21 Steps for Entrepreneurs to Raise a First Institutional Round of Financing

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This paper is based on 12 years experience in consulting 40 technology startups, including 19 for which I assisted in raising $150 million through venture financing rounds. In the 20 years prior to becoming a consultant, I was the CFO or VP Finance of 6 companies, 4 of which were public. Among several private companies on whose advisory boards I serve is FLG Partners, LLC. After closely collaborating over 5 years with most of its 23 partners, I am convinced that they are the most experienced, accomplished and versatile consulting CFOs in one firm on the West Coast.

This paper's primary purpose is to describe the research, analysis, and organizing sets which founders must complete with great rigor if they are to be successful in raising a first financing round from venture capital firms. The objective of the first 16 of these steps is to qualify the startup as having the potential to grow into a company which can reward the investors with the returns they require. This qualification is in not met by following an accepted outline for preparing documents and presentations. It is accomplished by the founders doing the homework that proves first to themselves, and then to investors that their venture meets the criteria for success posed at each step.

The secondary purpose, at which the last 5 steps are aimed, is to offer guidance on the processes of identifying, presenting to, and preparing for closing a round with the "right" investors. While the major issues in the term sheet are listed, no input is provided on how to negotiate terms, as the founder's only real potential to prevail in disputes on terms lies in having multiple investors vying for a "seat at the table."

Thus, instead of describing what constitutes a well written business plan, this paper will focus on the separate business issues that the plan must address. The business plan is rarely read in its entirety by investors until they have gone into the due diligence process penultimate to close of the round. However, most successful entrepreneurs, use the business plan's development for three purposes essential for the startup to succeed:

- Determining if the problem they perceive, the solution they have conceived and the markets they will serve qualify their startup as a venture that deserves their devotion and investors' funds.
- Guiding the development of the business with the goals, objectives, strategies and milestones clearly defined.
- Recruiting other key members of the founding team.

1. Identify, Research and Quantify a Serious Problem

Startups are almost always founded to solve a problem the founders believe to be serious. Before effort is wasted on developing a solution, this belief needs to be supported by research to determine and document:

What precisely is the problem(s) company's product/service will address, ameliorate, or solve:

- Adverse consequences to end users of not having the company's solution, in terms of missing effectiveness, completeness and cost.

- Incumbent products and services which might be direct or indirect competitors which inadequately deal with problem.
- Where do the incumbent products fail?

How Big is the Problem(s):

- Numbers of end users who are suffering from the lack of an adequate solution.
- Installed base of systems or applications through which solution is delivered.

2. Define a Valuable, Differentiated, Product or Service

Research and analyze the unmet need in the marketplace that the company aims to fill. Define the characteristics that set the product/service and company apart from the potential competition. For end-users these products/services must be a good solution to a serious problem or disruptively (not incrementally) superior those solutions already on the market. The product or service should be difficult for competitors to imitate or improve on, at least in the short run. Preferably, it will be based on technology that can be protected by patenting. The solution must have a thoroughly researched and analyzed value proposition which describes**:**

What is the Solution:

- How it solves the problem, by what unique technology, techniques, processes.
- Its direct or enabling capabilities, functions, features, and applications.
- Why it is better than its potential competitors.
- What barriers to entry prevent further competition.
- The specific end-user segments that will be targeted.

What is the Value of the Solution to the Customer:

- Capabilities that are new or which are improved to significantly increase effectiveness or reduce cost, or some combination of thereof.
- Price that users will pay for this value when compared with incumbent or similar solutions in the market.
- ROI; the time to recover the cost of solution by various classes of customers
- Future product developments which offer new features and/or functions which will add value beyond the first solution and stay ahead of the competition.

3. Analyze a Big Market that can be Developed and Penetrated.

The market analysis should be as specific to the company's solution as possible, and should be based on believable, verifiable data. Nothing will hurt a founding team's credibility with investors more than to be discovered exaggerating the size of the market. Market research should start by identifying the various kinds of end-users who will buy the product. It should include the number of potential customers, the purchase rate per customer, and a profile of the decision-maker. The market sizing should comprehend the customer's demographics, their purchasing habits for similar solutions and what they are paying for them. Bore in on specific well-known large customers the company aims to capture and whose characteristics can be generalized.

Industry research should include growth rates, size of the market, recent technical advances, government regulations, and future trends. Size the market using recent market data and respected analysts firms'estimates of current and projected size and growth rates.

Build a metrics driven model of the market by segment over the next 5 years. A

critical element of this model will be the adoption rates by year predicted for the kind of solution the company is offering. Do not guess at this. Build the model based on historically documented adoption curves achieved by similar products and services. The model should be for the served available market (SAM) and not the total available market (TAM). The SAM includes those segments and geographies for which the company is able to fund product development, sales, marketing and service over the next 3 years. The TAM includes all markets to which the technology can be applied and all regions of the world.

4. Develop a Well Thought Out Go-To Market Strategy

Research the selling and distributions strategies that have been successful in penetrating similar markets for similar products and services. Determine the distribution channels that will best get the company's solution to the end-user.

Explore the sales and distribution options available, which may include:

- Direct sales through the company's own website.
- Channel sales through the websites of partners or resellers who have complimentary or more comprehensive products or services.
- Inside sales made by the company's own staff.
- Field sales though direct contact through salespeople, and telemarketing.
- Original Equipment Manufacturers (OEM) sales through integration of the product into other manufacturers' products.
- Distributors or Wholesalers sales.
- Retailer sales.

Do a thorough analysis of the financial benefits of selecting these distribution approaches. This should include laying out the projected prices, competitive commissions, and achievable revenue share with channels. It should include a well thought out estimate of the sales cycle for each channel from initial customer qualification to close of sales.

Craft the GTM plan based on the unique or incremental value that your product or service can add in the market. Use this understanding of why you are going to win over your competition to decide which segments you are going to attack first and how you are going to sell into those segments – how you will "cross the chasm."

5. Create a Revenue Model tied to Market Analysis and GTM Plan

The fundamental logic of the revenue model is to start with the projection of sales units in the served available market model. These sales units are multiplied by the percentage of the SAM that the company can reasonably capture (the market share) times the company's price of its product or service. If a service is offered in the form of seller (or cloud outsourced) hosted software as a service (SaaS), and the service will be tried by users for free or offered in a "freemium" upgrade scheme, the metrics for converting users to subscribers for various levels of service, for "monetizing" the solution over time, must be incorporated. Once the tops down logic of the model is designed, it must be built up by segment and by the sales channels selected in the GTM model.

The pricing metrics in the model must take into account:

- The company's and its products or service image in the market place, starting as a small startup and growing its share.

- The competition both direct and indirect, and its pricing of similar products
- The discount structure for each distribution channel employed
- The expected incremental value over the initial offering of future product improvements and new product introductions,
- The kinds and costs of sales promotion programs the company plans to use.
- The resulting gross margins, but only when there is little or no competition

6. Assemble a Team Capable of Executing the Business Plan

In most startups, the founders compose only a few of the senior managers. Thus, the founders must recruit the other team members. The founders must know how they are going to fill the gaps in the team, including identifying some good candidates and/or recruiters. The founders and these hired or to be hired team members must meet three requirements if the company is to qualify for venture capital investment:

- The team must consist of executives who have proven success in managing the essential functions of a similar business, General Management, Engineering, and Sales & Marketing.
- At least one of these three executives must have direct experience in the market that the company's products or services will be sold in.
- Each member of the team must have quit their day jobs and be dedicated 100% to the new company.

The startup's team will be stronger if it includes a board of directors and/or a board of advisors, drawn from industry and technology experts who believe in the founders and the company and can lend vital strategic and tactical guidance and credibility with key employee candidates, and potential investors and customers.

7. Have an Architecture, Prototype, Beta, or an Initial Product

Depending on the kind of product or service offered and the level of funding obtained from founders, friends, family and angels, the company must have before it seeks its first institutional round, an architectural spec, a prototype, a beta or an initial offering. A hardware, semiconductor or biotech company whose solution or technology is "new to the world" will almost certainly have only an architectural spec. On the other end of the spectrum, a SaaS company would usually be expected to have an initial offering, even it is being tried and not paid for by users, so long as it demonstrated the features, functions and performance for which users will pay.

Venture firms vary in their willingness to be the first institutional investors in companies in different industries who have reached different stages of product development. However, almost all of them will insist on at least the following**:**

- An architectural specification for the first product in the form, for example, of a system circuit layout or a block diagram or a sequence of chemical formulae.
- Convincing evidence offered by the company's or outside technical experts (sometime of the VCs choosing) that the solution will work as intended.
- Detailed listing of the sources of and stage of development of the enabling technology for the first product, including required in licensed IP and SW, APIs.
- A development schedule for the first product by task element starting with architecture, and continuing through coding, system integration, functional test,

quality assurance, alpha, beta and first offering showing estimated man-years and elapsed time required and completion dates.

- A product roadmap showing introduction dates of planned upgrades and new products, by feature, function, performance and the estimate engineering staffing required over the next 3 years.
- A complete detailed description of any inventions and provisional patents and patents filed where appropriate.
- A listing of inventions completed or proposed for the next 3 years that are expected to be patentable.

8. Identify and Evaluate Competitors

Entrepreneurs should aggressively seek to learn the existing and potential competitors. Web browsing with a description of your solution can be productive in this. Look up the startup potential competitors on Techcrunch. If the market need is as great as your analysis indicates, there will be companies who are already meeting that need, however poorly or incompletely. Nothing is more important than determining how the company's solution will compete against the existing solutions.

Learn the competitive solutions strengths and weaknesses relative to the company's solution. Try to anticipate the competitors' responses to the introduction of the company's product. Where possible, set up a comparative matrix of the company's and the competitive products by feature, function, performance, quality, price, and distribution arrangements. Use publically available information, from company web sites, from SEC reports found on EDGAR-online or reports on the competitors industry published by investment banking and research firms.

9. Engage a Corporate Attorney to Form the Legal Organization, Establish Corporate Governance, Draft Required Documents

Among the legal documents that your corporate attorney will draft, file or finalize prior to your company's raising the first institutional round of financing are:

- Articles of Incorporation
- Bylaws
- Operating Agreement
- Trademarks
- Web Development Agreement
- By-laws
- Stock Subscription Agreements
- Stock Purchase Agreements
- Shareholder Agreements
- Buy/Sell Agreements
- Minutes of Shareholder Meetings
- License agreements
- Stock Option Plans
- Stock Option Vesting Agreements
- Convertible Promissory note Agreements
- Convertible Promissory Notes
- Joint Venture Agreement
- Non-Disclosure Agreement
- Investor Rights Agreement
- Outsourcing Agreement
- Employment Agreements

10. Layout the Critical Milestones over the Next 3-4 Years

These milestones will be most important steps in launching and scaling the business. They will consume the most time, effort, expense and capital. The cost and results of meeting each of these milestones will be reflected in the financial plan, and will represent a

significant reduction in the risk of attaining the results projected in that plan. Each milestone must be based on a detailed sequence of events to accomplish its objective. The founders must know the key obstacles to reaching each milestones and how they plan to overcome them. Among the vital milestones whose timing and accomplishment must diligently planned and executed to target dates are**:**

- Recruiting key People, in management and next layer
- Reaching staffing levels required by function
- Developing the products or services by stage
- Licensing in key technology not invented internally
- Validating that the technology and solutions works
- Obtaining qualified suppliers and subcontractors
- Setting up self hosting and/or cloud outsourcing
- Signing up channel partners
- Launching alpha, beta and first products
- Implementing marketing and promotion programs
- Establishing significant bases of users
- Gaining first paying customers and key accounts
- Determining from experience the sales cycle by step and how to shorten it.

11. Develop a Detailed, Realistic Bottoms up Financial Plan

The financial plan must include linked income statements, balance sheets, statement, and cash-flows statements for a period of three to five years. The more capital intensive the business, the longer the time frame required because cash flow breakeven will be farther in the future. The plan must be broken into monthly statements for at least the first year, followed by quarterly statements for two years, and then by yearly data for the remaining timeframe.

Entrepreneurs and their financial advisors or consultants who believe the financial plan should be aggressively optimistic so as to impress venture investors are making a big mistake. First of all the financial plan should be used as should the business plan to guide the development and decision-making of the business. Second, most VCs who have experience with the kind of products and markets the company is targeting, know an unrealistic plan when they review one. They will become suspicious of the credibility of the founders and other aspects of their plan if they are presented a financial projection with a low probability of being achieved.

The plan should not just show the 3 financial statements but should be based on underlying schedules that analyze and document the major assumptions used to develop revenue, expense, expense, working capital and capital expenditures. Among these critical subsidiary schedules are those showing the buildup of revenue and those laying out staffing requirements by position by hire date and by competitive salary and benefit level.

It is also important to show on subsidiary schedules the calculation of balance sheet lines such as deferred revenue, deferred compensation, accumulated depreciation, receivables, payables. Any important assumptions driving the plan that are not clearly shown in subsidiary schedules should be documented in a set of footnotes.

While the plan may be detailed in as many as 200 lines, the revenue line in the P&L is more important than the other 199 lines combined and should be supported by a number of subsidiary schedules. The 4 critical drivers of the revenue line are:

- Market analysis which defines served available customers and end-users.
- Revenue model which includes market share and pricing assumptions.
- Go-to-market plan, which lays out the use of channels and discounts.
- Sales cycle which sets forth the elements and timing from customer qualification to sales close.

Here is an outline of typical elements in a detailed bottoms up financial plan

a. **Summary of output of the market analysis,** including served numbers of customers and/or end users by market segment

b. **Revenue model buildup** by market units X share X pricing X channel discounts

c. **Deferred revenue calculation**, based on payment terms and GAAP revenue recognition rules

d. **Staffing Requirements and expenses** by function, hire date, competitive pay, benefit and bonus levels.

e. **Product development costs,** reflecting engineering staffing and in licensed technology and outsourced engineering services**.**

f. **Income Statement tied to supporting detail including but not limited to:**
   - Sales Units/Transactions multiplied by average selling prices
   - Period End Staffing levels by Function and by Position
   - Compensation rates for each position
   - Fringe benefits, including payroll taxes, medical insurance, paid time off.
   - Cost of sales, including operations "overhead", and customer service,
   - Occupancy expense by element based on staff size and space metrics
   - Outside Services purchased, including accounting, advertising, etc.
   - Commissions to direct sales
   - Payments to and support cost of channel partners.
   - Advertising, Sales promotion and Trade Show expenses
   - Depreciation on Capital Expenditures

g. **Balance Sheet tied to Income Statement, Cash Flow. supporting detail:**
   - Schedule of Planned Capital Expenditures
   - Planned days sales outstanding in receivables
   - Planned days expenditures outstanding in payables
   - Planned convertible debt financing
   - Note redemptions and repayments
   - Equity investment including founders' and initial investors' common stock

h. **Cash Flow Statements based on Income Statements and Balance Sheets showing:**
   - Cash expenses by function, segregating headcount related and other
   - Capital expenditures
   - Working capital requirements
   - Debt raised and repaid
   - Tax and interest payments
   - Equity capital raised

i. Summary Financial Schedule showing:

- Numbers of customers and end users purchasing the solution.
- Share of served available market (SAM)
- Revenue, cost of goods, operating expenses and operating income
- Capital raised by common stock, convertible notes, preferred stock
- Cash burn per period
- Cumulative capital requirements by time period over successive rounds.
- Timing of Cash Flow Breakeven

j. Calibrating, Benchmarking Financial Statements

After the first draft of the financial plan is prepared, it is crucial that it be calibrated against the financials of similar companies whose financial statements can be found for their early years of operations. These benchmarking financials can be found in the S-1 registrations statements of companies that have gone public and can be accessed via EDGAR-online. If your first rev 0 plan projects $50 million in revenue in year 4 and none of the public "comps" exceeded $50 million in that time frame, your plan is likely too optimistic. Likewise if your plan reflects becoming cash flow positive on $15 million in equity and none of the public companies reached that milestone on less than $40 million of capital, you are probably not being realistic.

12. Prepare a Capitalization Table and a Projection of Equity Ownership by Key Employee

The Cap table should show by name, date of investment, dollars invested and share of common equivalent shares and conversion terms of notes**:**

- Common Shareholders
- Convertible note holders
- Warrant holders.
- Owners of exercised stock options
- Shares owned by class of stock and date of investment.

The projection of equity ownership should show the share of common equivalent shares that will be owned by key employee on the team or to be hired over the next 2 years. These equity ownerships should be based on recent survey of equity ownership for companies who have raised "A" rounds should show the average and top and bottom quartiles of equity ownership as a percent of common equivalent shares:

13. Show Convincing Evidence of Customer Interest or Better Still Traction

If the startup is a SaaS company, particularly with a B2C model set up to gain users and convert them into paying customers on the website, customer interest in the form of 100s of thousand of unique visitors to the site may suffice for "A" round investors. If the licensed or SaaS software is being sold to corporate customers, the company will need at least to have customer in trials or paid proofs of concept willing to testify to their strong interest in buying the solution. If it is a hardware or semiconductor product, it must have at a minimum a spec sheet defining the yet to be released product's features, functions and performance and must be in the hands of lighthouse customers will express a serious desire to be either Beta sites for the first sample, or better still customers for the final release.

While venture firms vary as to how much customer interest or traction they require to invest in an "A" round, most will insist that software users must be trying the solution in numbers achieved by successful similar products at equivalent stages of development and

introduction, and that hardware customers have progressed as far with about the same number of beta customers. However, exceptions are made by VCs who perceive the solutions to be uniquely valuable and protectable and the market to be unusually large and fast growing.

14. Know Who Will Buy Your Company

While in item 11J above, you were urged to calibrate your financial plan against companies that had gone public in your space, you should know that less than 1% of startups that receive series "A" funding ever go public. Almost certainly the returns to founders and VCs will depend upon M&A exits. Thus, you should do the homework to learn who are the likely buyers of your company in terms of specific companies and categories of companies and what they are apt to pay in terms of multiples of your last 12 months revenue or EBITDA.

You can find this information by reading the reports of transactions by target, buyers, total economic value of the consideration and price-to-revenue multiple published by investment bankers who manage deals in your industry. You should be able to find examples of sales of companies closely comparable to yours and if not at least some similar companies in other industries. You may be able to identify some target acquirers that are especially good fits. If so your product and market planning should comprehend how you will strategically get on their radars.

15. Prepare a Concise and Incisive Executive Summary

The major elements of the business plan must be summarized into a 3-to-5-page synopsis which will generate interest from the targeted venture investors. Recently entrepreneurs have begun creating a 1-page executive summary to attract VC interest. However, the limited information this affords, often prompts the prospective investor to request the entire Powerpoint presentation. This can cause the VCs to come to the presentation particularly critical. As VCs must vet many hundreds of presentations to make a single investment, they are motivated to find reasons not to invest. The extra time afforded them by having the presentation enables them to dig into the vulnerabilities of the plan and its questionable assumptions. Besides the longer format enables the summary to be more enlivened with charts, graphics, and tables.

The subjects that must be covered in the executive summary, usually in the order shown are as follows**:**

- **Problem to be solved** that creates the Market Demand
- **Company's proposed solution** to the problem in technology and product
- **Status of development of that Solution**, and any actions taken to protect the technology such as provisionals or patents.
- **Background on Company** – how came into being if relevant
- **Competitors**, direct and indirect and advantages of your solution versus theirs.
- **Revenue Model** explaining how sales to paying customers are generated.
- **Served Available Market** size and metrics by Segment over next 5 years
- **Go-to-Market Strategy** – what channels, partners, customers, segments
- **Key milestones** over the next 12 months and 2-3 years
- **Amount of Investment** Company is Seeking
- **How funds in this round will be used** to meet specific milestones
- **Financial summary of customers, revenue, and cash burn**

- **Founder, Key Team members Brief Bios** (include BOD and BOA members by expertise)

16. Create a Convincing, Hype Free, Powerpoint Presentation

This pitch investors should cover all of the subjects listed above for the Executive Summary in not more than 20 slides taking not more than an hour to present. Avoid making the slides too busy with information and make good use of graphics and charts where possible. Prepare backup slides that will answer questions that you anticipate being asked by investors or which elaborate on summary slides in the presentation.

17. Target the Appropriate Venture Capitalists

It is far better to be introduced to VCs by people who respect you who already have a relationship with those investors, than to make a "cold call." Even if you have an offer to be introduced by a mutual relationship, first learn who the VCs are. Just as the VCs perform due diligence on a company, a founder must evaluate the benefits that a particular investor and his/her firm can provide to the company. Thus, before approaching a venture capitalist have affirmative answers to the following**:**

- Does the venture firm have experience investing in similar companies?
- Does the firm make a practice of investing in companies at this stage?
- Is this firm enthusiastic about companies with the level of capital our company requires to reach cash flow self sufficiency?

- Do they invest in companies attaching markets the size of ours?
- Are there companies in their portfolio that might be competitors?
- Do they take a highly active role in helping the company?
- Can they help provide contacts for key customers, new members of management, suppliers and distribution channels?
- Are the personalities of the VCs compatible with those of the founding team? Do you look forward to engaging with them at board meetings?
- Does the firm have a record of syndicating with other firms for whom the answers to the questions above are positive?
- As best you can learn, is the fund out of which the firm is investing large enough to provide the deep pocket for future rounds?

18. Present to Prospective Investors.

While a great pitch does not assure the investors will write a check, it is the critical first impression that the founders make. After that pitch it is hard to change your image with the investors. The VCs will use the pitch to size you up. Besides a promising business plan and a team that can execute it, they are looking for personality, confidence, passion, knowledge, intelligence and most of all, integrity, in the founders. Anticipate their issues with your business plan and come prepared to field their questions, have backup slides.

Here are some of the VCs' questions for which you must provide affirmative answers**:**

- Is the product unique, and what value does it create so that buyers will want to purchase the product or service?
- Is the technology fully developed and if not do they have a realistic plan for completing it?

- Can the products be brought to market in time to have a competitive advantage?
- Do the founders understand the competition or are they over confident there will be none?
- Do significant barriers to entry exist? Can this invention be patented?
- Is it likely that the founders' former employees have rights to the technology being used?
- Are the founders realistic about the competition they will face?
- Can a profitable business can be built based on the revenue model and the GTM and other strategies detailed in the plan?
- Is the market potential large enough?
- Does the team understand how to penetrate the market?
- How much capital is the company is seeking?
- How are the funds in this round to be used to meet specific milestones and other defined cash requirements?
- Will achievement of milestones over time adequately reduce risk to investors, given the capital required to attain them?
- Does the financial plan seem realistic or too optimistic?
- Is the management team capable of growing the business rapidly and successfully?
- Have they done it before?

19. Start Early and Prepare Well to "Negotiate" the Premoney Value.

No term of a VC's proposed investment in that first round (or in subsequent rounds) is more important to the founders than the premoney value as it determines the percentage ownership of the company which will remain with them after the VCs take their share. In many cases the VC's who are interested in investing will advise the founders of the round size, syndicate members and the premoney value they are considering offering before going into due diligence. Thus if any of these are unacceptable to the founders, they do not waste their, their staff's and their attorneys' time and expense in learning more about and preparing a term sheet for a company whose founders are likely to reject their offer.

However, instead of latching onto a goal for a premoney value based on the highest price you heard a similar company receiving at its "A" round or what share you want to retain after the round closes, I urge founders to do the following**:**

- **Gain several examples of "A" round premoney values** accorded to companies with similar solutions, similar market sizes and similar stages of product development.
- **Read recent survey on venture capital rounds terms** published quarterly by Fenwick & West, which provides statistics on valuations and other terms
- **Accept the valuation statistics of multiple surveys** by the National Venture Capital Association, Dow Jones VentureSource, and PriceWaterhouse which show that about 90% of Series A round close with the venture investors owning between 35% and 60% of startup. To increase your chances of limiting the VC's ownership to the lower end of that normal curve, take the advice below.

- **Start preparing steps 1 through 17 in time** so at the time you begin presenting to VC's (step 18) you still have 4 to 6 months before you run out of the funds required to meet your milestones for staffing and product development. While founders of some "hot" startups succeed in closing an "A" round in 2 to 3 months, the process typically takes 4 to 6 months.

  There only two effective means by which founders can negotiate higher premoney values, of which the first is by far the best approach**:**

  (1) Take the advice above in doing a rigorous and convincing job in steps 1 through 17 earlier enough to get multiple VC syndicates into competition to fund your "A" round and who are ready to go into due diligence preparatory to offering term sheets.
  (2) Have enough capital to last another 4 or 5 months beyond getting that first offer so that you can get one or more competing term sheets. In effect saying, "No thank you."

- **Do not contract the *Dilution Devil Disease* or "D^3."** Some time entrepreneurs prepare steps 1 through 17 thoroughly and in step 18 convincingly present to VCs the solution, the market and the team, but still do not receive premoney offers that meet their expectations for keeping the majority of the company's stock. Some founders faced with this disappointment are simply not willing to have their ownership diluted by a low valuation and determine to run their venture without institutional participation and thus on less capital. Some within the business and academic community support this capital starved or "shoe string" approach as a legitimate way to resolve the dilemma a founder faces in accepting venture capital while loosing control of their "baby." I could not disagree more.

  In most cases the founder who is afflicted with D^3 is opting to own a large percentage of a venture that never grows large or which fails altogether. Among the most common constraints on growth and success that capital starved companies face is not being able to adequately staff product development, sales and product support. This causes the startup to bring to market a solution that fails to win share because it lacks the features and functions which more engineers could have designed and/or because it is preempted by a public or well financed private competitor who was seeking to solve the same big problem. Even if the startup does manage to get a superior solution to market on time, the lack of sales and support resources leaves the market open for better financed imitators, especially with software products whose technology is difficult to protect with patents.

20. Prepare for and Respond Convincingly to Due Diligence

If the presentation answers the above question positively and convinces the venture investors that they should invest in the company, the entrepreneur will be contacted for the first of what will generally be several follow-up meetings, and the venture capitalist may begin the due diligence process. To address both the risks they have identified in the presentation and those they have not perceived, the venture firm and its attorneys will conduct a thorough analysis of the company's business prospects, management team, industry, and financial forecasts before investing. It will want to review in detail the company's market analyses, revenue model, financial plan, cap table, option pool, and legal documents, and check references from users, beta sites, customers, and channel partners.

It is crucial that the entrepreneur provide to the venture firm and its attorneys all of these analyses and documents and stand ready to explain and defend them and to supply supporting evidence and additional analysis when requested.

21. Prepare for the Term Sheet Negotiation Process

If the company passes the deep scrutiny of the due diligence process, the company and its attorney will enter into the negotiation process, where the structure and terms of financing *other than the premoney value* will be determined. The entrepreneur must carefully prepare for this step by becoming familiar with the various structures of venture capital financing and preparing a bargaining position in consultation with his corporate attorney.
The attorney will provide guidance on the issues worth fighting for. Among these are**:**

- Founder stock vesting
- Founder salaries and deferred compensation
- Stock restrictions
- Convertible not conversion
- Dilution protection
- Option pool sizing
- Board membership
- Composition of the management team.