Harper James

How to secure venture capital for your business

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Getting started with venture capital

If you're an early-stage business looking for investment, you'll probably have considered raising funds from a venture capitalist (VC).

VCs typically invest in innovative businesses with some trading history and a strong potential for growth, although some invest in start-ups. In return for providing capital, VCs take a share in the ownership of your business. While a VC partner may seem an attractive option, securing investment can be time-consuming and complex, and VCs have become highly selective. VCs typically pool funds from institutional investors like pension funds and insurance companies and specialise in particular industries or geographical markets.

Doing your homework and finding the right VC firms to pitch to is essential, as is making sure your pitch is, well, pitch perfect.

This White Paper will help you:

- take a look at the VC market in 2020 and beyond get inside the mind of your typical VC
- show you how to prepare for your VC pitch
- help you deal professionally with the diligence process

We'll examine what VCs are looking for in today's market, how you can make sure your business has the best chance of securing VC funding, and how to avoid common pitfalls.

Sources of funding for start-ups

For seed and early-stage businesses, the most obvious source of funding is from your personal funds, and those of friends and family – this is called bootstrap finance. Other popular ways to fund new businesses is to look for investment from angel investors who are seeking to make money from companies with high growth potential.

Start-ups typically raise funding in stages known as rounds. Seed money is often bootstrap finance that will get you off the ground. Series A funding will consolidate your operations and help you invest in technology and marketing to start to grow. Series B, C and beyond are used to help you scale – these rounds typically involve cash injections of £10 million and beyond – and are where you'll find the bulk of VC funding.

VC firms are increasingly interested in funding seed and early-stage businesses. Government initiatives like the Enterprise Investment Scheme and Seed Enterprise Investment schemes, as well as tax benefits of venture capital trusts, have driven the general increase of UK venture capital funding.

VCs are often highly specialised, targeting particular markets, regions and types of company. Some firms might place relatively small amounts of capital, whereas others might aim to invest to the tune of £5 million and upwards. Similarly, one VC may specialise in supporting start-ups, and another prefer to invest in established companies with at least four years of trading history.

What are vcs looking for in 2020?

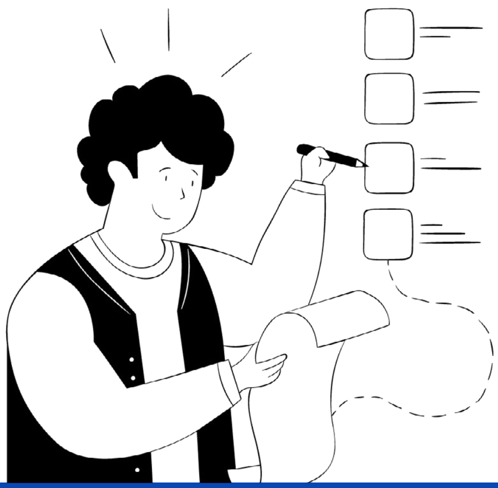
Getting investors to part with their cash is never easy, and VCs are no exception. VCs are looking to achieve a strong return on their investment, and they can afford to be picky.

Despite this, the global volume of VC investment is growing steadily, from seed/early stage and beyond. Historically Fintech, digital healthcare, cybersecurity, energy, educational technology, AI and e-commerce have been particularly attractive to UK-based and global VCs. While 2018 saw a dip in VC funding, probably due to investor uncertainty around Brexit, VC funding looks to have increased during 2019, with Fintech leading the charge (see this report by Whitestar Capital).

Venture capitalists look for high-growth businesses so they can make money from their shareholding as the company becomes more valuable. VC fund managers also take a slice via management fees and a percentage of the returns achieved by the VC investors. A VC firm will drive your business to grow in a way that ensures a healthy return for both the fund and the managers.

It's important to realise though that few VCs make stellar returns on their investment: only 5% of VC deals achieve a 3x return on their investment, and more than 50% actually lose money (see this article by Tomer Dean for TechCrunch).

Now that the markets appear to have absorbed the initial impact of Brexit, how can you best exploit this and secure VC investment in the coming months and years?



Steps to securing vc funding

1. Be clear about your objectives

Before you approach a VC firm, you need to make sure that your goals are clear. Are you aiming to grow a global business and take your company public as soon as possible? Or are you looking to consolidate your position in the domestic market and grow internationally when the time is right?

VC firms are looking to grow businesses quickly. If your personal goal is to keep your business ticking over to provide you with a steady income and capital growth, then VC funding might not be right for you, especially if you wouldn't be comfortable giving up some of your control over your company.

2. Pick the right VC firm

Before you create a wish-list of potential VCs, research firms' objectives, preferred location and market segment. Geographical location may seem relatively unimportant, but VCs often wish to meet in person, so you'll need to make sure you can accommodate requests for face-to-face sessions. Once you have compiled your list, do your homework on each VC. You can find out a lot about a VC firm from their website, such as their portfolio and approach. Try to draw parallels between the companies in which they have previously invested and your own.

Ideally you need to be a business that has not yet exhausted its current market, with the opportunity to grow quickly. When you do your research, make sure you target the VC firm that best suits your particular market and the amount of investment you need. Check the British Venture Capital Association for a list of reputable VC firms. The best way to approach a VC is an introduction from someone in your network.

Be aware that VCs balance growth potential and risk of failure. If your business is too new to market, you may be able to demonstrate a high potential for growth, but the risk of failure could prove too much for a VC to take on. Older companies (eight years of trading or more) are likely to be seen as too slow-growing to be suitable for VC funding. Ideally you need to be a business that has not yet exhausted its current market, with the opportunity to grow quickly.

3. Time your approach

As well as making your approach to VCs at the right point in your company's trading history, make sure that you're not cash-poor when you start to pitch. Raising funds is a relatively slow process, and due diligence can be time-consuming and lengthy. You must be solvent and have enough working capital to see you through to completion. Your potential VC partner will be poring over your books, and any solvency issues will be immediately clear.

Because a VC firm may drop out of the process at any point before completion, make sure you approach a number of VCs when seeking funding. Draw up a shortlist and be aware that word travels fast in the VC community – potential deals often get discussed. Contact the VC firms that you believe are most likely to invest before those further down your list, and don't draw the process out too long – if there's a belief that your company has been trying to attract funding for some time, this can raise alarm bells for investors.

4. Be professional, be human

Make sure your correspondence with VC firms is professional and concise. If you're not the best speller in the world, get someone in your office to proof-read your emails. Your business plan and pitch-deck need to be pitch perfect. You'll have to tell a good story: a compelling narrative that will persuade a VC firm to back you. VCs are human beings, and they will be looking to establish a connection with your business that will help them towards an investment and have belief in you and your team. That issue becomes crucial when you meet in person.

5. Build your team

By the time you reach the stage of seeking VC investment, the demands of your business will already be taking up a lot of your time. You'll need to focus your efforts on making sure your company is solid and well as devoting time to your pitch, so building a great team around you is essential. VCs will need to know that key roles have solid team members in place (operations, marketing, tech, CEX, HR, finance), and that you have appropriate legal and financial advisors to stand behind you. Make sure you pick expert advisors who have experience of the VC process.

6. Prepare your pitch

When you're in front of a VC, you need to close the deal. Here's the content you need to prepare to have a fighting chance of success:

- **An elevator pitch**
  This should sum up your business in a sentence. 'Ten thousand songs in your pocket' was Apple's original elevator pitch for the iPod.
- **Executive summary**
  Summarise the key takeaways from your pitch in a few paragraphs, in a digestible format (graphs are good).
- **Business plan**
  The detail behind your business, your market, your plans to scale and grow. Make it readable – most VCs will skim.
- **Pitch deck**
  Create a shorter version of your business plan in a slideshow format. Use lots of graphics.

7. Cover off due diligence

Due diligence can be a lengthy and frustrating process. Make sure your paperwork is in order, and that you've prepared for the kinds of questions you'll be asked. In terms of documents, you'll need:

- Copies of your company's articles and any shareholders' agreements
- Contracts of employment and service agreements
- Contracts with customers
- A cap table: details of other investors, how much they own, and what kinds of shares they own Financial forecasts and previous years' statutory accounts, management
- accounts pre- and post-investment
- Sales, marketing and HR plans
- Customer lists
- Product development, sales and marketing plans
- Information about your team: CVs and competencies

Setting up a virtual data room (such as Merrill DataSite or file sharing service such as Dropbox) is a good idea. Be proactive - send information before you're asked for it.

8. Provide references

You should have personal references for all senior managers in your business and references from existing and potential customers. Make sure that you share references only with VCs who are about to sign a term sheet, so that the same referees are not being contacted repeatedly.

Spotlight on: your business plan

Be clear on the market opportunity

VCs will want to grow your business quickly, so you'll need to demonstrate that your company can disrupt a large market. Be realistic about the addressable market (who would buy your product or service), as opposed to the market as a whole. To convince a VC that there's a genuine opportunity, you'll need to look at the ways in which the market is currently behaving, what the competition is, any recent trends that prove the market is ripe for disruption, and why consumers might buy from you.

Detail what's unique

Share why your offering is significantly better than anything currently offered in your market. You cannot 'just be as good as', or 'marginally better than' what is already out there.

Tackle your track record

You need to demonstrate proof of sales and ability to deliver on the contents of your business plan.

Getting to market

If you're a start-up, talk about your proposed route to market. How do consumers currently buy what you're offering and how will you market yourself to position your product or service?

Better your competitors

How does your business stack up against the competition, and how will you respond to market challenges if your business is a success? Can you build a winning brand that will be rewarded by customer loyalty? Do you have a patent or technology that's better than what's already on offer?

Talk about talent

The personalities and competence of your team is probably the most crucial factor in terms of seeking VC funding. How they work together, and their track record will be of considerable interest to VCs considering investment.

Show scalability

Demonstrate that the business you want to grow is scalable and how you plan to grow. What are your plans for hiring, and how much will this cost? Will you need additional manufacturing capability, and where will this come from? How will you market your product or service? Will your tech platforms be able to cope with increased demand, and how will you fund further development?

Get your financials ready

You'll need to have audited accounts for at least two years and a realistic three-year forecast. The audited accounts should be prepared by a reputable accountancy firm to give weight to your figures.

Be open about risk

It's better to be aware and upfront about risks your business faces, rather than try to hide them. All businesses face risk, but if you can deal with this honestly and state clearly how you would deal with specific risks, you are more likely to earn trust from an investor.

Common reasons for failing to get vc funding

Increase in workload – securing VC investment can be a long and arduous process. You will need to be able to steer the business successfully whilst dealing with complex negotiations.

Due diligence – this can be a long, frustrating, detailed and expensive process. Some businesses, particularly those who are less established or have issues with cashflow, can't handle the distraction or cost, so drop out pre-funding.

Director skillset – VC funding and the restructuring of the business's capital required by VC firms can get complicated. Some owners don't have the range of skills needed to handle VC investment.

Investor mismatch – failing to approach the right type of VC firm for your business.

Poor business planning – uninspiring, unrealistic or unoriginal business plans and/or pitches.

Poor preparation – lack of professional input into the VC process.

Unrealistic valuation – one of the top turn-offs offs for potential investors.

The last word

You'll have seen in this White Paper, to be successful when pitching to VCs, you need to do your homework. Choosing the right VCs to pitch to, preparing content for your pitch that is appealing, developing a compelling narrative to invest, and being on top of the detail – like financials and your company's capital structure – are the key to obtaining VC funding.

If you're an entrepreneur raising money for the first time, one of the best things you can do is find an adviser who's already been involved in successful VC pitches. Choosing a lawyer or accountant with experience in these kinds of deals, especially within your industry, is an excellent way to get ahead of the competition.

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A modern law firm purpose built to support entrepreneurial businesses

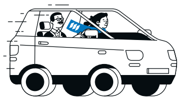
Legal support to help realise your ambitions and evolve your business from start-up to scale-up and beyond

When you've got the big idea

It's time to think about protecting your idea as you start to consider the structure and how to fund your business.

Time is focused on getting started

You're getting contracts and policies in place to ensure your company is built to grow. Employment, shareholders and director duties need locking down.

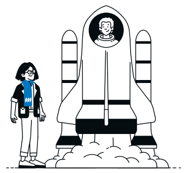


Your team is getting on with it

Things are moving forward and you want to optimise and protect your 'business as usual'. Small disputes and resolutions are likely cropping up.

When it's all about scaling up

You've got targets in mind and an ambitious vision for the business. You're structuring for a certain scale, internationalisation and acquisitions or mergers.



If you're looking to exit

Leaving your current situation means you're looking to sell shares, structure deals and secure a smooth transition for your business as well as your own next venture.

An extension of your team

An objective friend, our lawyers are impartial advisors, empowering you to make the right decisions for your business.

We've stepped away from the traditional law firm mindset and reinvented how legal support can be delivered to better serve businesses.

Enjoy legal peace of mind with our unique subscription plans where you can quickly access highly experienced solicitors in all areas of business law.

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- Intellectual Property

'We rely on Harper James to provide us with support across a full range of service areas, from commercial contracts and employment issues to fundraisings and investments. The team is always available to provide us with cost effective, pragmatic and commercially focused advice.'

NICK HOLZHERR, CEO

Whisk

'We'd like to thank Harper James for all of their support throughout the investment deal process. As well as providing vital legal advice, Adam and the team at Harper James gave us guidance on the next steps of our growth, and we look forward to working with the team on a variety of projects in the future.'

SCOTT CLIFFORD, FOUNDER

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