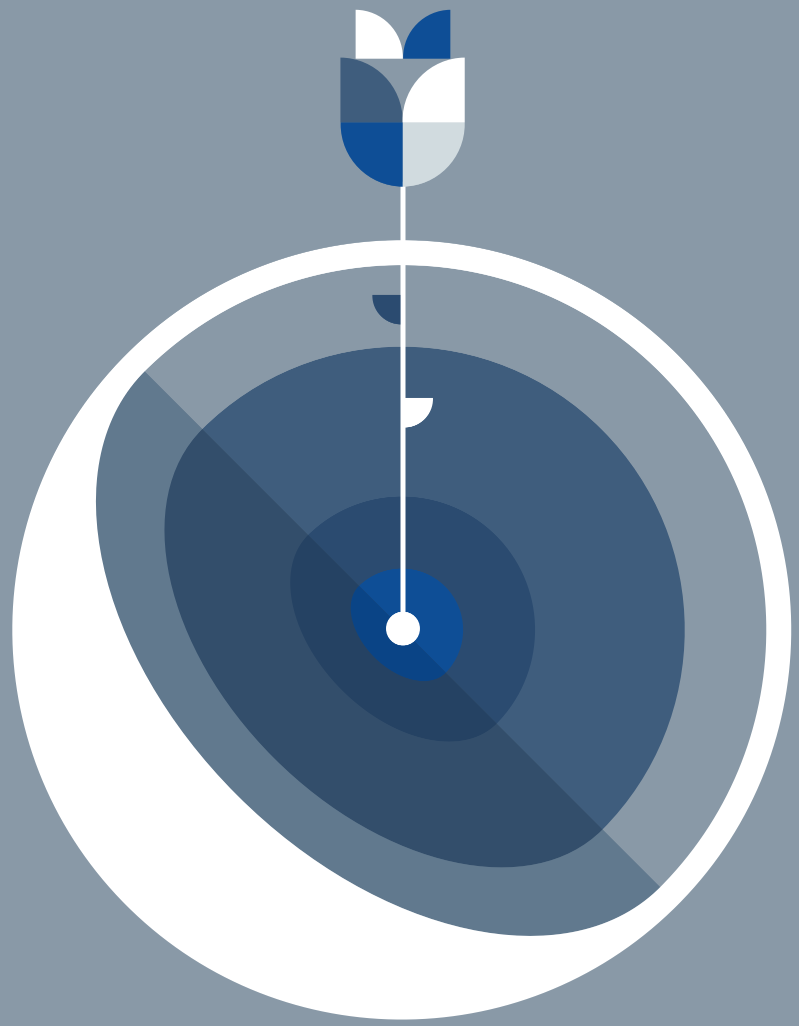
lool
VENTURES

# RAISING YOUR SEED ROUND

## A PLAYBOOK FOR ISRAELI ENTREPRENEURS

*Written by Max Marine, featuring Ido Bar-on*



2021
EDITION

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INTRODUCTION:

# WHY YOU NEED TO READ THIS GUIDE

I came to Israel as a volunteer in 2012, teaching English and working in community centers in Karmiel, Arad, and Netivot, before spending two months in Tel Aviv.

While in Tel Aviv I understood that there was an enormous gap between Israel's startup community and the US market. Since moving back to Tel Aviv in 2015 and joining the Israeli VC community, I've spent the last four years closing the gap and building a stronger bridge between the US and Israeli tech markets. I plan to continue this work for at least the next twenty years.

Along the way I identified another big gap in Israel's startup community, the information gap between entrepreneurs raising their seed round and VCs. Consistently, I've seen founders make avoidable mistakes in the way they present themselves and their business plans. These mistakes stem from a lack of knowledge of how VCs really operate. In the following chapters, I've summarized learnings from ~10 years of seed investing in Israel, with the hope that it will help bridge this information gap. And if you want the TL:DR version, check out this video :)

Big thanks to Avichay, Yaniv, and Tony for their support in developing this eBook, and a special thanks to former lool team member Ido Bar-On ("The Closer") who wrote the final two chapters. I wouldn't be where I am without the entire lool family, so for that I am eternally grateful.

Our intention when we published this eBook last year was to update it annually, including new insights and information accumulated from my professional experience.

**If you had told me last year that Zoom and Shopify would be worth $100b+, global economies would shut down for weeks and months because of a virus, and Israel would normalize relations with the UAE and Bahrain, I probably would have laughed you out of the room.**

But here we are, a year later, in what looks like a very different world. In the spirit of this new world, We've updated Chapters 1-5, and Chapter 7 with helpful content that can help you navigate the evolving VC landscape.

Enjoy!
Max

CHAPTER 1

# DO I NEED VENTURE CAPITAL AND HOW MUCH SHOULD I RAISE?

You found your co-founder(s).
You validated a market need. Maybe you have a PPT, MVP, PoC, Design Partner, Alpha, Beta, Pilot, or your first paying customers. Now what?

**BEFORE YOU APPROACH A VC FUND, STOP TO CONSIDER WHETHER IT'S REALLY NECESSARY.**

## YOUR COMPANY MAY NOT NEED VENTURE CAPITAL TO SUCCEED.

In fact, bootstrapping, grant funding, angel investments, consulting projects, and holding companies can occasionally bring a startup to profitability and in control of its own destiny.

Aviv Shapira
CEO
XTEND
Extending Reality Skywards

However, many high potential technology businesses require significant investment before generating sales and even more to reach sustainable profits. If this is the kind of business you set out to build - if you have your sight set on creating a significant impact in the world, on ringing the NASDAQ bell, or in carving out a place for yourself in the history of great companies, then VC funding is probably your best option.

As you set your foot on this path, you will find that ironically, before you sell your product, you'll need to first successfully sell a financial asset - ownership in your company (equity)!

**Fear not though, as a sale is a sale is a sale. Like in any other transaction, to succeed, you need to understand what motivates and drives the buyer to buy.**

Whereas an IT buyer may be motivated by corporate strategy or the severity and frequency of a specific problem, an investor is primarily motivated by the future potential of your venture. So to successfully sell your equity, you must understand venture economics. In my experience, more than half of the founders that I speak to have not taken the time to do this, so if you are reading this book, hopefully it will give you a competitive advantage.

# VC ECONOMICS

## Believe it or not, VCs also have to fundraise. Rather than a seed round, and hopefully A, B, etc. they raise fund 1, and hopefully, fund 2, 3, etc.

Rather than promise product market fit or $10m in sales, they promise to generate a 3x+ return on investment over a 10 year period.

Unfortunately, after 2% in management fees & 20% in carried interest ( a fancy way to say a % of the profits), a $100m fund can only invest $80m and needs to generate $350m in returns (4x) in order to generate 3x to its investors.

What type of investment strategy will yield these types of results?

**Let's consider four possible exit scenarios, given that the fund invests in between 10-20 companies.**

1. One portfolio company exits at $3.5b and the VC holds 10%
2. Two portfolio companies exit at $1.75b and the VC holds 10% in each.
3. Four portfolio companies exit at $875m and the VC holds 10% in each.
4. Eight portfolio companies exit at $437.5m and the VC holds 10% in each.

**While each of these scenarios results in the same $350m in proceeds, which scenario seems the most probable?**

While these four scenarios all yield the same amount of exit proceeds, they have wildly different probabilities of occurrence. Growing eight companies from $0 to $437.5m is considerably harder than growing one company from 0 to $3.5b. As VCs underwrite each investment, the high rate of failure forces them to back companies in which they believe will independently compensate for all of the companies that fail to get to that magical "inflection point".

VC funds need triples and home runs ($100m-$1b+ exits) to make the model work and thus cannot justify investing in the singles and doubles ($10-$100m exits).

The whole point of this exercise is to illustrate that you should think long and hard about your motivations and aspirations before approaching VCs.

This doesn't mean you should assume all the risk as a founder to generate an outsized return for the VC. There are common mechanisms to reduce your personal risk along the journey, such as selling some of your equity to secondary buyers.

**But know that either you're going to have to convince VCs you are building a multi-billion dollar business, or hope that the VCs haven't properly done their math.**

Before you choose wisely, let's take a brief look at the current fundraising climate.

# COVID-19's
## Impact on Fundraising

The impact of COVID-19 varies by domain, founder, and fund. While March's stock market crash led many VCs to assume post-COVID-19 valuations would tank and make it more difficult to raise follow-on funding, restrictions on movement have actually increased global demand for technology, sending the NASDAQ soaring to historic highs and VC confidence bouncing back to pre-COVID levels. From work to education, entertainment, retail, logistics, finance, socializing, gaming, communication, manufacturing, construction, real estate, agriculture, healthcare and the tech infrastructure supporting all of these domains, many investment sectors are **more** desirable, creating a tailwind for VCs and therefore many founders. Furthermore, early-stage Israeli VCs have raised $2b in new commitments since 2018 and need to invest in new companies.

At the same time, if your company relies on in-person interaction to generate leads or close deals, will you have enough traction to raise your series A?

If you're someone who makes great eye contact, how will that translate if you're now forced to fundraise over Zoom? What if the VC you're speaking to thinks we're about to enter a prolonged global recession, congress will break up big tech, the NASDAQ will crash and dry up follow-on funding like we saw in March and April? Given this ever-changing macro-environment...

# HOW MUCH
## SHOULD YOU RAISE?

Work backwards. First, what level of traction would convince a Series A investor to write a ~$7m-$15m check into your business? Second, what amount of capital do you need to generate that traction? Unfortunately question #2 is dependent on your answer to question #1, so let's start with that.

The general rule of thumb is that you should have "product-market fit" when you raise Series A. However, Automotive tech faces slower sales cycles but larger deals, Cyber is super competitive, Digital Health may require clinical proof, and an enterprise SaaS company might have 1 paying customer or $1.5m in ARR when it raises Series A. Thus the "product-market fit" rule is often subjective and forgiven, and is a function of a wide range of investor's risk tolerance and personal biases/preferences. Furthermore, because Series A investors compete with one another, you might convince one of the funds to take more risk by creating sufficient FOMO.

**On the one hand you'll be dealing with a handful of personalities, each one susceptible to falling in love with you and your story, regardless of the assets you've built. On the other hand, when you're looking for love, you're least likely to find it. So rather than rely on storytelling & FOMO for Series A without business proof, build a plan to have both at your disposal.**

Another way to reduce your follow-on funding risk is to develop relationships with Series A investors from the beginning. Meet them and share your business plan while you're raising seed. Get a sense of excitement and belief in your vision and what proof points they would require to get comfortable investing. See which personalities you click with. If you come to a seed round investor with target achievements based on conversations with Series A investors, you'll be able to answer question #2 with more confidence and clarity.

Still, given the variety of areas in which VCs invest, the amount of seed capital you'll need depends on your domain, competitive landscape, talent required to build a product and get to market, and the impact COVID-19 has on your remote work and go-to-market strategy. Lastly, it will also depend on how much capital you've raised before your seed round, a topic we'll explore in the next chapter, "Understanding the Funding Landscape".

CHAPTER 2

# FUNDING SOURCES

# UNDERSTANDING THE FUNDING LANDSCAPE

# THE EARLY STAGE FUNDING LANDSCAPE HAS SHIFTED DRAMATICALLY IN THE PAST FEW YEARS.

**Most of Israel's "super angels" stopped making new investments and a cluster of pre-seed-only funds emerged**. Equity crowdfunding platforms gave international investors access to start-ups on a deal-by-deal basis, while donation-based crowdfunding platforms gave entrepreneurs a channel to convince consumers to fund R&D costs. Decentralized finance built on blockchain technology made waves in 2017 and continues to mature as another crowdfunding alternative to traditional venture capital.

Larger funds began including pre-seed and seed in the definition of "multi-stage". Dedicated post-seed funds sprung up to help extend runway for companies that needed extra time to show more business proof for Series A. U.S. funds, which historically waited for Israeli companies to set-up a U.S. headquarters before investing, dropped the requirement and became more comfortable deploying capital with less U.S. traction. Clearly there's a lot to unpack here.

## Israel is maturing as an ecosystem

Israeli start-ups have proven they can go all the way. At least 40 of them are worth more than $1b, and Israel has firmly cemented its brand not just a hub for innovation and technology, but as an exporter of global category leaders. At the same time, large tech companies like Amazon, Facebook, Microsoft, and Google have expanded their Israeli presence and increased the premium for talent, while fewer start-ups are being created than at any point in the last ten years.

Unsurprisingly, more funds, fewer start-ups, and increased competition for talent has translated to larger rounds at higher prices and start-ups getting VC attention / funding that wouldn't have made the cut a few years ago. Furthermore, US funds have started to invest in Israeli companies earlier (though rarely at the Seed stage), with several additional later-stage funds setting up local offices in the past year.  Beyond that, COVID-19 has further leveled the playing field for Israeli founders to have Series A conversations with US funds over Zoom.

In addition to the current oversupply of capital, fear of losing an outlier to US Funds may also explain why Israel's multi-stage funds are both lowering the bar for large seed rounds (traditionally reserved for an exclusive club of serial entrepreneurs), and for the A round (many companies have raised with limited revenue, or no revenue), despite US funds doing the opposite! It seems that Israeli funds are increasingly desperate to get in early, and are willing to take on unrewarded risk to do so.

## Is Seed a Phase?

In recent years, a handful of VCs have come out of the woodwork to say that "Seed is now a phase". In 2018, Hunter Walk wrote "For Fundraising, Seed is No Longer a Round, It's a Phase". The emergence of more than 20 new funds spanning pre-seed, seed, and post-seed in the past few years supports this view. However, given that seed rounds can now be larger than Series A rounds and the required metrics for Series A can range from a successful pilot to $2m in ARR, it increasingly seems like there are only two stages of a company's life: pre-inflection and post-inflection. Before you hit an inflection point, you still need to tell a story, i.e. package incomplete business data in a convincing way. During the time period between 0 and Inflection, you may need to raise anywhere from 1 round to 10 rounds and $1m to $100m, depending on the unique attributes of your business and target market. When you hit an inflection point, you'll have developed a system that can profitably acquire new and upsell existing customers/users. The more profitable this system, the more your company will be worth, and the faster you'll be pushed by every later-stage fund and their grandmother to take more capital. Rather than thinking of seed as a phase, think about pre-inflection as a phase, and build your fundraising plan to reach inflection.

# FUNDING SOURCES FOR ISRAELI STARTUPS

Before you build the plan, it helps to understand what type of ownership each type of investor seeks, how good their reputations are among other entrepreneurs and later-stage investors, and how much control they'll want over key decisions such as hiring, budgeting, selling the company, and future financings.

Each time you fundraise, ask yourself—how will this change the incentive structure of the company, and will the net impact be positive? Properly aligned incentives increase the probability that your company will succeed.

When it comes to raising capital at the early stages, giving away too much of your company too early may make future investors afraid that you lack the economic incentive to take the company the distance.

Below you'll find brief descriptions of the various funding sources in Israel, their investment size and ownership target ranges, as well as the impact they can have on your ability to fundraise in later stages.

**Funding Sources Covered in this Chapter:**

## The Israel Innovation Authority

(previously known as the Office of the Chief Scientist/OCS)

The IIA provides non-dilutive funding from the Israeli government that can help you cross the riskiest phase of your startup. This funding will come with conditions, such as a requirement for matching funds, keeping your IP in Israel, paying a revenue royalty, and/or paying an exit fee.

IIA funding is viewed positively by VCs, assuming they are the ones doing the matching. Often incubators (discussed below) are the ones who do the matching, giving them a significant amount of equity in the company for a small check. Before you find a "match," you must understand the conditions of the IIA's offer and make sure it is within industry standard ranges, or you may have a deal that's too risky for the next investor to swallow.

Make sure you explore the various programs and conditions thoroughly, rather than taking the first shiny deal that looks reasonable. The IIA is notoriously inconsistent with their decision-making timelines, so always have other options in hand.

## Incubators

Incubators are a source of high dilution funding, often leaving the founders with 60–75% of the company. VCs may consider incubators as a negative signal for any company that doesn't have extremely interesting IP. That's because it will be harder to align economic incentives when the founders have given up such a significant part of the company but still have limited commercial traction. Furthermore, if the incubator has a Micro VC attached to it, and that Micro VC passes on your seed round, this could also send a negative signal to other investors.

On the flip side, some incubators have an expertise, domain, technology, and/or access to initial design partners that can significantly reduce the cost of R&D and/or securing your first pilot. Sometimes the value-add of the incubator justifies high dilution, but judge each situation independently and do your due diligence before accepting an offer.

## Accelerators

Accelerators provide low dilution funding, often leaving founders with 90-95% of the company in exchange for $50,000-$120,000. Israeli VCs usually see acceleration as a positive signal if the accelerator is based abroad. There are also some highly respected Israel-based accelerators, but it's important to do your homework by checking with other entrepreneurs who have graduated and hearing about their experiences.

## Professional Angels

Moderately dilutive funding, often leaving founders with 80%-95% of the company in exchange for $50,000-$500,000. If the angel/angels provide significant value and have a great reputation (check with entrepreneurs from their existing investments), then it's completely worth it, especially in cases where angel reputation sends a positive signal to VCs for the next round.

In the past few years, Israel's traditional super angels have either scaled back their investment activity preferring to focus on operating and advising their existing portfolios rather than deploying new funds, or leveraged their brand to raise their own VC funds. In parallel, a cohort of founders & senior employees at Israeli unicorns have started to quietly invest in their friends directly and alongside pre-seed & seed funds.

## Private Investors

Private investors offer moderately dilutive funding, often leaving founders with 70-90% of their company in exchange for $250,000-$2 million. In this case, these investors are not professionally investing in startups, but are more opportunistic. They may come from your target market, have synergistic business interests with your startup, or want to diversify their holdings into tech.

While taking money from targeted business professionals can provide an advantage, taking money from less experienced “diversifiers” may decrease the likelihood that a VC will invest in your company. VCs, in general, don’t like to deal with investors who aren’t accustomed to the types of situations early-stage companies face, such as pivots, illiquidity, bridge rounds, uprounds, and a variety of documents that need to be processed quickly in order to effect changes in economics, control, and/or governance. Unless this private investor has given your company a clear competitive advantage, it is likely to be seen as a negative.

## Holding Companies

Extremely high dilution funding, often leaving founders with 10-50% of the company. In this case, founders are incubating a company within an existing service provider or holding company, and leveraging their resources to access customers and/or accelerate R&D. VCs and Micro VCs dislike these types of deals, because they require a complex and often emotional dance to rebalance the cap table and realign incentives, as well as all sorts of potential IP complications.

If you are starting a company within another company,the chances of getting VC funding for your seed round are close to zero. That doesn’t mean it’s a bad decision, but you should be aware that it limits your potential for raising venture capital.

### Donation-Based Crowdfunding Platforms (DCPs)

Non-dilutive funding, essentially allowing you to finance your development costs with prepayments from your early adopters. Very low risk, but increasingly challenging to break through the competitive noise which requires upfront capital to attract the attention of the crowd. In addition, DCPs are not a reliable fundraising channel for B2B or software products, as they tend to focus mostly on consumer hardware.

### Equity Crowdfunding Platforms (ECPs)

Moderately dilutive funding, often leaving founders with 75%–90% of their company in exchange for $250,000-$2.5 million. In this case, you are dealing with an online intermediary that is investing on behalf of a group of accredited investors. In some cases, the platforms have committed capital that allows for full or partial financial commitment to founders. In other cases, the platforms need to run a marketing campaign to their investor community to secure all or some of the capital, meaning that you lack visibility into the timing and amount of funding you will receive.

ECPs can have a positive impact on your business, because their audiences may serve as a marketing channel. Similar to DCPs, consumer-facing businesses that raise funds from ECPs immediately get their product/service in front of potentially thousands of users as part of the fundraising process. B2B, B2G, and B2D businesses have lower synergy with the ECP's investor community, but with the right algorithms or analysts, matching with a helpful investor in the ECP community can accelerate your progress in a number of ways.

ECPs can lead rounds or follow rounds, depending on their investment philosophy. Like all other funding sources, make sure to speak to other entrepreneurs and get feedback before you sign any documents.

## Strategic/Corporate Investors

Low dilution funding, often leaving founders with 90-95% of their company in exchange for $500,000-$1 million. In the seed rounds, it's unusual for corporate VCs to participate, as usually the traction threshold is too low and check sizes too small for them to pass it through their investment committees.

There are some exceptions to this rule of thumb, but if you do include a corporate investor in your seed round, aim to have two, with each less than 5% ownership. This way neither strategic has control or influence over key board decisions. Do your homework to understand if having their name in your cap table may cause issues with your target customers or future acquirers.

## Pre-Seed Funds

Moderately dilutive funding, often leaving founders with 80-95% of their company in exchange for $250,000-$500,000. In this case, you are dealing with professional investors who are investing both their personal capital and a potentially a group of external investors (Limited Partners). If it's a new fund and has a small portfolio, do your diligence by checking the resumes of the partners, and through your mutual LinkedIn connections.

There are a couple of reasons to raise a pre-seed before raising your seed, or skipping to the A. One, you try to raise your seed and get rejected. Two, you can prove out any significant assumption about your team, tech, product, market, go-to-market, and/or business model that only requires $250k-$500k but significantly reduces risk. This proof may allow you to raise your next round faster than if you had bootstrapped your way to the same achievement. It may also allow you to raise at better terms, from better investors, than if you had fundraised without first validating one or more assumptions.

## Seed-Stage Funds

Moderately dilutive funding, often leaving founders with 70-85% of their company in exchange for $500,000-$2.5 million. In this case, you are dealing with professional investors who are primarily investing on behalf of a meaningful number of external investors (Limited Partners) and leading seed rounds. There are only a handful of seed funds in Israel that have been around for more than a few years, so again, do your homework by speaking to founders who they've invested in previously, to make sure you are partnering with funds who will be there for you in both good times and bad.

## Multi-Stage Funds

High dilution funding, often leaving founders with 60-80% of their company in exchange for $2-$8 million. In this case, you are dealing with professional investors who are primarily investing on behalf of a meaningful number of external investors (limited partners), leading A rounds, and sometimes, B, C, and further rounds. However, in the last two years, as A rounds have become more competitive and expensive, many of these traditional A players have moved upstream to buy less expensive equity. In addition, a number of funds identify as "Seed and A" round investors, further blurring the distinction between Multi-Stage and Seed-Stage.

Raising seed from Multi-Stage Funds is generally more challenging, since these funds have to deploy a lot of capital. Generally, they want deals where they can invest at least $5 million, if not more. In addition, they have the flexibility to wait 12-18 months and pay a higher price in the next round, at potentially much lower risk. Seed funds, in contrast, have a dedicated focus to seed, which means there can be a greater urgency and speed of process.

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## Signaling and Future Financing Risk

If a Multi-Stage Fund leads the seed round, but doesn't lead the A, it could signal one of two things to future investors. First, the fund may have enough ownership to satisfy their return expectations, and doesn't want to have too much control over the company, as this may make it harder for a new VC to feel comfortable joining the board or working with the company. Alternatively, it's possible that the VC isn't excited enough about the company's prospects to lead the A round. Since VC is a game of outliers with a power law, the winning strategy is to go all-in on the one or two winners, which would logically require the VC to lead the A if the company was the "one," or "two" in the fund. Unfortunately, at the A stage it's still very difficult to estimate a company's future performance, so sometimes the VC could choose to lead the A in one of the losers, and fail to lead the A in one of the winners.

Either way, having a VC lead your seed but not your A may present a negative signal that you'll need to overcome in order to secure follow-on funding. This could create a suboptimal outcome for the company; either raising money from a lower quality investor, or closing up shop.

Traditional VCs may also have less experience guiding seed entrepreneurs to the A round, because historically they would wait until the company achieved relevant business traction before evaluating them. Unlike seed funds which live and breathe the chasm between seed and A rounds, and have hopefully learned a few lessons that they can share with their portfolio, multi-stage funds that are new to the seed-stage may share theoretical advice that makes sense, rather than practical

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advice that has been derived from watching their seed investments evolve.

If you raise from a seed fund, then you have the flexibility to fundraise from any multi-stage fund. If you raise from a multi-stage fund, you may limit your options for the A.

Setting a low bar for round A will impact your ability to raise future funds. You may rejoice when you get an early term sheet for your round A from an Israeli investor even though the revenue you generate is not yet at the level of, say, a US Silicon-Valley based VC. However, when it's time to raise your B round, you might find that the gap between your achievements and the industry standard increased to a level that severely limits your funding options, perhaps even to the point of requiring a down-round.

**On the flip side, if you need time to pivot or you have a longer than expected sales cycle, your financial projections will crumble pretty quickly and you'll need an additional infusion of capital. Multi-stage funds have more financial patience and can provide healthy bridge rounds, presuming they believe in you. Seed funds, by definition, have less money, which makes them less generous in bridge situations.**

## Post-Seed Funds

Speaking of additional infusions of capital, a number of moderately dilutive funds have sprung up in the last few years that are willing to invest between $1-$3m in between seed & A for 10-20% of your business. In this case, you are dealing with professional investors who are primarily investing on behalf of a meaningful number of external investors (limited partners), and will invest in a range of scenarios, from helping your company avoid bankruptcy to pleading with you to let them into your cap table because your seed round was oversubscribed.

## LEADERS vs. FOLLOWERS

In most cases, your seed round will consist of a lead investor who takes a board seat and a majority of the round, and a combination of followers - other funds, angels, and/or strategics. Make sure to understand the preexisting relationships between the different personalities around the table. The last thing you want is to have two investors in the round who have a prior conflict, as this will cause dysfunction at the board level and/or in strategic decision making. Usually, discussing the round construction with the lead investor will help you gain clarity on the types of co-investors they prefer. Also, keep in mind that most funds are open to either following or co-investing, depending on the situation, so make sure to understand each investor's policy before engaging in the investment process.

## DESIGNING YOUR FUNDRAISING PLAN

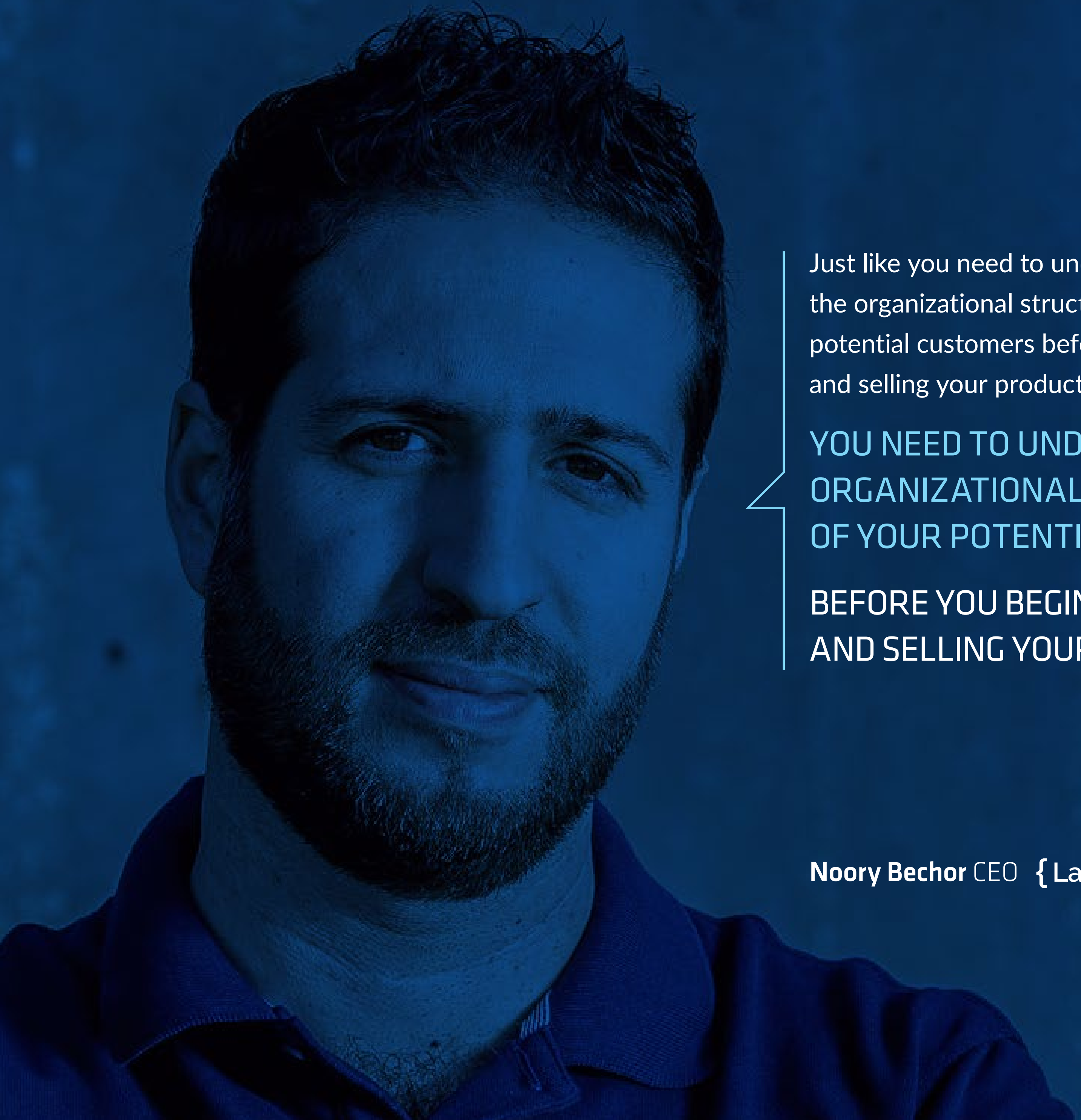
Whether you decide to raise a pre-seed & a post-seed, an angel investment and seed round, a jumbo seed and pre-A bridge, or go through an incubator, accelerator, and holding company before raising your A round, the choice is yours.

Convincing a fund to actually lead your seed round, however, is not. In order to improve your chances of securing a lead, the next chapter outlines the VC organizational structure and how it's evolving alongside this changing funding landscape.

CHAPTER 3

# VC ORGANIZATIONAL STRUCTURE

## AN OVERVIEW



Just like you need to understand the organizational structure of your potential customers before marketing and selling your product,

YOU NEED TO UNDERSTAND THE ORGANIZATIONAL STRUCTURE OF YOUR POTENTIAL INVESTORS

BEFORE YOU BEGIN MARKETING AND SELLING YOUR EQUITY.

**Noory Bechor** CEO {LawGeex}

In 2019, I focused on the roles of Partners and Investment Professionals. In 2021, I supplement this overview with two additional roles that many VCs also involve in the investment process, or at least in the post-investment process.

## THE ROLE OF OFFICE MANAGER / EXECUTIVE ASSISTANT

**This role is responsible for many administrative and operational aspects of the VC. In most cases when you need to schedule a meeting with a Partner, you'll need to coordinate with an OM/EA.**

If and when you arrive at the VC's office, you'll be greeted by the OM/EA. In some cases, you'll need to schedule anywhere from 3 to 15 meetings, and compete with other founders for VC attention. While it is possible to view the OM/EA as  an obstacle or a cog in the venture wheel, this type of mentality isn't likely to pay off. At most VCs, the relationship you build with the OM/EA can impact the impression you make with the fund and momentum you create through frequency of interaction.

I once was interviewing for a job opportunity over lunch. I ultimately didn't end up accepting the offer, but the Partner who took me out to lunch told me after the process that even more important than my answers to his questions was the way I treated the waiter. This experience has stayed with me ever since.

Oftentimes you can answer all of the questions correctly and check all the boxes. But if you don't respect each person in the organization as a human being, it may ultimately be your downfall.

## THE ROLE OF VALUE CREATION

**In the past few years, venture capitalists have been forced to compete in the ways in which they "add value" to their portfolio companies. For some, this comes naturally as part of their "personality", others needed to adapt and include this in their offering.**

Historically, "value add" was a blend of advisory and introductions, usually from the Partner that led your seed and sat on your board. Some firms have a more structured approach to this with a dedicated team supported by tools and processes. US firms like a16z and First Round Capital went even further and pioneered the idea of a "platform" that would equip their portfolio with additional expertise in HR, product, marketing, sales, as well as an ever-growing network of potential customers and channel partners.

This platform model has not yet made it across the Atlantic, but there are signs that it's on the way. Meanwhile, not only should you try to understand each VC's approach to value creation as you build your target list, but understand if this function has any involvement in the investment process, rather than just the post-investment process.

Some value creation professionals are an integral part of the fund's investment committee, while others are primarily focused on cold-emailing potential customers.

## THE ROLE OF INVESTMENT PARTNER

Investment partners, referred to as General Partner, Managing Partner, Managing Director, Junior Partner, and/or Founding Partner, have to sign off on each investment they lead. Several partners and all Solo Capitalists have full autonomy; i.e. the ability to make an investment decision without consensus or collective agreement from the other partners.

Usually autonomy is correlated to track record; the longer and more proven the Partner's track record, the more influence they bring to the decision making process. Other partners may have less autonomy and need to pass a deal through an Investment Committee that in the limit can surpass a global team of 30+ partners, but in most cases requires majority approval of the local Israeli team (if a global VC).

Before engaging with different funds, try to understand each Partner, their track record and influence within the fund, as well as the type of investment committee both of you will need to convince in order to secure funding. Realize that working with a less proven Partner may require a higher burden of proof to convince the rest of the Partnership to approve the investment. At the same time, a less proven Partner is likely to work like crazy for you as a board member because they need to prove out their reputation.

On the flip side, a more proven Partner creates a positive signal to the A round investor and likely has more experience/connections to support you through the journey. In business, reputation is everything. So do your homework before you begin outreach.

## THE ROLE OF INVESTMENT PROFESSIONALS

**Investment professionals at most funds occupy a highly coveted and competitive position often bringing more than 100 applicants per role.**

While you should judge each investment professional individually, remember that statistically speaking, VC investment professionals have some unique advantage(s) and can add value to your company, even if a Partner doesn't invest. Many of the investment professionals I've met in Israel have good intentions, critical thinking skills, and strong networks. It's best to view investment professionals as a relationship-building opportunity rather than an obstacle.

Within a fund, you can expect titles to reflect a chain of command, but between funds, titles are difficult to interpret. In general, Analysts and Associates focus more on sourcing and due diligence, while Principals and Vice Presidents focus more on due diligence, deal execution, and portfolio/LP support.

If the partners have the final say, you might conclude that it's a waste of time to engage with investment professionals. But in many cases, an Analyst, Associate, Principal, or VP must convince the partner(s) to spend time on a deal. Other times, the Partner(s) are the ones who drive a deal forward, tasking his/her investment team with certain assignments.

It's important to establish who leads the investment process in each fund. Sometimes you can discover this information by reading through the investor's website and learning who works on investments and in what capacity. What you find online isn't always accurate, though, so you should also speak with recently-backed entrepreneurs to learn who has the most influence over the decision making process

In some funds, Associates will have a stronger voice and process ownership than Principals at other funds.

In addition to speaking to recently-backed entrepreneurs, you can further assess the influence a non-check writer has at his/her fund by looking at his/her Linkedin and seeing how long he/she has been in the VC industry in general, and the current fund in particular. In the first six months at a fund, a non-partner will have limited influence, because they still need to build trust with the partners.

Since Partners at the seed stage don't have time to review all the companies that approach them, investment professionals often conduct an initial screening to determine whether or not your company is a good fit for the fund's investment strategy. This initial screening usually takes place on the phone or over Zoom. It's frustrating if you don't make it past this initial screening, so in the next chapter, I'm going to share my tips for optimizing the screening process and securing your First Partner Meeting.

CHAPTER 4

# SECURING YOUR FIRST PARTNER MEETING

BUT BEFORE YOU BEGIN APPROACHING INVESTORS,

# DECIDE ON THE TOOLS YOU'LL USE TO TRACK AND MANAGE YOUR INVESTOR LIST.

Google Sheets are an easy way to get started, followed by more advanced tools like Trello, and CRMs like Streak or Pipedrive.

## PREPARE A LIST OF RELEVANT INVESTORS

Once you've decided on your toolbox, begin building a list of relevant investors. Using a database like SNC, it's pretty easy to get a curated list of the funds investing in Israeli startups, including their stage and industry preferences.

If you are raising capital for an enterprise SaaS business, exclude automotive and hardware specialists from your list. If you are raising capital for a cybersecurity business, prioritize cyber specialist VCs, and spend more time thinking through the best way to market to these higher priority investors.

Keep in mind that the fund that leads your seed round sends a quality signal to A round investors. Given that there are more than 100 funds to consider, talk to other founders and learn about the different brands in Israel. Almost all VCs are nice and professional - until the shit inevitably hits the fan. You need to know which VCs and which Partners will have your back through the thick and the thin.

## CONSIDER YOUR TRACK RECORD

KEEP IN MIND THAT EVERY INVESTOR THAT SPENDS TIME WITH YOU IS, BY DEFINITION, NOT SPENDING THAT TIME WITH ANOTHER ENTREPRENEUR.

SO WHAT WILL INFLUENCE INVESTORS TO CHOOSE TO SPEND THEIR TIME WITH YOU?

**Adi Pinhas** CEO
Brodmann

**The first and most important factor is your track record. All investors predict the future by studying the past. If your personal history includes one of the following, you'll have a much easier time attracting investor attention.**

- ☐ Exited a previous startup as CEO
- ☐ Exited a previous startup as co-founder
- ☐ Joined a startup that exited as an early employee
- ☐ Joined a startup that exited as a later employee
- ☐ Ex-intelligence unit officer and team leader
- ☐ Ex-product manager or team leader at Google, Facebook, Amazon, Intel, or other large tech corporation
- ☐ Domain expert solving a problem you dealt with first hand in your previous job
- ☐ Unique PhD research now raising capital for commercialization
- ☐ Former VC who had enough of the dark side
- ☐ Failed at a previous startup that raised money, but was a victim of macrotrends
- ☐ Took a previous business to profitability, but could not sell it
- ☐ Already backed by a notable angel

If none of those apply, it will be difficult to secure a meeting with a Partner without impressive traction, since you have to compete with these 12 track records for attention. Without showing something super interesting from the market you're targeting, such as successful pilots, paying customers/users, and/or extremely interesting IP, your chances of capturing and sustaining Partner attention are low.

## DEVELOP YOUR MARKETING STRATEGY

Now that you've created your list of targets, you can segment your marketing efforts into two strategies; online and offline, and three tactics: inbound, relationship, and outbound.

## ONLINE

***Inbound Marketing*** involves capturing an investor's attention via your digital footprint and/or word of mouth. The investor then reaches out to you to learn more about your startup. In this situation, always ask how the investor heard about you, to get more clarity on your best-performing marketing channels.

In the inbound marketing scenario, you start from a place of strength, since the investor finds you interesting enough to approach you. You can more easily control the conversation dynamics. The optimal scenario is if a Partner approaches you directly. However, most inbound leads come from investment professionals, because their most valuable currency for building credibility is investment opportunities, or dealflow, that the Partners would have otherwise missed.

To optimize the interaction(s) with an investment professional who has approached you, it helps to understand their motivations. Investment professionals improve their credibility by bringing good dealflow, and damage their credibility by bringing dealflow that the Partner(s) think is a waste of time. "Good" dealflow must meet certain investment criteria, which I will discuss in more detail in Chapter 5. To meet this criteria, sometimes you'll need to share materials, have a call, and/or follow-up meeting with the investment professional to convince them that by bringing you in for a meeting they will improve, not damage their credibility. As discussed in Chapter 3, investment professionals can be your champion in the investment process and help your company regardless of the decision.

***Relationship marketing*** leverages your network to get a warm introduction. If you already have a personal relationship with a target investor, you can approach them directly and bypass the third party. But if you want to reach investors outside your first-degree network, consider this flow:

1. Confirm that your mutual contact feels comfortable making the introduction.
2. Provide them with an email that can be forwarded to the relevant Partner or professional at your target fund, including supporting marketing materials.
3. Follow up after the introduction, to secure a face-to-face meeting.

This can mean both following up with your mutual contact to make sure an introduction is properly made, as well as following up with the investor after the introduction, as sometimes an introductory email can get lost in the inbox.

For relationship marketing, keep in mind the hierarchy of trust in the mind of a VC, i.e. which sources they take the most/least seriously. The more credible the introducer, the more likely the investor will get excited by the opportunity. In other words, a warm introduction from a successful founder, both within or outside of the portfolio, angel, or industry expert has a higher probability of converting to a meeting than one from a service provider.

Furthermore, when investors meet you in person, the source will have some degree of influence on their level of bias. The more credible/trusted the source, the more interested the investor will be. The source will usually come up as a discussion point during later internal discussions and can either improve or reduce your chances at moving to the next stage.

## A quick note on using a "finder"

Occasionally, founders hire investment advisors to manage the fundraising process on their behalf. Most VCs in Israel prefer not to work with advisors at the seed stage, as they don't want 5% of their investment (and most likely, 5% of your already-stretched budget) going to a non-productive asset. Unless you are extremely experienced in your domain, have a long and proven track record, and have never spoken to VCs, this type of relationship marketing is likely to yield negative results.

## ***Outbound marketing*** means approaching investors directly.

This method signals that networking and/or marketing is not your forte, because Israel is a small country and it shouldn't be that hard to find a connection. If you fail to manage, and really want to get in front of a specific investor, acknowledge in your outreach why you've decided to cold approach.

Perhaps you come from a traditional industry and have no friends who have raised venture capital. Maybe you lived in a foreign country and just moved back to Israel. No matter the situation, if you can network your way to a warm intro, VCs will take you more seriously. You will also learn a ton along the way to improve your chances of converting the intro into an investment process. For further insight into this topic, check out Yaniv Golan's post, "Founders, don't cold-email VCs. Except sometimes you should." My advice is to avoid outbound marketing unless it's offline.

## OFFLINE

The previously discussed tactics apply to offline marketing as well. In an offline scenario, such as an event or conference, you can:

**A** | Get approached (inbound) by an investor;

**B** | Get introduced (relationship) to an investor; or

**C** | Approach (outbound) an investor.

Offline marketing usually converts at a higher rate to a follow-on meeting, because it's harder to reject someone face-to-face, and you stand out from the other entrepreneurs who are only doing online marketing.

However, in 2020, almost all of the events and conferences have been digitized or cancelled. Meeting new people in public has all but been banned, which means you need to be razor sharp online. If/when things go back to normal, you may find that you've become so good at online marketing, you can give up offline marketing altogether!

## PREPARE YOUR MARKETING MATERIALS

To execute effective online and offline marketing, you need to develop solid marketing materials that will support your efforts to garner interest from your target investors. Although occasionally you can get a face-to-face meeting without presenting any materials, this is the exception rather than the rule. Most of the time, even when working through a trusted connection, the investor will want to review a paragraph describing the business and team at the minimum, and a full investor presentation at the maximum.

All communication must be done in English, even if you're sending it to an Israeli investor. The tech world runs on English, the databases are in English, the tools use English, and many of the people investors may exchange with, internally or externally, on your startup speak only English. Using Hebrew in your written communication simply lowers your chances, and is an indication of a lack of marketing skill and business savviness.

## TEASER

Email communication is one of the most important skills in business. While Slack and Teams have replaced many internal email conversations, your ability to write emails in a thoughtful and coherent way is a strong indicator of your future fundraising, marketing, and sales performance.

Given that English is probably your second language, you may want to hire a freelancer to help you with email communications from day 1. If there are typos, grammatical errors, incorrect syntax, or the content simply doesn't make sense - you hurt your chances of getting funded. Throughout the investment process, you'll also be communicating through email. So you may even want to take an email communications course before you approach VCs. Emails reflect a cross-section of your personality and behavior that VCs will integrate into their overall assessment of who you are.

> If you go the cold approach route (which should be a last resort), personalization is key. Everything from the subject line to the introduction and closing should address the specific fund's interests / previous investments, as well as the recipient.

> If you go the warm intro route, your teaser email can be more general. Briefly outline your team & track record, the problem you're solving, the status of your company, and what you're aiming to achieve with the funds.

The email should be no more than two paragraphs in length. Sometimes investors will give the green light for an introduction after reading this email. Others will want a bit more info before making a decision. This brings us to the 1-pager.

## 1-PAGER

There's an ongoing debate in the VC industry about the need for a 1-pager at the seed stage. On the one hand, it's shorter than a deck and therefore easier to review / use to judge suitability for a meeting. On the other hand, if your teaser is well written and informative - it can usually provide enough data to determine whether or not the VC should pursue further. Since the jury is still out, better to be safe than sorry, and create one anyway.

### The 1-pager should include:

- Founding team, key advisors, and their respective track records including career accomplishments & academic background
- Problem you're solving & your unique solution
- Size & description of the market opportunity
- Competitive advantage(s)
- Unit of Value
- Status of company
- Size of Round (can be a range)
- What you are aiming to achieve with the funds

## DECK

**In many cases, even after a teaser or 1-pager, investors want to review your deck before meeting. The dirty little secret is that you should have different decks for different stages of the process. Generally speaking, the more you get to know the VC & trust they have good intentions, the more advanced the deck. Pre-meeting, send a deck that gives basic information on your team, problem/solution, size of opportunity, and traction.**

When reviewing a seed round deck pre-meeting, investors want to grasp the size of the business opportunity, major risks, fundability for Series A, and the skill of the management team. Investors are looking for a good fit between their risk model and your business, and your deck can help them understand this fit more.

Sometimes an investment professional will review your deck and ask you a few follow-up questions before bringing it to a Partner. Sometimes, a Partner will skim your deck before deciding if it's worth taking a meeting.

If the deck content is poorly written, and/or missing critical information about the management team, business opportunity, and risks, you reduce your chances of meeting with a Partner. Furthermore, humans are exquisitely visual creatures, emotionally influenced by aesthetics. Sometimes investors will pass on a company based on the feeling they get when viewing a 1-pager or presentation, which may not fully be based on the content itself, nor fully rational. To give yourself the best chance of conversion, make sure the deck follows modern design principles, with easy to read fonts & font sizes, pleasant colors, intuitive layout, and a good ratio of images to text.

**If you are wondering whether or not to have your marketing materials professionally designed and the content professionally reviewed—do both.** VCs see so many presentations and so much content that ugly and poorly-written materials get rejected at a much higher rate than the beautiful and well-written materials, all else held equal. Also, your marketing materials and all communication with the investors should be in English.

# HANDLING REJECTION

Let's close this chapter with a brief discussion of handling rejection, something you will inevitably face as you begin to interact with investors.

Rejection can come in various forms. It can be particularly frustrating to get rejected before you've had a chance to make a face-to-face impression with a Partner, especially if you disagree with the rejection logic. Even more frustrating is the silent treatment, where an investor says they will get back to you with an answer and fails to do so.

If you disagree with the rejection logic, feel free to push back. After all, VCs are not perfect. They do make cognitive processing errors and reach incorrect conclusions. If you push back and the VC doesn't change their position, accept the rejection with grace by thanking the VC for their time and feedback, and follow up once you have some exciting news to share.

If you get the silent treatment, feel free to follow up at least twice—sometimes the silence is a function of travel, personal emergency, information overload, or limited capacity. Don't take the silence personally, but if you follow up twice and get no response, move on. Once you have some interesting news to share, feel free to follow up again in a month or two.

In rare cases where you feel like you've truly been mistreated, escalate to someone higher in the organization, giving all of the prior context in a non-accusatory manner, and hopefully yielding some clarity.

Assuming you've marketed to your target list effectively, you'll start receiving invitations to meet Partners. Congratulations! It's time to discuss how to prepare for these meetings - both the virtual and the physical.

CHAPTER 5

# PREPARING FOR THE FIRST PARTNER MEETING

## 2021 UPDATE:

In light of COVID-19, many first (and last) meetings switched to video. Several funds have returned to face-to-face, but the majority are still on Zoom for meeting #1. Regardless of when & how we see a return to in-person meetings, video communication has become a mission-critical skill. Not only can it make or break your fundraising efforts, but also the happiness of your employees, customers, and partners.

> The way you show up on video chat is now part of the “team” assessment in each VC’s model, adding additional prep work not mentioned in the 2019 version.

Video communication brings new challenges. What % of personality is lost when body language, normally accounting for 55% of communication, goes two-dimensional? Is the VC listening to your pitch or browsing the internet? How can you avoid the dreaded Zoom fatigue?

If you’re pitching from home, upgrade your Wifi, invest in good lighting, and buy noise-cancelling headphones with a strong microphone, a good camera, a second screen... whatever it takes.

Don’t pitch from a cafe. The investor will be judging this experience as you ability to win customers, remotely. Poor technical setup can be a dealbreaker.

## ONCE YOU'VE NAILED DOWN THE TECH FOUNDATION, HERE ARE A FEW TIPS FOR IMPROVING YOUR CONVERSION RATES.

**1 | Strive to make virtual eye contact**

Pay attention to the listener's eyes and face. If you see their eyes shifting around throughout the meeting, they are likely distracted. Ask at least 2x more questions to check-in and maintain "virtual" eye contact.

**2 | Create a quiet space**

Background noise throws off your listener's attention. If you have space / noise issues at your house, try to schedule around it. If there's no alternative, use the mute button effectively.

**3 | Practice**

Handing off the microphone, listening, focusing, storytelling, smoothly handling interruptions, and responding to questions while in the virtual world.

**4 | Leverage the medium**

Identify features unique to video chat that you can capitalize on. Get 2x the # of meetings because VCs are traveling less and have more flexibility in their schedules. Schedule early in the day. Seamlessly weave video content into your presentation that would be clunky in real life. Use the group chat function to send engaging messages. The list goes on.

**Now back to the chapter...**

## BY LAW,

# VCS VALUE RETURNS ABOVE ALL ELSE.

They have a fiduciary obligation to act in the best interest of their LPs, aka shareholders, which means early-stage VCs want to see that each investment has the potential to appreciate by at least 10x in valuation. VCs have therefore developed and experimented with different models to assess the likelihood that your company's value will appreciate significantly and sustainably.

**Some of the common risk factors considered in these models include:**

- ☐ TTeam
- ☐ Target Market
- ☐ Technology
- ☐ Product
- ☐ Competition
- ☐ Go-to-market strategy
- ☐ Business model/ pricing
- ☐ Market size
- ☐ Achievements to date (traction)
- ☐ Financial and hiring plan
- ☐ Buyer universe & industry exit multiples
- ☐ Future fundability

Different VCs weigh these (and other) factors differently. For example, some VCs prefer investing in companies that use technology to improve existing industries, reflecting lower risk tolerance than VCs who prefer investing in companies using technology to disrupt existing industries. Some VCs prefer companies with a strong IP, while others couldn't care less about IP, focusing instead on other types of defensibilities. The common thread across all VCs, however, is the desire to identify qualified teams creating an appealing, monetizable, and defensible value proposition. So give them what they want!

## AREAS TO PREPARE FOR

# YOUR STARTUP PRESENTATION

You need to convince the VC that your team is uniquely positioned to deliver on your promise. In the first meeting, the VC will test you in various ways to better understand your team's strengths and weaknesses. Practice presenting with friend and become more self-aware of your tone and body language (2d or 3d). Good posture and intonation make a big difference in how others perceive you in either realm.

**Einav Itamar** CEO

voca.ai

## Demonstrate appeal and monetization

The VC wants to see that there is both demand for your offering, and a way to capture the value of the benefits. Some VCs will get it right away, while others will drill down deeper to better grasp your thesis.

To better explain these elements, you'll want to highlight trends in your market and demand drivers for your solution, as well as the research and experimentation you've conducted to acquire market knowledge.

Obviously, there's nothing more convincing than paying customers and/or highly engaged users, but if you have not yet achieved this, you'll need to convince the VC they should allocate more time to investigating its likelihood to occur. Beyond that, you'll need to walk the VC through your competitive landscape, go-to-market strategy, business model and pricing, and potential exit scenarios.

# PROVE YOUR DEFENSIBILITY

Equity markets place a low value on businesses which can be easily copied. Thus, you must convince the VC that you have one or more moats, aka sustainable competitive advantages.

**The five well-documented moats are:**

1 | Brand

2 | Scale

3 | High switching costs

4 | IP

5 | Network effects

The less well documented, but perhaps most important, moat is company DNA, or culture. You can highlight your moat(s) as you discuss your team, product roadmap, IP, technology, business model, competitive landscape, and go-to-market strategy.

By contemplating and preparing these elements in advance, you increase the odds of mitigating the VC's primary concerns. However, without weaving together these elements into a cohesive narrative, your chances of a deal suffer dramatically.

# STRENGTHEN YOUR STORYTELLING

Stories allow homo sapiens to cooperate flexibly in large numbers, distinguishing us from all other species on Earth. Without a good story, you cannot scale anything beyond a tribe of 150 and are therefore uninvestable.

**Your company story begins with customers/users experiencing a struggle.** In Google's case, it was an academic struggling to find useful information online. In Facebook's case, it was a college student who wanted to connect with his/her classmates online using real identities (okay, actually at first it was a game of Hot or Not, but that wasn't the story they told to VCs). For Amazon, it was a consumer who wanted to buy a book online.

The story continues by illustrating how the conflicts, problems, risks, and dangers posed to this character created an urgent situation that needs to be addressed.

Then the story explains how your company will resolve these issues. Your company needs to heroically come to the rescue and save the day.

You need a good story to help recruit employees and executives. You need other people to believe in your story to start working on it for less pay than they could get elsewhere. They have to believe that if the story comes true, the ownership they have in the company will more than compensate them for their short-term pay cuts.

Your story needs to inspire investors. You need them to feel that  you are in a position to either make a lot of money, and/or get acquired for a lot of money. But not just the seed investors. The A investors. The B investors. The C investors. And so on and so forth. You need to constantly convince investors that your story is the best way to deal with this problem.

Your story must resonate with your customers/users. Especially when they have multiple solutions to the same problem. Your story needs to be polished, refined, practiced, and perfected. Yet at the same time, it must evolve. As the world changes, so too must the way in which you fit into it. Your story also binds together partners, resellers, journalists, corporate developers, bankers, M&A scouts, recruiters, and dozens of other actors.

Which leads to a complex conclusion—the story must be compartmentalized and tailored to each audience. But when it comes to the VC audience, the most important elements (team, appeal, monetization, and defensibility) should be woven into the story of your customer/user and their challenges

If you want to gain a competitive advantage in fundraising, there is no better way than to improve your storytelling abilities. Taking an online course, reading fiction, and even hiring a personal storytelling trainer are likely to be high ROI activities as you prepare to interact with investors..

# FINAL PREPARATION TIPS

1 | Check who is on the calendar invite. Make sure you do your homework on each attendee and their respective roles within the organization.

2 | Look at the time that elapsed between the moment you agreed to have a meeting, and the calendar invite. Unless there is a stated excuse (travel, vacation, bandwidth), aim to have the first meeting within two weeks of agreeing to meet, in order to keep momentum.

3 | Even if they already have received your deck, share it again with all the participants on the day before the meeting. This way you'll remind everyone of who you are, and enable them to do some preliminary research, so you can hopefully dive into the more interesting questions face-to-face.

4 | Turn your phone on vibrate and keep it in your pocket. Don't pull it out unless you need it for a demo or emergency.

5 | For F2F meetings, show up ten minutes early so you can use the restroom, make coffee or tea, and relax into the environment, rather than rushing up the stairs or from the elevator to make it on time.

6 | If you're running even one minute behind schedule, send a text to the office manager to let them know.

At this point, you're about to start your First Partner Meeting. But once you get in the room or Zoom, what should you say? How should you act? What will happen? In the next chapter, I'll discuss key conversational dynamics to consider, possible outcomes of the meeting, and how to handle each scenario.

IF YOU WANT TO GAIN

A COMPETITIVE ADVANTAGE IN FUNDRAISING,

THERE IS NO BETTER WAY THAN TO IMPROVE YOUR STORYTELLING ABILITIES.

TAKING AN ONLINE COURSE, READING FICTION, AND EVEN HIRING A PERSONAL STORYTELLING TRAINER ARE LIKELY TO BE HIGH ROI ACTIVITIES AS YOU PREPARE TO INTERACT WITH INVESTORS.

**Avichay Nissenbaum**
General Partner
lool VENTURES

CHAPTER 6

# VC MEETING DYNAMICS 101

## AS UN-ISRAELI AS THIS SOUNDS -

# BEGIN THE MEETING WITH SOME SMALL TALK

The VC will extrapolate how you treat employees, customers, and partners from your initial interactions with them.

Also, if the VC doesn't connect with you as a person, they/he/she will not commit to 5-10 years of working with you.

**Zohar Dayan** CEO

WIBBITZ

As discussed in the previous chapter, early-stage investors have different models for assessing risk. In order for these models to produce decisions, they need to collect data. This data collection effort drives the entire investment process, as the VC tries to validate their intuitions and assumptions about you and your business.

Anyone can ask, "So can you tell me more about your fund?"

Be different and ask deeper questions that show you have already done some homework.

## HERE IS A STEP-BY-STEP GUIDE TO HANDLING THE MEETING.

### 1. Begin with some small talk.

**You will find yourself with 1-2 Partners and 0-2 investment professionals, depending on the fund. In the first few minutes, take the opportunity to make some small talk, show your personality, get to know something interesting about the other people in the room, and create a good vibe.** The VC will extrapolate how you treat employees, customers, and partners from your initial interactions with them. Also, if the VC doesn't connect with you as a person, they will not commit to 5-10 years of working with you. I've seen many entrepreneurs jump right into pitching without taking the time to make conversation, which may be a symptom of the Israeli "bluntness," but connecting on a personal level is culturally agnostic, and we're all human (for now).

### 2. Learn more about the fund.

After developing the initial connection, try to leverage your prior research to learn a bit more about the specific interests of the fund.

For example,

*"So I saw your last two investments were both in digital health. Is this a new focus area for you?"*

or

*"I saw your last two investments were syndicated with other investors. Do you typically syndicate, or do you prefer to take the whole Round?"*

## 3. Share your presentation.

Before you begin telling your story, ask if the VC prefers you to present with slides or without. In most cases, the VC will prefer slides, because it helps structure the conversation, focus visual attention, and provide facts, figures, and statistics to help the VC understand your offering.

If the VC gives you the option to choose, use whichever method gives you the most confidence.

However, if the VC prefers that you don't use slides, this indicates a willingness to connect in a more personal way, since the VC will pay attention to you rather than splitting attention between you and a television screen.

## 4. Respond to questions.

VCs will take notes and ask questions. Direct your responses to whoever leads the conversation. The more you prepare, the more likely you will have the spare attention to actually comprehend the question, as your mind will be less focused on remembering and more focused on the present. All too often, entrepreneurs focus too much on getting their point across, failing to realize that any successful sales effort is more about carefully listening and responding than promotion.

Don't get hung up on delivering your entire deck—remember, you're here to get them to invest, not to deliver each and every slide of your deck in the exact order you've prepared them.

In general, if a VC asks a specific question, answer it, rather than postponing it until later in the presentation. The VC wants to get an answer to the question before processing any new information. Delaying that answer makes it harder for them to process new information.

## 5. Stay open to feedback.

As you progress through your story and answer questions, strive to remain open to feedback. VCs can offer valid criticisms of your business that, when addressed, can actually make your company stronger. In cases where the VC fails to understand your point, exercise patience and try a different approach. In cases where the VC disagrees with you after several iterations, agree to disagree and move forward.

## 6. Skillfully handle the "ask."

Towards the end of your presentation/conversation is the "ask," the moment where you specify how much capital you'll need to get to the A round.

### At this point the conversation will go in one of five directions.

**A. The VC gives you an offer.**

This is a rare scenario where either the VC has an extremely high risk tolerance, feels comfortable rescinding the offer, and/or knows about other high quality investors who have given you an offer and doesn't have time to investigate further, if he/she wants to compete.

If you get an offer in the first meeting, congrats! But be wary of investors who offer to lead your round but haven't taken the time to get to know you.

**B. The VC wants to learn more.**

Depending on the VC, this can signal the beginning or continuation of the due diligence process, or it can be the first step in a sequence of pre-diligence meetings.

Take this opportunity to communicate your excitement about moving forward, while asking the VC to define their investment process. With limited time and a business to build, you need as much visibility into the remaining steps of the process as possible. Loosely defined processes are likely to result in frustration, rather than efficiency.

Before you leave, make sure you understand the outline of the VC's investment process and your place within it.

**C. The VC wants to discuss internally before deciding.**

Ask if this is a policy or an exception. In other words, does the VC always discuss opportunities internally before moving forward? Or can you get to the next stage of the process in the meeting itself?

Always ask for a timeline, sync with your CRM, and follow up as needed.

**D. The VC decides that you are too early and tells you to keep in touch.**

In this case, the VC doesn't feel comfortable with the risk/reward ratio and wants to see you reduce some of the risk factors before reevaluating.

Try to specify the exact risks the VC feels uncomfortable with, and when would be a good time to re-engage.

Record this information in your CRM and act on it appropriately.

### E. The VC says no.

In this case, the VC doesn't feel comfortable with your business, your plan, and/or your chemistry. Take the opportunity to see if you can extract additional feedback that can help you improve for the next VC.

Keep in mind that VCs only do 1-2% of the deals they review, so sometimes it will unfortunately come down to your business not being attractive enough relative to some of the other opportunities they are reviewing.

Sometimes it will come down to the VC having slept poorly and nothing to do with you. Other times it will simply be a lack of personal chemistry. Accepting rejection is not easy, but it is essential to progress.

# END ON A POSITIVE NOTE

## IN ANY CASE, TAKE THE TIME TO END THINGS ON A POSITIVE NOTE AND IN A GRACEFUL MANNER.

To be clear, closing down your laptop, getting up and walking out of the room in a defiant manner is not the right thing to do.

Quite often, how you respond to rejection is the difference between getting introductions to more relevant investors/people who can help you in your journey, and getting no help at all.

Assuming you've engaged the VC and they want to learn more, you're either about to enter into the investment process, or meet with other members of the fund to get their approval before moving into the investment process.

At this point you're ready to delve deeper into the key considerations for running a successful due diligence process.

**Yaniv Golan**
General Partner
lool VENTURES

CHAPTER 7

# OPTIMIZING THE DUE DILIGENCE PROCESS

FOR FOUNDERS,
THE POINT OF THE DUE DILIGENCE PROCESS IS TO GET TO AN INVESTMENT DECISION.

## YOUR JOB IS TO UNDERSTAND EACH VC'S PROCESS AND MANAGE IT EFFICIENTLY. OTHERWISE, YOU'RE WASTING PRECIOUS TIME THAT COULD BE USED TO BUILD YOUR BUSINESS

You can think of a VC as a neural network, taking in data, iterating, and readjusting risk factor weights with an output of Yes or No. Your job is to "score" as high as possible on each risk factor, so that the VC says "yes" at the end of the process.

**Zeev Braude** CEO

siteaware

process is different from legal due diligence which will likely occur after you've signed a term sheet (we're getting there, don't worry)

## PROCESS FACTORS

# FOR VC DECISION-MAKING

### In the next chapter, I'll dive deep into each risk factor and discuss what you can do to improve your scores.

To set the stage, however, I want to give you a deeper understanding of the process factors that determine the speed of decision making. You could theoretically score 10/10 on all risk factors and get a term sheet, but if the process takes six months, you just wasted a lot of time, and time is money (e.g. lost opportunities, competitors gaining traction etc). Optimizing risk factors increases your chances of getting a term sheet. but optimizing process factors significantly reduces the time it takes to get one.

## Bandwidth

If a VC with two Partners and one associate is diligencing four companies at the same time, the bandwidth available to evaluate your company is limited. What would normally take 1-2 weeks to complete might take 4-5 weeks. If the Holidays just kicked off, get ready for an inefficient process.

If you come to a VC with a term sheet from a competing VC, they have an incentive to allocate more attention to you, which will lead to a faster decision (although not always a better decision). If you come to a lead VC with strong US Micro VCs who are looking for an Israeli lead, you've created another positive incentive to speed up the process.

Since you can rarely predict when a VC will be overloaded with other opportunities, you should always aim to create a situation where the VC will prioritize your company over the competition.

You want to get a finger on the pulse of the fund's bandwidth as soon as possible, in order to align expectations and timelines. Look at how quickly the VC schedules follow-up meetings to understand the pace and level of interest. If your second meeting is two weeks after the first, assume less interest. Two days after the first, assume interest.

## COVID-19

Bandwidth took a hit at the beginning of the Pandemic when most Partners went into "triage" mode to support their portfolio.

In the past few months, VC activity has picked back up. On the one hand, now that VCs are spending less time commuting and traveling, they may actually have more bandwidth to dedicate to your DD process. On the other hand, getting to know & trust you over Zoom takes longer than the traditional physical process.The more virtual the interactions, the longer the process, the more bandwidth required, everything else held equal.

## Intuition

As Daniel Kahneman notes in his book, Thinking Fast and Slow, "intuition is pattern recognition." Some VCs have accumulated a critical mass of experience that allow them to pattern-match in an extremely efficient manner. In other words, they can subconsciously "sense" success or failure, because they've seen enough successes and failures to accurately predict your likelihood to succeed.

Intuition strength is highly correlated with bandwidth allocation. In other words, if a VC has strong positive intuition about you and your company, he/she will want to prioritize your company and accelerate the process. A strong negative intuition will most likely lead to a rejection.

Unfortunately, each VC has a unique set of previous experiences, so there's no systematic way to influence this factor. You just need to be your best self and hope that you fall on the right side of the intuition line. That being said, VCs with strong intuition move faster, which can influence how you build and prioritize your list of leads.

## COVID-19

The pandemic has scrambled VC intuition. Team intuitions based on body language, eye contact, voice, and EQ are less reliable when virtual. Demand/Supply intuitions continue to shift with political and social volatility, and GTM intuitions based on F2F interaction have been put on hold. Some VCs are more agile in tuning their sensors to the opportunities and challenges of the new world, while others have yet to adapt and will require more data than normal.

## Personal chemistry

Good or even great personal chemistry can accelerate a due diligence process faster than any other process factor. At the extreme, it resembles falling in love; the VC really enjoys spending time with you and tends to overlook your flaws and shortcomings, until one day the VC looks in the mirror and asks, "What have I done!?" But by that point the money's already in the bank ;)

Since VCs are humans (for now) with emotions (some more than others), shared hobbies, stories about your kids, military service, philosophical debates, and laughter can go far. These aspects of personal chemistry can have surprising influence on the decision making process, because many entrepreneurs treat VCs like bankers (debt) instead of partners (equity).

If you understand and develop personal chemistry, your process will be smoother and faster.

### COVID-19

Developing personal chemistry with a mask and/or social distancing is hard. Developing personal chemistry over Zoom is f***ing hard. If possible, meet the VCs you're most interested in working with at an outdoor cafe or an open-air office setting where both of your risk tolerances are accounted for and appreciated.

## Market knowledge

In general, the more a VC knows about your market, the less time they will need to make a decision. For example, if you have a cyber startup, a specialist cyber fund will understand your market, business model, go-to-market strategy, value proposition, differentiation, future fundability, and exit potential 5-10 times faster than a generalist VC fund that lacks cyber knowledge.

On the other hand, specialist VCs are more likely to fall into the trap of extrapolating negatively from their past experience on what may possibly be a completely novel approach, or a solution to a problem which is too new for them to appreciate. In the words of Daniel J. Boorstin, "The greatest enemy of knowledge is not ignorance, it is the illusion of knowledge.". Or, this version.

Generalists will need to "get up to speed" in cyber by interviewing you, consulting third-party sources, and conducting online research. Because this will take time and resources, creating a targeted list (as recommended in Chapter 4) improves your chances of an efficient process.

Generalists are also more likely to focus on the softer aspects, such as the team, the storytelling abilities and the long term vision of your company, and less on technical rejections. If these are your strengths, a generalist VC may be a better partner for you.

## COVID-19

Similar to intuition, many markets have been upended by COVID.

Some markets have accelerated dramatically and will continue to do so, while others are hanging on by a thread of government support.

Specialists are likely to remain efficient, as they can focus on the evolution of their domain. Generalists that accumulated some level of market knowledge on the domains of their prior investments may have to update many of their assumptions to account for the changes caused by economic restrictions and travel bans.

## Data

Since each VC has different knowledge and a different approach to analyzing risk, they may require different data. Try to define upfront exactly what data the VC needs to process in order to reach a decision. Keep in mind that this data set can evolve over time as the VC learns more; he/she may recognize new risks that require additional data/analysis to mitigate.

In the best case scenario, you've already prepared a data room that satisfies the VC's needs. In the more typical case, you'll provide some data, and the VC will supplement this data through their own research and network.

In general, the quicker the data flows from you to the VC, the quicker the VC can reach a decision. Your job is to prepare, organize, and analyze the data in advance, stay on top of all data requests, and respond as you see fit.

Sometimes VCs will ask for a lot of data up front, not get back to you for a while, and then pass. It's hard to know exactly what's happening in the VC black box, but I've heard stories of VCs that ask for data and then share it with their portfolio, other VCs, and in the worst case with a competitor. In my view, some of this is grey behavior, and some is blatantly unethical.

The best way to hedge against this behavior is not an NDA (which will likely kill the process entirely), but by using a password-protected data room which allows you to monitor the actions of the VC. It still blows my mind that less than 10% of Israeli entrepreneurs use DocSend. There is always a risk of data leakage, but sending the data over email maximizes the risk, rather than minimizing it. For any sensitive data, you can add a confidentiality footnote to send a subconscious reminder to the VC.

### COVID-19

No material impact

## Transparency

Since due diligence is fund specific, transparency is the degree to which a VC honestly communicates where you are in their process, the areas in which they lack sufficient data to make a decision, and clear guidance on the steps that remain.

With low transparency, you have slim chances of a quick decision and limited ability to manage the process.

With high transparency, you basically have an ongoing list of actions the VC is taking to further investigate your company, alongside ongoing updates regarding the status of their evaluation. When possible, develop a relationship and communication channel with a non-Partner who can give you better insight into Partner sentiment and process location.

## COVID-19

Many VCs are adjusting their investment process to fit their evolving meeting strategy. Don't be afraid to ask directly and deepen your understanding of how each VC's process has changed.

To summarize, before you begin to share materials, schedule follow-up meetings, introduce the VCs to your network and get introduced to theirs, honestly appraise your options.

Are there certain funds with a reputation for being more efficient? Are some funds more educated about your business? Do you feel a personal connection with one VC more than another?

Once you feel comfortable with the process factors outlined above, it's time to continue to Chapter 8, where I discuss how to optimize the risk factors that the due diligence process seeks to measure.

CHAPTER 8

# COMPLETING THE DUE DILIGENCE PROCESS

IN TERMS OF TIME ALLOCATION,
A VC MAY DEDICATE 5-10% OF THEIR MONTHLY TIME BUDGET TO A GIVEN INVESTMENT. HOWEVER,
YOU WILL DEDICATE 80-100% OF YOUR TIME TO YOUR VENTURE.

Since you therefore have a much greater risk exposure, if the VC sees that you haven't defined, mapped, analyzed, and managed the generic and specific risks facing your business, they'll interpret it as a negative signal.

**Oren Levy** CEO

ZOOZ

A PayU Company

## RATHER THAN SEEING DUE DILIGENCE AS AN ARBITRARY PROCESS TO GET OUT OF THE WAY, SEE IT AS A SET OF APPLIED METHODOLOGIES USED TO CHALLENGE THE ASSUMPTIONS OF YOUR COMPANY'S THESIS.

If anything, going through due diligence processes make your company more resilient, by shining the flashlight on risks that you may have failed to identify yourself, which you can then take steps to manage.

For example, imagine a VC finds a direct competitor that you never mentioned. The fact that you're willing to dedicate your life to building a business, but you failed to identify direct competition, suggests negligence. Bottom line: due diligence is something you should have already completed for yourself before you approach investors, otherwise you might be wasting the next two years of your life working on a business that has no chance of succeeding.

## THE RISK FACTORS THAT VCS CARE ABOUT MOST

With this introduction, let's now work through the key risk factors and how to think about them.

### PEOPLE

**At the seed stage, VCs care disproportionately about the people involved relative to other factors.**

At lool, we focus on track record, domain expertise, chemistry, body language, strategic thinking, motivation, agility, speed, character, competence, verbal and written communication, and confidence, among other characteristics. Each VC will have its own hybrid algorithm for evaluating the people involved, which meshes together intuition and data.

People data is collected and analyzed from your interactions with the VC, reference checks, your interactions with the people the VC introduces you to, and sometimes personality/psychological assessments. Usually, the VC will ask you for personal references on all of the founders.

Make sure to get the buy-in of your personal references and educate them about your venture at least a week before you start meeting with VCs. Furthermore, make sure to choose relevant references. Someone who you worked for less than a year or ten years ago does not typically have enough data on you to give credible answers. Pick your references wisely, as they can have a significant impact on the VC's perception.

In addition, you may be asked to spend time with other people in the VC network, such as HR consultants, industrial psychologists, portfolio companies, potential customers, and others. Some VCs also use personality/psychological assessments to further validate the data they are collecting from the process.

As I mentioned earlier, you will not click with everyone you interact with, so your best bet is to stay authentic and find the VC(s) with which you have the best chemistry.

**You may ask yourself "Why do VCs care so much about people?" Let me share a few reasons.**

1. Early-stage investing is like committing to a 5-10-year marriage. Would you want to marry someone for 5-10 years if you had bad chemistry and trust issues?
2. Ultimately, it's people who make the decisions that drive a business forward. If a VC senses a lack of competence or credibility when it comes to intelligent decision making, it doesn't matter how innovative the business idea is, it is unlikely to succeed.
3. People represent the creative force bringing ideas into reality. Without confidence in your ability to execute on your promise, the idea will stay an idea, and financial returns will not manifest.
4. Your business' success depends on your ability to sell a vision to employees, customers, partners, and other key stakeholders. If your team can't sell to the VC, how will you sell successfully to others?

# MARKET

**VCs typically want to understand the following market characteristics before making an investment decision in a B2B, B2G, or B2D context. I break down the market into four sections for clarity:**

## 1. The problem

- The problem you're solving
- The underlying causes of problem
- The type of individuals and organizations are experiencing the problem
- The number of individuals and organizations experiencing the problem
- The number of individuals and organizations that could experience the problem
- The segment of individuals and organizations for which the problem is most painful
- The segment of individuals and organizations which are willing to pay the most to solve the problem
- Trends that could make this problem more or less painful in the short-term and long-term
- Trends that could make this problem more or less common in the short-term and long-term

## 2. The competition (existing solutions)

- problem with internal and external solutions
- Advantages and disadvantages of internal and external solutions
- Characteristics of the external solution providers such as: date founded, money raised, investor profile, management team profile, number of employees, revenue, growth/penetration rate, pricing, business model, value proposition, messaging, IP, customer sentiment, company vision
- Breakdown of external solution providers into incumbent vs. new entrant
- SWOT and Five Forces Analysis

### 3. The opportunity size

Alon Amar does a fantastic job of outlining this exercise, and Matt Heiman does a great job of showing why it may not matter.

> The important thing to realize is that the size of the opportunity is less about the output, and more about the process. In general, the top-down approach to market sizing is seen as lazy, and the bottom-up approach as a more thoughtful exercise in segmenting your market, thus illustrating a stronger work ethic which can improve your "people" score.

You could come to a VC and say "The market for Cloud Infrastructure is worth $150 billion, so if we capture 1% we'll be a unicorn." Alternatively, you could say "We've identified 1000 SMEs that have a specific pain, we spoke to 50 and the range they'd be willing to pay for a solution is $50-100,000/year, so our initial revenue opportunity is between $50m-$100m, but according to Gartner, there will be another 4000 SMEs that will need a similar solution over the next five years, increasing our addressable opportunity by 5x." You can see the difference.

Yes, VCs know that you manipulate your Excel sheets to show the data you want. No, they don't really expect you to hit those projections you built out of thin air and very few facts. However, if you project $200M in sales on year 5, you may or may not hit the $200M mark - but if you project $20M in sales on year 5, you're a lot less likely to hit the $200M mark :) Those projections VCs ask from you are a great exercise for you as well, as they allow you to discover which parts of the plan will never yield the required return, no matter how optimistic your assumptions are.

Another consideration is the potential for rapid market growth. As Peter Thiel points out in Zero to One, becoming dominant in a small market that's about to explode usually produces better results than entering a mature, slow growing, inefficient market. It's the difference between Uber and Gett.

Finally, you should consider areas where business model innovation unlocks value and revenue streams that do not fit in the existing market structure. Airbnb is a great example. No market research reports were covering the multi-billion platform opportunity to monetize existing home ownership via short-term rentals. Investors relying on this approach to market sizing missed one of the biggest venture outcomes in history.

## The Upside

**As discussed in Chapter 4, VCs ultimately care about returns. Returns are typically generated by either selling the company to a larger company (M&A), or by raising additional growth capital from the public markets (IPO), thereby allowing your existing investors to sell their shares to others via the NASDAQ, NYSE, or hopefully at some point the LTSE.**

But how does the acquisition or IPO price get calculated? Rather than simply outsource this task to an investment banker, you should strive to understand the basics so you can have an intelligent discussion with your potential investors about the various exit scenarios for your company.

M&A and IPO pricing relies on a variety of components, including talent, revenues, growth, total addressable market, business model, business model efficiency, market leadership, product offering, comparable transactions, industry multiples, industry dynamics, and industry competition. Most of the elements look eerily similar to what VCs evaluate during the due diligence process. This should come as no surprise, since they make a living from estimating the likelihood that you will get acquired for a significant amount.

## Calculating likely returns

To bring this down to earth a bit, let's look at the automotive industry. Several years ago, GM acquired Cruise Automation for $1 billion. The company had no revenue, just an enabling technology for autonomous vehicles and a highly intelligent and capable team. Not too long thereafter, Argus Cyber Security was acquired by Continental for $430 million, also a pre-revenue enabling technology for autonomous vehicles supported by a highly intelligent and capable team. In a highly competitive trillion dollar automotive industry with 10+ players generating $100 billion in revenue, acquirers can afford to pay $500 million - $1 billion for game-changing technology.

Taken to another extreme, companies like Ironsource, Taboola, and Outbrain each generate close to $1 billion in revenue, and barely surpass $1 billion valuations. How come a company with $1 billion in revenue is worth the same as a pre-revenue company? Put simply, demand for autonomous technology amongst manufacturers at the time of the Cruise acquisition was far greater than today's demand for $1 billion of advertising revenue, relative to the available supply.

Another way to think about this is that perhaps with Cruise's technology, GM could improve its profitability by 10%, which would translate to $10 billion in new net income, a 10x return. On the other hand, what if Taboola's $1 billion in revenue translates to $50 million in net income? For a potential acquirer like Facebook, Google, or Verizon, an additional $50 million in net income on top of $20-30 billion barely moves the needle.

> These examples are meant to demonstrate that M&A and IPO pricing depends on a variety of factors, most of which you should research before you enter due diligence and negotiation.

Ultimately, if you are in an industry where exit/valuation multiples are accelerating relative to other industries, you have a better chance of passing through market due diligence.

# SOLUTION

**Solution due diligence aims to better understand your back-end (technology), front-end (product, UX, and UI), the value it creates for customers/users, and how unique, appealing, and defensible your value proposition is when compared to internal and external solutions.**

If your solution is built on deep technology, investors will care less about your front-end at the seed stage, and spend their time validating your back-end claims. Furthermore, they may not even require any front-end development before investing in your company.

On the other hand if your solution is a glorified Excel, investors will care much more about the status of your front-end, because this represents your initial value proposition and design philosophy.

## Validating a unique and appealing solution

To validate how unique and appealing your solution is, investors may take their "problem" due diligence checklist to existing and potential customers/users. They may ask you for these introductions, speak with industry experts and potential customers/users in their network, and introduce you to potential customers/users, listening to the conversations you have to better answer their questions.

## Testing a defensible solution

To understand how defensible your solution is, VCs will analyze five well documented defensibilities: brand, scale, high switching costs, IP, and network effects. In my view, the less-documented but perhaps most important moat is company DNA, or culture. During the seed stage, brand, scale, and switching costs are irrelevant, while IP, network IP can take the form of scientific breakthroughs, domain expertise, trade secrets, difficult technology integration, and non-trivial innovations. Investors typically care less about patents and more about unique knowledge that has been developed over a significant period of time, making it so difficult for your competition to build a similar offering that they won't even try, or they'll spend time building something that cannot provide the same level of value.

> I cover network effects with James Currier in this podcast, so I won't go into great detail here, but the key point to keep in mind is that network effects are about retention, not growth (viral effects). As more users use your product, it should become more valuable to all of your existing users, and you should be able to articulate the critical mass your solution requires to lock in the effect.

Although DNA/company culture can also be seen as part of the "People" due diligence, I consider it a key part of what makes your solution unique, appealing, and defensible, since culture is very difficult to replicate. VCs will infer your company culture based on the way you and your team behave throughout the due diligence. The way you interact with each other, the way you respond to questions, emails, phone calls, and texts. The office space you've chosen to work in, the logo, your deck, the way you handle yourself during negotiations, the way your references talk about you, the way you tell your story; these are all data points the VC will use to understand the type of culture you will continue to build once you get funded. Ultimately, your company values create value for customers, as evidenced by Amazon's story. Be prepared to discuss the type of culture you want to create and why it will attract and retain top talent.

Typically, the most difficult part of solution due diligence at the seed stage is striking a balance between focus and vision. You need to show investors that you are laser focused on solving a specific pain for a specific subset of customers/users and that you address this pain differently, while articulating your mission and vision, demonstrating that your solution will grow in scope as you get more customers/users and more resources.

## Monetization and Go-to-Market Strategy

**Similar to market sizing, seed stage monetization is less about output and more about your thought process.**

While sometimes you can derive your business model and pricing from existing market standards, other times you may have developed a product for an emerging market, or a 10x improvement in an existing market, which will give you much more flexibility regarding how to monetize. I recommend Tony Saigh's foundational post, "Get Customers to Love Your Pricing in 10 Steps" and a 16z podcast, "Pricing, Pricing, Pricing" to brush up on the fundamentals of business modelling and pricing.

Notice the word "strategy." Becoming a category leader is like beating 10 opponents in chess at the same time. Sometimes you need to bait your opponents by exposing a pawn or bishop so you can swiftly take their queen. This could translate to giving your product away for free or at a large discount, so you become embedded into a business process, and then leverage your stickiness to charge a significant premium at renewal.

SINCE THE WAY YOU MODEL/PRICE YOUR OFFERING IMPACTS YOUR SALES CYCLE AND ADOPTION CURVES, MONETIZATION INTERSECTS WITH YOUR GO-TO-MARKET STRATEGY.

You'll need to walk investors through the logic of both, the relationship between the two, and prepare to defend and justify your assumptions based on the market research you've conducted.

**Tony Saigh**
VP Value Creation
lool VENTURES

## The dangers of shortcuts

Given the limited resources of a seed stage company, working with distribution partners to help with marketing and sales seems like a magic shortcut to significant revenues. Yet this “shortcut” often prevents you from establishing a direct feedback loop with early customers, a communication channel that can help significantly with product development. Be prepared to defend your chosen path to revenue, as the VC may challenge you to find a balance between efficiency and sustainability.

**Another magic shortcut I often see in the go-to-market plan is to have $0 allocated to marketing, and give the CEO responsibility for selling the first $1 million. This shortcut usually doesn’t work too well because Series A VCs want to see initial signs of scalability.**

As mentioned in Chapter 1, the Seed round is just a means to a Series A round, and thus your initial go-to-market strategy should be designed to prove to Series A investors that their investment will go towards executing a marketing and sales strategy that has already shown signs of scalability.

If you’ve spent $0 on bringing leads through marketing, the Series A VC will need to take a much larger leap of faith that you’ll be able to use their capital efficiently, since it takes time and experimentation to learn which channels have the highest ROI.

To further your knowledge of marketing, I highly recommend “Traction” by Gabriel Weinberg, the CEO of DuckDuckGo.

## Financial and Hiring Plan

Your financial and hiring plan are two critical elements of fundraising that can make or break the due diligence process. As mentioned before, seed money provides you with the resources to build the assets necessary to raise A money. How you allocate and convert these financial resources into human and technological resources will determine whether or not you attract follow-on financing, which is what your seed investor cares about most. Thus, you must be prepared to rationalize the amount of capital you're seeking by walking the VC through the people you'll need to hire and what your team will achieve.

Sometimes founders respond to the question, "What will you achieve with this capital?" by saying, "We'll have a team of highly skilled engineers and our product will be GA after 12 months". Other founders respond, "$1 million ARR." While the second reply is more impressive than the first, the first lacks business orientation and the second lacks depth. The key to passing this part of due diligence is to have both business orientation and depth in the plan.

For example,
if you expect to reach $1 million in ARR in 12 months, but your developers won't get to productivity for three months and sales cycles are 3-6 months, you most likely have an issue achieving your plan.

If you expect to reach $1 million ARR in 18 months but will run out of cash in 15 months, you may not have sufficient assets to raise an A round, and will most likely have an issue achieving your plan.

> Often times founders assume they'll need less capital because they plan to generate revenues. Be careful; revenue forecasts at the seed stage are highly volatile. It may take six months more than you planned to begin seeing cash flow from customers.

Speaking to both successful and unsuccessful entrepreneurs about their respective journeys can help you learn about the assumptions and decisions that either proved to be accurate or fatal. This research will help you build a more economically sensible plan that you can defend against the criticisms of the VCs.

## Company History

**Company history helps the VC better understand the trajectory and motivation behind your start-up.**

If you started four years ago and are now raising a seed round, you should have convincing reasons as to why it took you 2-3 times longer than your competition to get to a point where you felt comfortable raising. If you are still working full-time at Intel and don't have enough faith in your vision to take the financial risk and dedicate all your energy and resources so this venture, you should have convincing reasons as to why. If you are a single founder, be prepared to explain why you chose not to work with a partner. When investors listen to the backstory behind your company, they are looking for anomalies; things that indicate a higher probability of failure. If you have skeletons in the closet, build trust through transparency, rather than plead ignorance. This shows maturity and ability to take responsibility, two factors that go a long way in building a successful company.

## Cap Table

**This final element of due diligence aims to understand any previous financings and the way you've negotiated ownership between your co-founders, early employees, and existing investors.**

Once again, investors are looking for anomalies and misalignments of interest. If you took $100k and gave up 40% of your company, this is problematic. If you took $1m from a strategic investor and gave up 40% of your company, this is also problematic. Your seed investors want to make sure that the economic incentives are aligned around the table to build a huge business. If, by the time you raise a Series A, you and your co-founders each have 5% ownership, you may not be incentivized enough financially to stay determined. On the flip side, if you and your co-founders each have 25% at Series A, you may not be incentivized financially to build for the long run. Be prepared to discuss the ownership situation in detail and realize that certain capital structures at the seed round are incompatible with the VC model. You may have no choice but to restructure your company's ownership in order to raise funds.

CHAPTER 9

# HONEY, I'VE GOT A TERM SHEET

Term sheets come in different shapes and sizes. Some VCs pull them out at the end of a successful partner meeting, some submit them in "Take it or leave it" mode, and some set a 48–72 hour expiration date to it.

## MOST VCS, HOWEVER, TRY TO CALIBRATE EXPECTATIONS ON THE MAIN COMMERCIAL ASPECTS DURING THE INVESTMENT PROCESS, AND USE THE FIRST DRAFT HANDED TO THE FOUNDERS AS A FRAMEWORK, WITH CERTAIN FLEXIBILITIES.

**Zviki Ben-Ishay** CEO

Lightico

In this chapter , we will explain what a term sheet actually is, how to prepare one, and what to expect from one; review the main elements of the document; discuss where you should and where you can negotiate; and try to explain in non-lawyerish language the meaning and impact of the term sheet's many different elements.

## What is a term sheet?

A term sheet is an outline of the deal your company is being offered. Investors issue term sheets to calibrate expectations regarding the main aspects of the deal, and make sure both parties are aligned before deploying more costly resources on drafting definitive agreements (a.k.a. "the closing").

As exciting as getting (let alone signing) a term sheet is, it is critical to note that it is a **non-binding** legal document (other than specific elements in it we will discuss later) which means that legally, both sides can pull out up to the very last minute of the closing. Such cases are relatively rare, so you should be wary of any investor with a reputation for this practice.

## Bring in the suits

They say there are only three real lawyer jokes in the world, because all the others are true stories. However, using a good, deal-making lawyer is a key factor in getting your term sheet signed quickly, effectively, and fairly. As the seed round is likely to be your first equity round, it is also the round in which the company's Articles will be drafted, the different investor and founder rights and restrictions will be set, and many other long-lasting elements inked into formal company documents. You can rest assured that your prospective investor is going to hire a top lawyer to make sure their interests are protected and that the majority of the 50–50 cases end up in their favor. Don't put yourself and your company in an inherent deficit by saving a little money on a lower-tier lawyer.

## THREE'S A CROWD

### Term sheets tend to surface a hard truth, usually not present to founders until that point: from this point forward, you are entering a three-sided legal (and professional) relationship between the founders (you), the company (maybe also you?) and the investors (probably not you). Each of these three entities has its own incentives, goals, rights, and restrictions – and it is important to understand the delicacy and note the balance of these as early as possible.

As founders, you might find yourself wearing three different hats — founder (shareholder), CEO, and director — with each hat bearing different duties and considerations. Your prospective investor will also usually be wearing both the investor (shareholder) and the director hats, sometimes leading them to vote differently as a director (prioritizing the company's interest) and as an investor (prioritizing the shareholder's interest).

A classic example of this is an early, low-ticket exit — a first-time founding CEO holding 25% of the company shares would think hard before saying no to a $20 million acquisition offer, while an investor looking to return 3x on their $100 million fund would be very disappointed with such an outcome. Wearing their director hats, the CEO might claim that the company had tripled its value within a couple of months and approve the acquisition, while the investor might claim that only a small portion of the potential value had been captured so far and push to reject.

There are no easy answers here, but a recommended practice is that all parties agree to make the company's interest their #1 priority and acknowledge that #2 and #3 might clash in certain scenarios.

## DIVIDE AND CONQUER

One of the best practices I recommend is to have a preparation talk with your (top-tier, deal-maker) lawyer about the key objectives for you, and how you prefer to split the work between the two of you. Being a first-time founder, you are likely to be less experienced in such processes than your lawyer, and you should definitely use your lawyer's experience and knowledge, while maintaining the driver's seat; not every question or decision should go through you, not every point is critical. Moreover, you're not likely to have good answers for each and every point your prospective investor or their lawyer would come up with.

Put your lawyer in front of the investor's legal team with some agreed liberty, and make sure to deeply review and re-review the term sheet with them before and during the process – to make sure you understand what is crucial for you, and not less important, what is not – and can be used as a bargaining chip in your negotiations.

## POISONED APPLES

The common ground for almost all investors is that they hate being a sucker. In this first equity round, every right you give your investors beyond standard conventions will set an undesirable precedent for next round investors (so if a $1.5 million investor cashes in on his high demands, then the $15 million investor will expect even more). To avoid this slippery slope, avoid any custom items in your deal — meaning named rights, Israeli shtick, oversized boards and any other uncommon and unacceptable terms. If in doubt, take a look at the US VC market standards.

Note that your seed investors are very close to you in terms of the cap table -any poisoned apple requested by another investor down the line is likely to affect their returns in a similar manner to you. Therefore, good seed investors are likely to try to slow down this escalation process by providing you with plain vanilla, founder friendly terms in their own term sheet.

# KEY ELEMENTS IN A TERM SHEET

### Economics

- Round size: Is there a fixed number or a base with an upper limit?
- Investors: Who are the known investors? What are the criteria for any deferred investors? And how much is each planning to deploy?
- Pre- or post-money valuation: If the round size is fixed, there shouldn't be a difference. But if it is defined as a range, then post-money would benefit the investors and pre-money would benefit the founders.
- ESOP goal: Startup employee options are professionally referred to as ESOP. Each investor wants the company to be able to attract talent and be able to compete over the best employees, so it needs the company to be able to offer those candidates significant equity — preferably without diluting anyone around the table. The ESOP goal in a term sheet defines what portion of the company's shares would be allocated to employee options *after* the round is complete, and derives the number of shares that would be dedicated for this purpose *before* the round.
- Price per share (PPS): You get this number by dividing the pre-money valuation by the total fully diluted number of shares — *just before* the round — assuming that all notes, SAFEs, and employee options (yes, including the newly allocated ESOP) were converted to common shares.

## Board

This section is pretty straightforward — it defines the size and structure of the board. A seed-stage company's board shouldn't be too much of a headache, but rather a thinking and measuring tool at the CEO and the founders' disposal. It is also helpful to set governance displicine, which you'll hopefully need when you raise your subsequent funding rounds and bring in new board members. To keep it simple, you should try and minimize both the size of the board and the courtesy gestures you are handing out. Remember (see the above Poisoned Apples section): every future investor will (rightfully) demand the same...or more.

Example #1

Investor ABC, would invest $1 million in Company XYZ in a $1.5 million round based on a pre-money valuation of $3 million. The remaining $0.5 million would be invested by investors acceptable by both the founders and the investor, in a deferred closing, within 90 days of the closing. The PPS would be calculated based on the pre-money valuation divided by the total fully diluted number of shares, including a reservation of 10% of the company's shares post-round for ESOP.

Example #2

The board will be composed of three directors: two nominated by the founders and one nominated by the lead investor.

## Liquidation preferences

Even though investors are all into this game for a significant return, they still need to hedge and protect their investment in the less fortunate yet very likely outcome of a low-ticket acquisition. This isn't relevant if the company burns, as no one gets anything in that event.

When VCs invest in a startup, they get preferred shares and liquidation preferences is the mechanism that actually defines what that means:

Who gets money first? Usually, the last investor in takes the first money out and so on. Last in line are the common/ordinary shareholders, usually the founders and employees.

How much money do they get? Two factors define this: the multiplier on PPS and the interest rate (if any).

Participation mechanism: There are two main methods: "Non Participating" is the fair and most common method, meaning that if investors got their money back first, they do not get a piece of what is left for distribution after all the preferred shareholders get their cut. "Participating" (a.k.a. "Double Dipping") is the more aggressive approach that means that after all preferred shareholders get their cut, they also get a proportional cut of what is left for distribution.

Example #3

Each preferred shareholder will get a 1x non-participating return on each preferred share, with 6% yearly interest compounded annually.

## Protective provisions (veto rights)

Protective provisions give the investors the right to veto certain actions by the company, even if these actions were approved by the board and are aimed to help those investors protect their position in the company and keep a healthy balance between company, shareholder and founder interests above.

These rights do not give the investors any active, enforcing rights, but only passive veto rights — mainly on different variations of the three elements: (a) the issuance of new shares (to prevent non-agreed dilution); (b) changing the rights of the share class; and © changing the nature of the company's business or making extreme business decisions that will dramatically impact it.

Now you might be asking: If I can't issue any new shares without approval, then how can I raise my next round? The veto rights are usually balanced by a Qualified Financing threshold — meaning an agreed definition of what would be a future financing offer that the current investors can't veto — and it usually refers to a minimal round size and pre-money valuation that investors, shareholders and founders should be satisfied with.

Example #4

Without consent from the majority of the preferred seed shareholders, the company will not: deviate from the budget by more than 20%; issue new shares; decide on liquidation, IPO, shutdown; change the main business of the company; or change the board composition.

## Reverse vesting (repurchase)

By definition, early stage investors are investing primarily in teams. As such, they expect the founding team to stay in the company for a long, meaningful period. Investors also need to be able to somehow get the company back on track in the unfortunate case that one or more of the founders end up leaving early on. Reverse vesting means that if you leave the company early on, a portion of your founder shares is returned to the company pool. The factors that define that portion are: (a) time period (usually four years); and (b) vesting mechanism (this could be yearly, quarterly, or monthly — customary terms define the first year as a "cliff," meaning during that year your shares don't vest gradually, but as a single block at the end of that year, and gradual vesting begins on a monthly/quarterly basis over the remaining time period).

Example #5

100% of the founder's shares will be subject to a repurchase right, over a period of four years, with a one year cliff for 25% and the remaining 75% vesting monthly over a 36-month period.

## No sale, co-sale, right of first refusal (ROFR)

As mentioned above, founder shares are a sensitive point for investors.

If a founder sells all their shares, it's both a negative signal on the company (i.e. the founder doesn't believe in it) and it creates an unhealthy disincentivized founder situation. To mitigate those risks, term sheets usually include three mechanisms:

- **No sale:** a set of limitations on when, how much, and how fast a founder can sell their shares;
- **Co-sale:** this gives the investors the right to "piggyback" any transaction in which a founder is selling their shares, and force the buyer to also buy a proportional portion of the investor's shares;
- **Right of first refusal:** this gives the investors the right to match any offer the founder gets for their shares.

Example #6

Founders will not sell any of their shares three years from closing; after that, they can sell up to a total of 30% of their shares, and not more than 10% each year.

## Closing conditions

This last part of the term sheet is optional and case pending.

In some deals, investors like to mitigate some of the risks they are seeing by conditioning the closing on a variety of elements. These may include: getting IP clearance for former workplace or academic institute; getting the additional portion of the round committed; signing a key employee or advisor; clearing separation from a spun-off entity, and so on.

As a founder, you need to make sure the closing conditions make sense to you and most importantly that you are highly confident you can meet them. A scenario where you have a signed term sheet but failed to close the round because you didn't meet agreed upon closing conditions might make it extremely challenging to find an alternative investor, which would be devastating to a young startup.

Example #7

Closing conditions: The company will find a co-investor committed for no less than $1 million; the founder will get an IP clearance from the Hebrew University regarding his PhD research.

## No shop

No shop is the *only* legally binding aspect of a term sheet, and basically it means that during an agreed timeframe which is dedicated to finalizing the deal ("the closing"), the founder can't shop around for other investors to take the deal, or offer better terms. This is an indication from both parties that "they mean business". While the risk is mainly on you, as the obligation is one sided, good VCs who care about their own reputation will seldom back down from an issued term sheet without a very good reason.

Example #8

No real example here... Think wisely before you sign, and conduct business in good faith after you do.and conduct business in good faith after you do.

## Takeaways

There's a lot to digest for what is typically a simple and short document but, understanding each party's interests and the implications of each key term will put you in a strong position to successfully secure your investment partner at the start of your journey. In the next chapter, I will cover how to negotiate the term sheet to close the deal and also how to manage the process where you've been fortunate enough to have received multiple term sheets.

CHAPTER 10

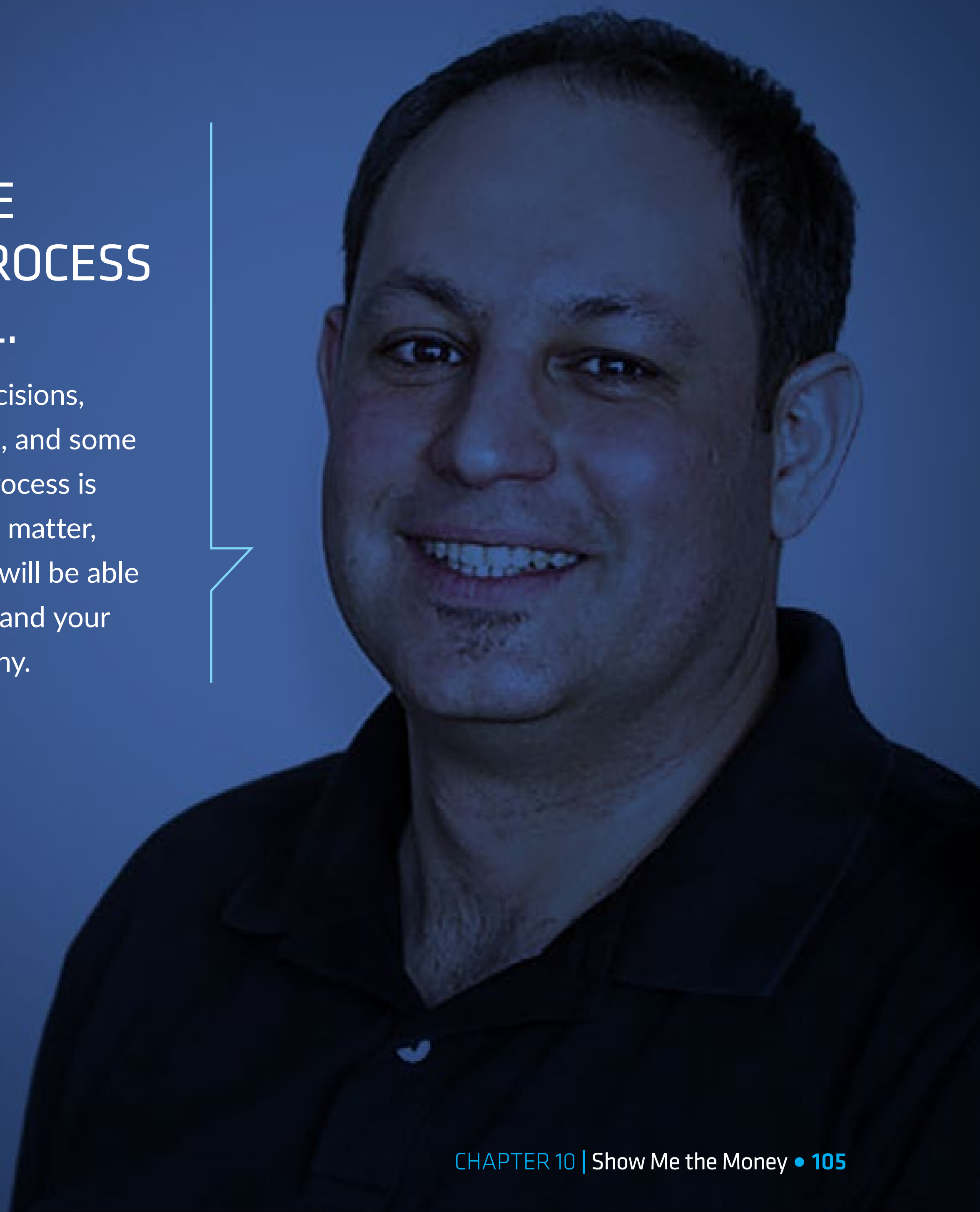
# SHOW ME **THE MONEY**

## AT THE END OF THE DAY,

## YOUR MAIN OBJECTIVE THROUGHOUT THIS PROCESS IS TO CLOSE THE DEAL.

you will be faced with hundreds of decisions, some small, some big, some important, and some not. Your main goal throughout this process is to stay focused on things that actually matter, both short and long term, so that you will be able to get the best end result for yourself and your cofounders, as well as for your company.

**Omri Shor** CEO
Medisafe



In this final chapter of **"Raising your Seed Round: A Playbook for Israeli Entrepreneurs,"** we will cover the closing process, getting the deal done and hopefully some 7 digit balance in your company's bank account within a couple of weeks.

## BEFORE WE BEGIN:

# CHOOSING THE RIGHT TERM SHEET

If you're fortunate enough to have more than one term sheet to consider (which should always be your aim) your duty as founder and CEO is to try and optimize the deal that the founding team and the company will sign with its first institutional investor. Even if you've only received one term sheet, the key question is, how do you weigh the different elements of the deal? When is a good deal "good" enough, and when do you risk burning all your bridges? Let's try and define the key considerations:

## LET'S TRY AND DEFINE THE KEY CONSIDERATIONS:

### 1. Check size

**The amount of money you take in your first financing round can impact your company in many different ways:**

- Taking a high-bar check brings high-bar expectations, and high bar business milestones
- Taking a much-lower-than-competitors' check might signal weakness, or hint to the world that your investors know about a hidden flaw in your startup

Most importantly, you need to feel confident that no matter what size check you take, it's enough to get you to the next funding round, be it seed extension, A round, or cash independence. Yes, bridging is always an option, but if you aim for mediocre achievements to begin with, you will probably not end up doing amazing. Also, investors tend to bridge successful companies, ones that are on the right trajectory but fall a little short in time or in speed, not the companies who met poorly-planned goals and are doing “as expected.”

## 2. Equity

**In his masterpiece “The Founder’s Dilemma,” Professor Noam Wasserman describes the tradeoff founders make when choosing between being “rich” or “king.” He explains that when fundraising, you always have to choose between keeping a smaller portion of a business that is potentially much bigger, or staying in control of a small business that has a capped value.**

Breaking this concept down a little more, I’d say some tradeoffs are easier to comprehend (i.e. more money for more dilution), and some are less tangible but are just as important (i.e. investor brand, value add, and founder-investor chemistry).

You should be willing to give up more equity in order to work with Sequoia or USVP, or the top investor in your specified domain, or just to work with that specific investor who you learned the most from and felt great talking to through the diligence process.

### 3. Commercial terms

The key issues that I discussed in Chapter #10 highlight different soft spots with different founding teams. Make sure to prioritize the absolute critical points for yours, as most early stage investors have their “system” in place and will not be willing to make drastic adjustments to more than a few items.

### 4. Alternative cost

**You should always try to evaluate both the likelihood to close and the time until closing, as these might cost you in alternate funding options, missed hires, or failed deadlines with customers. Sizing and evaluating these two factors is a delicate craft, usually mastered by serial entrepreneurs who have raised multiple funding rounds. If this is your first time, my best advice is to find a trusted mentor.**

After weighting and scoring the 4 items above, you are likely to find that no term sheet is “best” all around. As investors are usually educated players who are aware of the competitive nature of funding processes, you should be able to try improve certain elements in your top candidate’s term sheet, simply by telling them that you hold other offers that have better terms for certain matters.

At this point, be prepared for several potential answers, and prepare your response in advance to reduce impulsive reactions:

1. The investor says "yes" and waits for your reply. This probably means that you have some more room for optimization. I try to never leave a partnership deal where my counterpart feels defeated, so be aware and considerate here before you turn the screw.

2. Investor says "yes" or a partial "yes" but calls last offer. If you're still unhappy with the deal at this point, it means that you did a poor job on prioritizing your item(s) for negotiation. You should consider this to be truly a final offer, one which many investors might also bind with a deadline.

3. Investor says "no" and calls last offer. Most investors have a certain "system" in place. If it's crunch time and you received a definitive "no" on your last request, the chances are good that you're asking for something outside of their flexibility zone.

4. Investor says "no" and takes the offer off the table. While not common, you definitely need to prepare for this option. Before pushing for that extra point for optimization, make sure you're not taking the negotiation and optimization effort one step too far.

# FIRST THINGS FIRST

**After signing your term sheet, the first thing you should do is build a game plan across 3 fronts:**

- **The investor side: calibrate timelines and expectations. Find out when the closing is really due (in practical terms), when the wire is due, and if there are any further significant hurdles you need to overcome.**
- **The lawyer side: share the aforementioned timelines with your lawyer, and coordinate internal timelines and recurring touch points with them. These will be directly affected by the resources they are allocating for the deal, their current workload, and the expected costs, so be sure to discuss those as well.**
- **The founders side: set up process expectations with your cofounders, covering both timeline and content. During the coming weeks, you are going to make some hard decisions, a few of which could potentially impact you and your cofounders personally. Make sure you have their blessing to run the process according to your best judgment, and set up an update/discussion mechanism to make sure you are able to process complex and sensitive issues effectively. As the CEO and the one leading the negotiation, if you're not able to manage your cofounders, then this will be perceived as a negative signal to investors.**

After aligning your three main fronts, the next step is to define the work channels between yourself, your lawyer, the investor, the investor's lawyer and your cofounders. Well-defined processes and channels will create a productive closing process, while mismanaging them will set the stage for a slow, redundant, ineffective, and incoherent process. A piece of great advice that I borrowed from Ben Horowitz's "The Hard Thing About Hard Things" is to impose fake deadlines onto the closing process, so as to to push everyone towards a finalization mentality. At this stage of the deal, all sides are genuinely interested in getting it done, so there is little to no risk in drawing those lines in the sand. In the worst case scenario, the deadlines will be extended.

# EYES ON THE PRIZE

In the next few weeks, you will be faced with hundreds of decisions, some small, some big, some important, and some not. Your main goal throughout this process is to stay focused on things that actually matter, both short and long term, so that you will be able to get the best end result for yourself and your cofounders, as well as for your company. With the help of your counsel, pointing out the key points would also enable you to give away tokens during the process and keep your investor partially satisfied.

**How do you define what is really important? Ask yourself the following questions:**

**1 | Does it handicap the company for the short or long term?**

As much as possible, avoid things like excessive veto rights, uncommon liquidation preferences, named rights, and any other factor that might make the company less attractive or function less effectively in the future .

**2 | Does it create or enhance misalignment of interests?**

As noted in Chapter 10, you are now entering a new era in your venture, one in which 3 and potentially 4 legal entities are taking part: Founder, Investor, Company and Board. Every item in the legal documents that creates or enhances a misalignment in interests between these entities is effectively a ticking time bomb with a fuse of unknown length. These cases usually occur around the financial interests of the different parties, and can vary across a wide range of subjects such as ESOP, indemnification, liquidation preferences, and many others. A good way to resolve such conflicts is to always try and stick to the market standard and to the company's best interest.

**3 | Does it hurt the founders economically or put them at risk of legal action?**

In definitive agreements, you'll discover tens of clauses and items which have the sole purpose of carving founders out of their equity or economic rights, or so it seems upon first glance. In fact, most of these clauses are standard, and usually refer to extreme cases of misfortune or misconduct. As distressing or uncomfortable as they make you feel, pushing back on most of them will be a complete waste of time.

However, it is totally legitimate to try and improve your stand on specific items that you feel are out of line, or are simply sensitive issues for you. Your counsel should be able to prevent you from fighting gravity, for example pushing back on terms that no reasonable investor would accept but we have seen occasions where lawyers try to prove their worth by over negotiating on terms unnecessarily, so be wary of this. We can say that because some of our best friends are lawyers :)

## CLOSING CLICHÉS

**During closing, you're likely to hear some cliches that never get old:**

- Our office always does X that way;
- I have worked with partners from your firm who agree with my approach;
- X, Y, and Z were not specified to that extent on the TS;
- The TS says exactly that;

etc.

When it comes to deal-making, cliches are used when good reasoning and logic are lacking and your claim is based on little ground. Yes, you might pull off such a tactic once or twice, but never on important issues and surely not for long. A good indication of when to give up on an item is if both you and your counsel are struggling to truly justify it for reasons other than "I want it." The only time when "I want" might be sufficient argument is when you're negotiating unconventional terms that deviate from the market standard. Also note that second tier VCs may offer you terms that a tier 1 VC would never accept, so don't over negotiate, just decide on what's more important to you and most importantly, who you'd rather work with.

To keep cliches to a minimum, make sure that both sides' legal teams have direct preparation calls before the business guys join the line. That way there will be less need to impress their clients, and more drive to resolve and minimize pending open issues.

# WHAT'S ACTUALLY IN IT?

## The main documents

Seed round deal documents are the DNA of the company legal structure, for better or worse. Proper deal documents will make your future rounds quick and effective, requiring only minimal updates, while messy, sloppy, or non-standard documents will make closing and diligence of future rounds a nightmare. So while I highly recommend that you leave the legal work to the professionals, please do your homework and get to know the materials and the mechanisms that are going to have an important role in your company's future. These include:

- **SPA (Share Purchase Agreement)**. This document defines everything that has to do with the actual sale and purchase of the company's shares, in a specific agreed price and specific agreed amounts.
- **IRA (Investor Rights Agreement)**. This document defines (wait for it...) the rights of the investors in the company: who is eligible to elect a board member, what type of decisions require the investors' majority consent, what kind of majority would that be, information rights, and other issues.
- **AoA (Articles of Association)/CoI (Certificate of Incorporation)**. This document goes by different names in Israel and the US, but it always includes some of the most important items in a venture deal: many decision mechanisms, active or passive veto rights, quorum definitions, liquidation preferences, and others. An AoA/CoI is also the most "lasting" document, as it sets some conventions in place. Any future investor looking to change them would have to go through an Article Amendment process, which is never obvious and could consume costly time on future funding rounds. Good AoA/CoIs set the company up for a healthy set of relationships between investors and founders, and among the investors themselves, by applying clear, well defined and fair mechanisms from day one.
- **DS (Disclosure Schedule).** Disclosure schedules aim to create maximal transparency between the founders and the company, and the investors. They include all the "by the way"s and "just so you know"s that usually pop up during or after diligence. It also places a separation between

the investors and the founders regarding legal liability for actions that took place before the investment. Your DS will be reviewed by future investors during diligence, so everything you put in there should have good reason and justification. Drafting the DS is a good time to iron (legally of course) any wrinkles in your historical paper work, get all those required waivers from vendors signed, and basically do some healthy housekeeping in your company's legal work.

## CLOSING THE CLOSING

**When there's more than one investor, you'll typically use one of two common practices:**

1. **Simultaneous closing**. The lead investor represents all the investors in the round, and the deal documents are delivered "as is," with little to no room for comments or changes. Depending on the inter-investor relationship and the size of each investor's check, the co-investors might be looped in to the deal documents early, and sometimes they might get the documents signed by the company and the lead investor. Make sure to be on top of these delicate relationships; the last thing you want is to start off with a poisoned relationship or a vengeful investor waiting for payback.

2. **Deferred closing.** The lead investor's check covers only a portion of the round size (or potential size), and there is no co-investor willing to sign a check at the same time (as in section #1), the lead investor and the company usually agree upon a deferred closing mechanism. This generally lasts for about 90 days, give or take 30. During this time, the round remains semi-open and the founders can calmly find the best fit for the co-investor slot. Deferred closing investment is usually done in the same terms as the rest of the round, but if your company did really great in that short time period, bullish investors will be willing to pay a small premium on the round price (10%-15%) just to get through the door. The execution itself is rather simple; the new co-investor signs a Joinder (that's the technical legal term) agreement and becomes a party to all the above mentioned deal documents.

# IT'S LONELY AT THE TOP

Being a first-time fundraising CEO underscores the hardship of leading a company. To the extreme. During the closing period, you will be forced to take some hard decisions: some may personally impact you and your co-founders, and some may create bad blood with existing or joining investors. With some, you will have one and only one option, and with others you will knowingly hurt the company's chances for success. With some, you will have zero knowledge or time to decide, and for some you will make a call that is not popular, doesn't make anyone happy, and is not even optimal, but is still the right call for your company.

At the end of the day, your main objective throughout this process is to close the deal. That said, you are also required to pay attention and identify signals that indicate this may not be the right long term partnership for you and your company. As you go along your founder journey, you want to make sure you have the right partners alongside you. That said, as important as they are, it's not investors that make or break companies, it's the founders and the decisions they make. Choosing, negotiating and closing the right investment is one of your earliest defining choices you'll have to make.

# CONCLUSION

So there you have it! In just over 18,000 words, a step-by-step guide for you, the entrepreneur, to optimize your chances of successfully raising a seed round. If you've made it to the end of the book, either you like spoilers, you're extremely diligent and read cover to cover, or most likely, you're someone in between. Either way, thank you for taking the time to enrich your knowledge and understanding of a critical piece of building a high-growth business. By reading this ebook you have gained a competitive advantage over entrepreneurs who go into fundraising with little to no preparation, and competitive advantages lead to outperformance :)

Fundraising is rarely fun, and sometimes it can feel extremely discouraging to get rejected over and over again. But what doesn't kill you makes you stronger and prepares you for raising your A Round, and much more intense and thorough process.

One final note before saying goodbye: Technology is quickly replacing natural selection as the driving force behind the evolution of our planet. We face many challenges as a species over the next ten years, and technology can be used for both good and bad. As you begin to build your business, I encourage you to think deeply about how you and your company can use technology to improve the health and well-being of all conscious systems.

Wishing you amazing luck in the journey. If you're an Israeli entrepreneur getting ready to raise your seed round, we'd be happy to hear from you at hello@lool.vc!

Love,
Max

# ABOUT LOOL:

We are a venture capital firm investing in early stage startups, based in Tel Aviv. We work shoulder to shoulder with exceptional founders with huge dreams that once realized will make the world a better place.

## Investment Focus

- We value teams that are diverse, supportive of each other and exceptionally committed.
- We value software. We value IP.
- We value doing over talking. We are more likely to invest our capital in teams that already invested their own resources and actually created something.
- We think Global. We appreciate teams that think global from day one, and validate their thesis with their target markets.
- We are vertical-agnostic. The world is changing is so fast these days, what's a vertical anyway?!
- We have a preference for startups with Israeli founders. We were Israeli founders. We know the pros and the cons, we think we can help maximize the value of the first while working around the later.

## What does lool mean?

If you write lool, in lower-case, or turn it upside down, it kinda looks like 1001, which is a subtle hint of just how much we subscribe to the view that software is what it's all about in the digital era.

It turns out lool is also an Hebrew word, and it means a Crib, or a Hatchery, or a Chicken Coop. In fact, we like to think of lool ventures as all of these combined – a place where precious things are born and raised, and quickly grow.

## Things We Are Not

- Accelerators are great. We are not an accelerator.
- Incubators are wonderful. We are not an incubator.
- Hamama is also a Hebrew word, just like lool. We are not one.
- We are not fond of jokes related to chicken and eggs. We've heard them all. Unless you came up with a really new one, in which case, by all means, we'd love to hear it.

Think we can make awesome happen together? Tell us: hello@lool.vc

lool
VENTURES