subject to what's called a right of rescission, which means instead of selling equity you've essentially sold debt-bearing interest.

That means the investors have the right to get their money back with interest – all because you used a finder.

So the long and short is: if you're based in the US, you don't want to do it. But what about other jurisdictions?

I've lived in a number of countries and in some of those countries it's not illegal. It's really not an ethical issue; it's a legal issue. So it doesn't seem like paying somebody a fee to introduce you. People do it in real estate and other areas. But within the securities area, the bottom line is: in some countries the answer is: “It's okay.” But you'd better know the answer to that question. You should have a securities lawyer on your team who can answer that question and give you the comfort. It’s really important.

How does this operate in practice? Usually the finder is somebody who's desperate to raise capital and will do virtually anything to get it. There are people who say, "Yeah,I've got a Rolodex and I can introduce you to some people."

I was involved with a Danish startup. And it wasn’t actually illegal at that time to pay a finder's fee in Denmark. These people were doing a perfectly legitimate business. The problem was we were marketing the securities globally and we had investors in the USA, in the UK, in India, in Denmark and all over the place.

So if you engaged this finder and the finder is based in Denmark but the investors are in other jurisdictions, is it okay because it's legal in Denmark? The answer is: no. You probably won't get into trouble necessarily for the investments that were made in Denmark. So maybe you can pay a fee in Denmark.

But these guys, they put a lot of work in and so they want to get paid on the global deal. And if it turns out that it's not legal, for example in the United States, it blows the exemption in United States and that can lead to rescission. It's just not a good idea.

You need a coordinated strategy that complies with the law in all the jurisdictions. And that's what I've learned. I've seen this over and over. It's a tough issue. I wish the US would change the law but until they do that, it is what it is.

5. Pitching

Presenting the offer

But what have you got to do when your opportunity comes? Meetings are better than calls, although meetings take more time on both your part and their part. In some cases, a quick call is better to qualify the lead.

We talked about the toolkit. If you've got that toolkit, using it shouldn't take up too much time. But before you have the call and the opportunity to present, it's my view that less is more. You need:

A three-paragraph description that can be communicated in an email or a calendar invite just to give people a nutshell of what you're doing, together with the one-pager. That's enough to whet their appetite – to see whether they want to take the meeting or the call.

If you're doing the meeting on a call, I'd strongly recommend one of the video conferencing capabilities: Zoom or Skype – something that's high quality and preferably with screen sharing capabilities. That is where you would want to be respectful of their time.

What can you expect?

What are they going to give you? 30 minutes, 60 minutes of their time? To be honest, 60 minutes is on the long side. First and foremost, you need to understand how much time you have. And then you tailor your pitch to give you enough time to present the big idea and also to engage in a conversation.

I won’t say that the pitch has to be exactly 15 minutes but if you've only got a 30-minute phone call, by the time you do the pleasantries and the pitch, honestly, you want to give yourself at least ten minutes for Q&A. If you've got an hour, obviously you can get into a longer discussion. But respecting their time is extremely important.

Even if they haven't said, "Hey look, I've got to get off," it's important that you respect other people's time. That's big. Because on both sides of the deal, they're taking a lot of meetings, looking at a lot of potential deals.

6. Closing

It really depends how the call goes. At a minimum, you're going to obviously want to send a thank-you note and that thank-you note can be canned and then customized. It should pretty short and sweet, delivered preferably within one business day

If you think that there's interest, then you would want to attach some additional supplemental materials regarding next steps. And if you really are ready with a compelling offer, particularly if you have an ongoing offering and you already have traction on that offer, then you definitely want to ask for the sale. That includes all the materials.

All you've got to do is sign this subscription agreement or, if it's a term sheet thing, "These are the proposed terms." If you don't have a signed term sheet and you just want to kind of float, this is the general idea of it. That's better, in my view, than nothing because both parties should know within one meeting whether there's a potential for a real deal here.

It's incumbent on you to be respectful of their time and put something in their court that they can respond to. Different people have different ways of doing this. Some salespeople are better than others. I would simply repeat this: it is a numbers game.

On the front end of the funnel, the key is to make sure that you have enough good leads – qualified leads – and then you've just got to run through it.

I'm from Seattle and I remember in the early days of the '90s Starbucks was just taking off. There was a ton of coffee companies in Seattle. Starbucks was not founded by Howard Schultz; it was actually founded by three other guys who later founded Peet's. But Howard Schultz essentially came up with a scalable retail concept, and when he was out raising money for that, I'm told it took him 72 meetings before he got his first $50,000 commitment.

Think about that: 72 times. 71 times, he met, pitched the story and heard, "No, thank you." But he kept going. And I just read that he said that in the first year when he was trying to raise the first round of capital – less than two million dollars – he met with something like 242 investors and I believe 217 of them said no.

Since that time, of course, there's been great success for that brand in terms of raising capital and scaling the business. But all I can I say is: if somebody who's that charismatic spent that much time with that many no's . . . think about what it takes for the average entrepreneur.

I'm not saying that you're going to have to pitch it 100 times before you get to yes but it might it might take 200. Don't sell yourself short.

Since I created this first course, I had about 800 people take a quiz and about 200 people scheduled a free call where I was doing research to figure out about how hard is it to raise capital over here in Europe. And one of the more compelling entrepreneurs was somebody from Poland with a really good tech-focused startup in a hot space: the cybersecurity space, with a good team and actually pilot customers. So pretty much everything you're looking for.

I said, "Well, how long have you been raising capital?" He says, "God, like a year and I just haven't found anyone." And I'm like, "A year – wow, that's a long time. How many meetings have you had?"

"Five."

Five? I mean, seriously.

You couldn't raise capital in Silicon Valley, probably, with only five meetings. You need to kiss a lot of frogs to find the prince. You need to get up every morning and not be depressed about the fact that yesterday and last week you got no's because today might be a different day.

There is a tipping point in venture finance. One of the keys is to try and find somebody who really is a leader. And if you can do that, then you can start to load people onto the train. As people start to get onto the train – and I'm talking about angel investing here – you blow that whistle: "Hey, train's leaving the station." And people will go, "Who else is in?"

They find out, "Oh, it's leaders: people that might know more than me, or people that are savvier. I want in on that deal." People, are just like sheep; they start getting on the train.

A dirty little secret for angels is you want to be the last guy on the train if you can. Because at that point, other people have done the due diligence. You're kind of a little bit of a free rider. But that's okay. If it takes a village to fill out a round, then your goal is to find the very best fit: the smartest investors – not necessarily the ones that are going to give you the best deal. It's the people that are going to be able to help you build the most value.

That's what the smartest entrepreneurs I've worked with do. They look to bring in people that can add value. And so you're investors are partners. They're not just a source of money, they're partners.

You have to get out there, just like dating. You need to go on a few dates before you find your soulmate. But this really is an important relationship and it's not one to be taken lightly.

7. How long does it takes?

A common question for people who are thinking that they might want to 'test the waters' (I don't like the attitude – do it or don't do it) is: "How long will it take?" The answer is: it depends.

I've been doing this for almost 30 years and it would be an extremely rare case where, from start to finish, you could do it in less than 30 days. Even if you have your house in order. Frankly, even if you have a signed term sheet, it's hard to close a VC deal in 30 days or fewer.

There's usually a period of due diligence and the lawyers have got to get on board. So 30 days would be a very, very small percentage of people. More commonly, it's going to take three months to six months if you have your house in order. That's my view.

The average,I would say, if you're really organized, it would be three or four months. It's very do-able if you know what you're doing.

What if you're pitching this deal and nine months later you still haven't closed? To be honest, that's not time to say, "It's time to buckle up and figure out how to bootstrap it." You might have to go back to your friends and family. You might need to think of other ways. But really what the market is saying is: "You don't have enough traction."

They're not saying no, they're just saying: "Not yet: you haven't proven it – you don't have product/market fit," or, "Your prototype is kind of cool but it doesn't work."

I've been involved with companies that raised significant amounts of capital on prototype hardware that didn't work. Getting the next round of financing was really difficult because the company had a prototype that didn't work.

It is important at each stage of the venture that you can prove, "Okay, if you give us the capital, this is what we can do for some period of time."

This gets back to how long does it take to close the first round and how much time you should give yourself for the next round. I would say, in traditional tech finance, you typically want to not raise capital more than once every 18 to 24 months.

Once you take the capital, you want to do something with it, you want to prove that you've achieved something and taken it to a step up in valuation before you go back to the market. Otherwise, you get this really weird drip-feed thing and it's not optimal for the investors or for the company.

8. Is this information US centric?

Is this masterclass US-centric? It kind of is. I spent the first 20 years of my working life on the West Coast in the United States doing startup and venture capital and emerging growth companies. That's where I cut my teeth.

Since 2010, I've lived outside the United States. I spent four years in Denmark working the startup and emerging growth ecosystem throughout the Nordics and Northern Europe, Ireland and the UK – not just Denmark. That informed me of the nuances and the differences.

There are clearly differences between how the startup ecosystem works in, say, Stockholm from how it works in Seattle. And for that matter, there's differences between Stockholm and Copenhagen or Berlin and Paris.

This isn't surprising for people who live in Europe. The ecosystems and the negotiating styles and the cultures are different; the languages are different. But for people like me living in the United States, they may not appreciate the subtleties or, frankly, not-so-subtle differences.

The unfortunate thing about a lot of this information is that it is US-centric. So if you go online and do a Google search, there's tons of information that's available in the English language but most of that information is US-centric. I guess the question for those of you who don't live in the United States is: is this relevant?

I would like to think that the general principles are relevant. And there is probably some localized version of pretty much everything that I've mentioned here. Which isn't to say that there aren't differences. Particularly when you get into sources of funding that governments can provide, because some of these countries have fantastic programs.

I think of Enterprise Ireland or I think of Finland or other Nordic countries – all have great government support for innovation and entrepreneurship. And so those are clearly local and those should be explored.

When you think about how you're going to approach the investors, no matter where you live, there are probably other kinds of investors, some of whom may behave slightly differently because they're just a product of a different culture.

9. Next steps

The good news is that, right now, the world has never seen more capital available for science and technology startups. Unlike the last dot-com bubble 20 years ago, this time there's global capital that's available everywhere, all over the world and you can tap into that capital and tap into those markets and expertise.

There's probably never been a better time to be in business. There's lots of capital – the world is flush with capital. We've never had more venture capital and private equity and other sources of funds to help entrepreneurs grow than today.

In this free course, we've looked at the WHAT of raising money for startups. There's also another course where I explain the HOW. If you're interested in taking this knowledge and turning it into funding faster and smarter with practical guidance, I recommend clicking on this link:

https://aeryadvisors.com/venture-finance-101/pro-masterclass/