INSIGHT

A Founders Guide:

Series A Fundraising

Introduction

Not long after a Founder has closed their seed round, they will begin to consider when and how they should raise their Series A.

This is a simple question but will yield a significant number of conflicting online and offline answers.

With a Series A the ‘when’ is more subjective than the ‘how’ and so in this guidebook we provide advice on what to consider when thinking through the timing of your Series A raise.

We then focus on the ‘how’ and provide comment on the process you could adopt and leverage you can achieve.

Finally, we identify several issues that Founders get caught up in when seeking to optimise their round and provide advice on what is and isn’t of consequence.

I hope you find this helpful as you consider the next step in your journey.

James Kenward
Partner

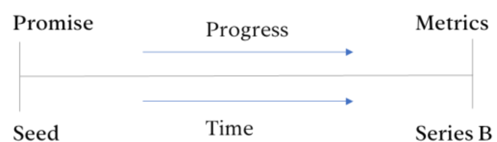
When to Raise a Series A?

One of the hardest questions to answer when considering a Series A is “when is my company ready?” This is another one of those questions for which there are hundreds of answers on the internet, none of which are particularly satisfying. The reason these answers don’t work is that each rule has so many exceptions as to make the rule seem silly.

Founders often want clean and concrete answers as to when they’re ready to raise. This is why the idea that VCs filter exclusively on metrics is attractive. For instance: SaaS companies are ready for an A when they cross £1m in ARR. This sounds good, but we’ve seen As happen for SaaS companies with ARR between £200k and £9m with plenty of companies failing all along that range. Clearly VCs don’t care that much about this rule.
The other end of this set of advice says, “raise when you can.” This is correct, but tautological. You only know that you can raise if you actually do so. It doesn’t form a coherent framework for deciding when to raise money.

Michael Siebel of at YCombinator has built a framework for how to solve it. Full disclosure - I don’t think there’s a perfect answer here, but I think having more context around why that answer doesn’t exist is helpful.

To understand what’s going on at the A round, it’s helpful to think of the decision process for funding as sitting along a horizontal axis. This axis roughly corresponds to the progression of a company from an idea to a functioning, scaling business. The decision process and the progress of the company are so closely related because - at each point in the life of a company - an investor looking at the company has the evidence of everything that the company has achieved up to that point. That evidence strongly informs that investor’s decision. The biggest gap in this axis is between Promise and Metrics, which maps to the seed round, and the B round.



Most seed rounds get raised based on the quality of the founders and the raw story that they can tell about their company and the future that company will create.

By the Series B, those founders need to have accomplished a significant set of things that prove their ability to accomplish that future. This usually takes a few years and comes with a set of in-depth metrics about the health of the business and the impact of additional capital on that business.

The reason the A is so hard to figure out is that it sits somewhere between these two points, and the point at which it sits differs based on the founders, the progress created, and the amount of time that the company has existed.

When to Raise a Series A?

If you think of the A as being either a giant seed or a small B, then the conflicting advice starts to make sense because it's all actually right and wrong depending on the specific situation. There are founders who can raise what looks like an A in dollar terms because they are so compelling. This will only work early on in the life of the company and before it has raised significant seed capital since time + money has to equal progress or investors will get suspicious.

The longer a company has been in business - or the less good a founder is at telling a story - the more concrete and certain the metrics of that business need to be. Part of the challenge companies that have raised too much seed money face is that the requirements they face for an A are significantly higher than for those who raise less. They generally wait longer for their As, so investors expect to see associated progress.

Whilst this doesn't provide the sort of certainty founders want in answering the question of when to raise. I think that knowing that there is no clean answer is important because it provides a framework for thinking through the relative advantages you have when thinking about a raise.

One advantage of running a proper process when fundraising is that the early parts of the process are designed to let you test your story over time to see if it resonates. If it does, then you know you're ready to raise an A. If not, keep working on the company until you are.

Process & Leverage in Fundraising

In any negotiation, leverage is the pressure that you can bring to bear on the other party to achieve your goals. While leverage is never the only thing that matters, it is a powerful and generally misunderstood tool.

It is critical to understand when and where to use leverage while fundraising. However, many founders – and most first-time founders – don't think systematically about leverage.

Though you can generate leverage from several different sources, fundraising leverage generally comes down to effectively using an investor's fear of missing out on an outlier company. As most venture returns are driven by a tiny number of companies, investors know that they need to invest in those companies in order to make money.

The trick, then, is convincing investors that your company will be one of those outliers. The way you do this varies slightly by stage, but always comes down to a mix of traction, team, vision, market opportunity, and product. Founders who combine these elements in a way that makes their upcoming success appear inevitable generally have more leverage while raising money.

Importantly there is another critical factor that founders must utilise alongside these five elements in raising money, to materially influence the leverage a founder has in any round – this is process.

Running a tight process while fundraising is a deceptively complex task. On the surface, it seems very simple, but without conscious focus, founders invariably screw it up.

Process is important because it gives founders the best opportunity to create a market for startups that favours the founders in the most important aspect of raising money: getting the right investor.

While a "good" market can also influence price, the quality of the investor is the most important target of leverage.
The difference between a market that favours founders vs one that favours investors is not the difference between an open market and a closed one. The difference is based on who has more information about – and control over – the process of the raise.

Process & Leverage in Fundraising

Serial fundraising tilts markets to investors

Early-stage startups usually operate in markets that favour investors. This is because the founders of those startups usually pitch investors serially – one by one as they convince those investors to meet and hear a pitch. Each time the founder walks into a meeting with an investor, the investor has full control of whether to make an investment decision.

As a founder meets with each new investor, chances are that some information about the company has reached the incremental investor before the meeting. This is because the network of investors is relatively small and often collaborative. Each investor that meets the company therefore has an information advantage and knows that either a) this company has been passed on before or b) this company is gaining momentum.
The investor in this dynamic has total ability to set the process and terms. If the deal is slow, then there's no reason to move quickly. If the deal is moving faster, then the investor gets to enter a bid with significant knowledge of terms and capacity. This is a great place for the investor to be.

Parallel fundraising tilts markets to founders

Founders who can reverse the information advantage create markets that favour them. When founders can create the same starting point for many investors, the investors are forced to operate in parallel. This means that any piece of information investors get has less time to spread through the network, which forces investors to make decisions on their own.

What's more, investors are not able to get a sense of whether the market is moving quickly, so they need to make decisions under the assumption that it is. If they don't operate under this assumption, then they'll lose their chance to invest in what they've come to believe is an outlier because someone else will grab it.

On a purely psychological level, this kind of opacity creates a competitive dynamic in a group of people – investors – who are extremely competitive. This is a significant advantage for founders.

Incubator programs where companies fundraise together, enable parallel fundraising, because the companies are willing to share information about where the market is at any given time, as well as pass on useful information about specific investors.

Founders can create this same dynamic whenever they raise by making sure that the number of investors getting first time access to the company at the same time is greater than one.

Process & Leverage in Fundraising

Series A Process

When thinking through a Series A, I advise founders to select a group of 15-20 investors who they think will, one day, be the right partners for the life of the company.

Figuring out who these investors are is more art than science. However, there are techniques which can help. Founders should talk to other founders in their industry to find out who is helpful and who simply writes cheques. They should spend time reading the posts that investors write – this will tell them what the investors are interested in and what they like to talk about.

At some point well in advance of the actual raise, founders should start meeting with a subset of those investors. Founders should work through that subset until they find the group with whom they want to work with. Founders need to impress and engage the investors through these meetings without sharing so much that the investor can fully evaluate a decision. Part of this is done by clearly communicating a timeline for when fundraising will start.

While these pre-fundraising meetings are valuable, founders shouldn't confuse them with actual fundraising. I've had founders tell me that the best way to raise an A is to pretend that they're not raising at all, and just have lots of social conversations with investors. This is almost always a bad strategy. The founders who have the most success in raising clearly and actively decide when to raise and then communicate that decision to investors, advisors, and other founders. These founders run well thought through processes in which they prepare their stories and decks, prepare diligence items, set up formal pitch meetings with the investors they liked most, and practice.

Founders who spend time figuring out who they want to work with before they start a formal process ensure that they have a market made up entirely of good investors. They've limited their risk of only receiving term sheets from investors they don't want to work with. At this point, founders have already started the process to tilt markets in their favour.

Founders continue to improve the tilt of the market by grouping meetings as tightly as possible by stage. First pitches should all happen within a one-to-two-week period, partnership pitches in a different one-to-two-week period. Ideally, this means that investors make their offers at the same time, without being able to collude or discover that others have passed.

Process & Leverage in Fundraising

There are two different common errors at this point – some founders let initial meetings drag out over the course of months, which moves the market back into the investor's favour. The other end is sometimes worse: founders create artificially tight deadlines for term sheets. Investors tend to react very badly to this latter case unless the momentum behind the company and deal are incredible. Getting this sequencing right is tricky because investors who know more about the company – and know that a fundraising process is coming – will be heavily incentivised to try to move ahead of all the other investors.

Founders have to manage this carefully. On the one hand, founders need to make sure that all their introductory meetings happen in a tight timeframe so that all funds are moving at the same pace. On the other hand, there are often inside investors who are good enough – and aggressive enough – to offer quality terms before a formal raise begins. Balancing this tension is different in every situation, and it's a good thing to discuss with someone with no interest in that round. Often, these early offers are good enough to take without running the process.

Founders who do not take pre-emptive offers must push the process forward. Managing this tightly creates the exact same type of market that founders who are part of incubators will experience as part of a demo day, if at slightly smaller scale. The impact of arranging meetings in a week instead of letting them drag out over many will provide a significant advantage and tilt toward the founders. At the same time, running a sloppy process – one in which founders lose track of the schedule or make overly aggressive timing demands – can destroy a fundraise for a good company.

Work vs. Fundraising

A final word of caution: founders often become obsessed with the process of fundraising. This is usually a fatal mistake for their companies. It is much easier to spend time theorizing and optimizing about when and how to apply leverage to specific investors than it is to focus on the fundamentals of a company.

In nearly every fundraise I've seen, great companies barrel through and keep going, no matter how heavily they optimize. Bad companies twist themselves into knots, celebrate silly meetings, and then run out of money – no matter how much they raise.

Knowing when and how to fundraise is important, but it's only worth thinking about when founders need to raise. Any other time spent on it is time that should be spent building your product / service and talking to users.

How to Optimise your Fundraising Round

It seems to me that many founders approach fundraising as they would a math problem. They think that there's a single correct answer. This usually leads to over-optimization, which is a mistake.

Optimization presumes that incremental changes improve fundraising and/or company outcomes. It does not. Because fundraising is never the deciding factor in the success of a company, founders should instead look to use a regret minimization function when fundraising. Essentially, they should get what they need, avoid doing stupid things, and move on. Part of the challenge in learning to not over-optimize is understanding what qualifies as a "stupid thing" and what qualifies as a big deal. There are nearly as many ways to over-optimize a fundraise as there are founders.

Here are some of the more common mistakes:

1. **Over-optimizing for price** - Founders optimize for price largely because of ego. If you've raised at a higher price than someone else, the thinking goes, your company and therefore you are better. This is absurd. Raising at high prices has almost nothing to do with the quality of the company. It doesn't necessarily even reflect how good the founder is at fundraising. Price mostly reflects where the market is at any given time.

2. **Over-optimizing for investor** - The funny thing about this one is that people start doing it before they even have offers. You only get to pick your investor if you have a choice. In the end, while some investors are better than others, none of them translate directly to success.

3. **Over-optimizing for dilution** - This is another take on price. Founders who quibble over selling 18% or 20% of their company in a round have lost sight of what actually matters - building the company for massive success.

4. **Over-optimizing for the amount raised** - When founders begin to obsess about the amount they are raising, independent of what they need, they lose sight of why they are raising money. Money is a means to an end, not a goal in and of itself. Raising more money doesn't yield success, but it usually results in more dilution.

5. **Over-optimizing for speed** - Founders who try to close rounds in days seem to believe that humans make better decisions under extreme pressure. This is almost never true.

Here's the tricky part: each of these decisions, price, investor, dilution, and speed are important. The right way to deal with each of these is to step back and approach them from the perspective of a goal that needs to be achieved.

a. Price - This needs to be high enough to allow the company to raise enough money to achieve its goals without so significantly diluting the founders and employees that they are not incentivized to work hard.

b. **Investors** - Most investors are fine. They provide capital and some help when asked. Some investors are great. They provide capital, are hugely helpful when asked, and get out of the way when asked. There is, however, such a thing as a destructive investor. These investors can hurt companies in several ways - they should be avoided.

c. **Dilution** - Founders need to retain enough ownership in the company to be committed to its success over and above any other business venture that they might pursue. If this flips, there's a risk to the founder drifting off or doing a mediocre job. Ownership is also often linked to control. At some point, most founders lose control of their companies, but it's generally good for this to happen as late in the life of the company as possible.

d. **Amount** - Founders raise money in order to hit specific milestones. Founders need to raise enough money to actually hit those milestones, with some buffer to account for mistakes or delays. While the press loves to talk about gigantic fundraises, smart founders raise enough to succeed, and not more.

e. **Speed** - Fundraises that stop moving quickly generally die. This is because it is always easier to not fund something than fund it. Founders need to be careful to keep a round moving fast enough to close, but it doesn't have to be much faster than that.

When fundraising, founders need to stay on top of many conversations with many people without losing sight of their businesses or employees or lives in general. With all of this in play, it is easy to lose sight of what matters and to start focusing on the wrong things. What matters most is getting enough money to achieve a set of goals. Paying attention to price, investors, dilution, and speed is important, over-optimizing them is not.

Discuss your business, its potential suitability for a sale transaction and the options available to you at an individual consultation with a senior INSIGHT partner. You'll be able to discuss your position in complete confidence, and meetings can be arranged at a time and location convenient to you.

To schedule, email contact@insightcf.com
or call: +44 (0) 7832 226916

COMPANY DETAILS
167 – 169 Great Portland Street,
5th Floor, London, W1W 5PF

+44 (0) 7832 226916

contact@insightcf.com
www.insightcf.com