



Raising Your Seed Round 2023 edition

A Playbook for Israeli Entrepreneurs
3rd edition



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Introduction

Why you need to read this guide



For the majority of founders, the process of securing funds is as enjoyable as undergoing a root canal. Both are uncomfortable yet necessary, involve preparation, and hopefully result in a positive outcome. This guide primarily focuses on the aspect of preparation.



Moving away from analogies, there is an inherent information gap between VCs and founders. Most VCs have navigated the investment process multiple times, and quite often from various perspectives, while the majority of founders will experience each stage of fund-raising for the first time. This information gap usually favors the VCs. To overcome this, it is crucial that VCs and founders build a foundation of mutual understanding and transparency in order to form a lasting partnership.

In the following chapters, we've collected and summarized what we, and other fellow entrepreneurs and investors, learned over many years of starting companies, fund-raising for them, and investing as both angels and as VCs. Hopefully this will help bridge and mostly eliminate the information gap.

The first edition was published in 2019, a time that seems incredibly distant now. The second edition was released in 2021, mid-COVID, in a much different world. Startup valuations skyrocketed soon after

the guide was published, only to plummet later. However, it's worth noting that some of the world's most successful companies were born during an economic downturn, and there has never been a more opportune time to launch a new tech venture.

Hence, the 2023 edition.

Big thanks to Max Marine, who authored the first two editions, to Ido Bar-On, who contributed the final two chapters in the preceding editions.

Chapter #1

Do I Need Venture Capital and How Much Should I Raise?



Let's begin with a quote
from **Aviv Shapira**:



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

BEFORE YOU APPROACH A VC FUND,
TAKE A MOMENT 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.



Realistically, many tech businesses with high potential require significant investment before they start generating revenue and even more to achieve sustainable profits. And, if you have your sights 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 embark on this journey one of the first discoveries you'll make is that before you sell a product you must first sell financial assets - namely, ownership stakes in your company (e.g. equity). In fact, this notion can help define your attitude during the fundraising process.

**You're not begging for money,
you're selling a valuable asset.**

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 urgency 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 our experience, over half of the founders that we 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.



UNDERSTANDING EARLY STAGE VC ECONOMICS

Believe it or not, VCs also engage in fundraising. Instead of securing a seed round, and hopefully subsequent series (A, B, etc.) they raise Fund I, and hopefully, Fund II, III, etc. Instead of promising product market fit or \$10m in sales, their pitch to investors is that they can generate 3x or higher return on investment over a ten year period.

However, after 2% in management fees and 20% in carried interest (a fancy way to say a % of the profits), 3x return "cash on cash" is calculated as \$300m for a \$100m fund. That's nearly 4x ($3.75 \times 80 = 300$) on investible capital in order to get to a 3x return.

So, what kind of investment strategy can produce these types of results?

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

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

While each of these scenarios leads to the same \$350m in proceeds, which scenario seems the most probable?

Although these four scenarios all yield the same amount of exit proceeds, they have wildly different probabilities of occurrence. It is substantially more challenging to grow eight companies from \$0 to \$437.5m than it is to expand 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 can independently offset the losses from all 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, the founder, should bear all the risks required to generate an outsized return for the VC. There are standard mechanisms to reduce your personal risk throughout 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.

Fund-raising in 2023

Have we entered a new ballgame? The recent economic downturn, combined with widespread tech layoffs, and uncertain political climate has made the fundraising landscape more challenging than ever. Unlike the upmarket in 2021 through early 2022, 2023 marks the return of "fundamentals": a convincing solution to an actual, demonstrable pain, with a viable business model and a credible Go-To-Market strategy.

Raising seed funding can also be beneficial for entrepreneurs who want to scale their business quickly. With the right amount of capital, you can invest in growth initiatives

such as expanding your team, entering new markets, or increasing your marketing efforts. This can help you achieve significant traction and revenue growth in a shorter period of time.

However, there are also downsides to raising seed funding. One of the biggest risks is that you may give up too much equity in your company. This can be especially challenging if you are a first-time entrepreneur and have little experience with fundraising. Additionally, raising seed funding can be time-consuming, as you will need to spend a significant amount of time and energy on fundraising activities, such as networking and pitching to investors.

So, how much should you aim to raise when seeking seed funding?



The answer to this question will depend on the specific needs of your company. However, a general rule of thumb is to aim to raise enough money to cover your expenses for the next 18 to 24 months. This will give you enough time to reach significant milestones that will allow you to raise a great following round (such as a developed MVP, validation of your business idea, and traction).

Factors for Consideration

One of the first things to consider when deciding whether to raise venture capital is the stage of your company. Seed (or pre-seed) funding is typically the first round of funding for a startup, and is used to finance the initial stages of product development and market validation. If your company is in the early stages of development, seed funding may be the best option for you.

Another important factor to consider is the size of your market and the potential for growth. If your market is large and growing, and your product or service has the potential to capture a significant share of that market, then raising venture capital may be a good option. However, if your market is small or stagnant, it may be difficult to attract investors and raise the necessary funding.

Consider asking yourself the following questions:

1. What are my goals for the company and how much funding do I need to achieve them?
2. What is the size of my market and what is the potential for growth?
3. What is the current economic climate and what is the state of the venture capital market?
4. How much money do I need to reach my next milestones?
5. How will I attract and retain top talent?
6. How will the Israeli political climate impact my ability to raise capital?

By considering these factors and asking themselves these questions, entrepreneurs can make a more informed decision about whether to raise venture capital and how much to raise. It is important to remember that raising venture capital is not a one-time event, but rather a continuous process, and entrepreneurs should be prepared to continue to raise capital as their company grows and evolves.



Chapter #2

Understand the Funding Landscape





The funding landscape
in Israel in 2023 presents
**a challenging yet
exciting opportunity**
for entrepreneurs who are beginning
their funding journey.

The current economic downturn, tech layoffs and recent wave of political climate have resulted in a more cautious approach to investment, with investors looking for businesses that are well-positioned to weather the storm.

However, despite these challenges, Israel continues to be a hub of innovation and entrepreneurship. The country has a strong ecosystem of venture capital firms, angel investors, and accelerators that are actively searching for the next big thing.

Before going on pitch meetings, it's critical that you understand all of the relevant funding options that exist in the ecosystem and find one that best aligns with your goals.

Funding Options

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 and specializes in your chosen market, bringing valuable access to design partners/customers and domain expertise. There are also some highly respected Israeli-based accelerators, but it's important to do your homework by checking with other entrepreneurs who have graduated and hearing about their experiences.

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.

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, several groups of founders & senior employees at Israeli unicorns have started to quietly invest in their friends directly and alongside pre-seed & seed funds.

Fear not. This might make raising money from angels sound daunting, but by reaching out directly, or through a warm introduction to an angel or angel group, you could be well on your way to securing funding.

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.

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.

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 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.

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, but if you do include a corporate investor in your seed round, aim to have two, with each less than 5% ownership, and be very careful with the rights you provide them. This way neither strategic investors have 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 the potentially capital of 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 a 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.



Chapter #3

VC Organizational Structure – An Overview

The organizational structure of a VC firm can vary depending on the size and stage of the firm, but typically includes a team of managing partners, investment professionals, and support staff.

The managing partners of a VC firm

Typically the most senior members of the organization. They are responsible for the overall strategy and direction of the firm, as well as making investment decisions and managing the portfolio of companies in which the firm has invested. The managing partners are typically the most experienced members of the firm.

The investment professionals of a VC firm

Responsible for identifying, evaluating, and executing investments. They typically have a background in finance, business, or a related field and are often responsible for conducting due diligence, analyzing financial data, and negotiating terms of investments. They may also play a role in the management of portfolio companies, providing guidance and support to help them grow and succeed.

The support staff of a VC firm

Responsible for the day-to-day operations of the firm, including administration, finance, and legal. They may also provide research and analytical support to the investment professionals.

In addition to these core roles, some VC firms may also have **a board of advisers or limited partners** who provide additional support and guidance. These individuals may be experienced entrepreneurs, business leaders, or investors who can provide valuable insights and connections to the firm.

The main function of a venture capital firm is to generate returns for its limited partners, typically institutional investors such as pension funds, endowments, and high-net-worth individuals. The firm raises capital from these limited partners, known as a venture capital fund, and uses that capital to make investments in early-stage companies. The firm then manages those investments, providing support and resources to help the companies grow, and eventually exits those investments through an acquisition or initial public offering.

When it comes to organizational structure, VC firms can take on different forms, such as a partnership, limited liability corporation (LLC), or a corporation. Regardless of the legal structure, the key components are General Partners (GP) and Limited Partners (LP). The general partner is responsible for making investment decisions and managing the portfolio, while the limited partners provide the capital for the fund and share in the profits generated by the fund.

VC firms operate on a fund structure, which means that they raise a specific amount of capital for a limited period of time, usually around 10 years. Once the fund is closed, the firm can no longer accept new capital commitments. The firm then uses the capital to make investments, and the returns generated by the fund are distributed to the limited partners on a regular basis.

VC firms typically have a defined investment strategy, focusing on specific stages of companies, sectors, or geographic regions. Some VC firms focus on early-stage investments in technology companies, while others focus on later-stage investments in more established companies. Some firms focus on specific sectors, such as healthcare or clean technology, while others have a more general investment focus.

Who will you meet at a VC firm?



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. ”

Max Marine



Value Creation

In the past few years, venture capitalists must also demonstrate the ways in which they “add value” to their portfolio companies. For some, this comes naturally as part of their “personality”, others need 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 approach has slowly, but surely, made its way into the Israeli ecosystem - with most seed funds having dedicated team members focused on this. Meanwhile, not only should you try to understand each VC’s approach to value creation as you build your target list, but you should also aim to 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.

At lool ventures we pride ourselves on pioneering Value Creation in Israel, and believe it has played a critical role in our portfolio companies that have successfully raised a second round.

**75% of lool companies
successfully raised a Series A round.
2x the industry average. No big deal!**

A main attribute to this success is a careful (and strategic) balance of guiding founders and giving them freedom.

**When advising our portfolio
companies with regards to selecting
investors, our guidelines are:**

- 1.** First and most important, select the ones that are known to not create obstacles for entrepreneurs
- 2.** Only then, if possible, select the ones who are able to add the most value in the areas you need

Marketing

It has now become more common for VCs to incorporate Marketing into their brand and portfolio strategy. At its core, the role of marketing is to create and communicate a compelling brand identity for the fund that resonates with both founders and investors. Realistically your interaction with Marketing will be minimal during your fundraising meetings, however upon signing a term sheet the Marketing department can be a vital resource for growing your company. Often offered as part of the firm's Value Creation efforts. Marketing can offer expertise and resources to portfolio companies, such as branding and messaging guidance, customer acquisition strategies, and PR and media support. VCs want their portfolio to succeed, and are willing to offer support wherever is needed. If Marketing is something you know you need, but you're unsure where to begin, you shouldn't hesitate to ask any questions.

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 who 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 you and your cofounder 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 team 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 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.

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 in Israel have strong character, 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 their fund by looking at their LinkedIn and seeing how long they have 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, as 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, we're going to share our tips for optimizing the screening process and securing your First Partner Meeting.





Chapter #4

How To Get Your First Meeting

Exciting, it's time for 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 Monday, 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 a cybersecurity business, prioritize cyber specialist VCs, and spend more time thinking through the best way to market to these higher priority investors.

As the startup ecosystem continues to evolve in 2023, founders should keep the following tips in mind for identifying relevant seed investors:

- 1.** Evaluate investor reputation and track record: Look for investors who have a good reputation in the industry and a strong track record of successful investments. This can provide valuable validation for your startup and help you attract additional funding in the future.
- 2.** Look for investors who specialize in your industry: There are many seed investors out there, but not all of them will be a good fit for your startup. Look for investors who have experience and expertise in your industry and can provide value beyond just funding.
- 3.** Do your research: Before reaching out to potential investors, research their investment history, portfolio companies, and investment thesis. This will help you understand if they are a good fit for your startup and how to position your pitch to them.
- 4.** Leverage your network: Talk to other founders, mentors, and advisors in your network to get recommendations for potential investors. This can help you get warm introductions and build relationships with investors who likely to be a good fit.

Now, let's dig deeper on what founders should consider before their first meeting.

Consider your track record

Keep in mind that every investor that spends time with you is, by definition, not spending that time with other entrepreneurs. So what will influence investors to choose to spend their time with you?

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:

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

If none of the above 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.

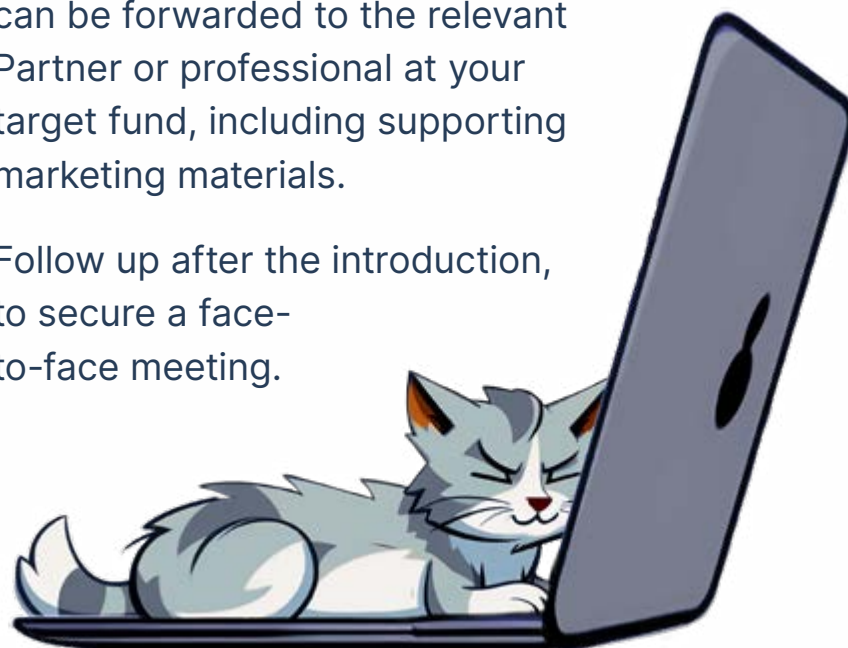
To optimize the interaction(s) with an investment professional who has approached you, it helps to understand their motivations. Investment professionals improve their credibility by bringing good dealflow, and damage their credibility by bringing dealflow that the Partner(s) think is a waste of time. "Good" deal flow must meet certain investment criteria, which we 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

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. 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 introduction source, 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 has a high probability of converting into a meeting.

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..." Our 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;
- c.** Approach (outbound) an investor



Chapter #5

Preparing for the First Partner Meeting



As a seed-stage founder, meeting with a potential investor for the first time can be nerve-wracking. However, after proper preparation, you can make a strong first impression and increase your chances of securing funding.



10 Steps to Prepare for Your First Meeting:



- 1. Do your research:** Before your meeting, research the investor's background, investment portfolio, and areas of interest. This can help you tailor your pitch to their specific preferences and show that you've done your homework. Look for commonalities between your startup and their portfolio companies, as well as any potential synergies or areas for collaboration.
- 2. Practice your pitch:** Your pitch should be clear, concise, and compelling. Practice your pitch in front of friends, family, or a mentor to get feedback and refine your message. Keep in mind that you only have a limited amount of time to make a strong impression, so focus on the most important points and avoid getting bogged down in unnecessary details.
- 3. Develop a robust budget:** Investors want to see that you've thought responsibly about how you plan to invest the funds you're looking to raise. As you're most likely pre-revenue, separate out any sales plan (where relevant), as that is unpredictable. Remember, you control 100% of your expenses, so be very clear about this, particularly your hiring plan. Be prepared to discuss your assumptions and how you plan to use any funding you receive.
- 4. Anticipate questions:** Investors will likely have questions about your business model, market opportunity, and team. Anticipate these questions and prepare thoughtful, well-reasoned responses. Don't be afraid to admit when you don't have all the answers, but be willing to do the research and follow-up with additional information.
- 5. Be transparent:** Honesty and transparency are key to building trust with investors. Be upfront about any potential risks or challenges facing your business, as well as any prior failures or setbacks. Investors want to see that you're aware of the potential pitfalls and have a plan in place to mitigate them.

- 6. Know your numbers:** Investors will want to know your current runway, your burn rate, and how much funding you're seeking. Have these numbers at your fingertips and be prepared to discuss how you plan to use any funding you receive. Be realistic about your valuation and be willing to negotiate if necessary.
- 7. Show your passion:** Investors want to see that you're passionate and committed to your startup. Show enthusiasm for your mission and explain why you're the right person to lead the company. Be confident, but also open to feedback and willing to collaborate with others.
- 8. Consider the investor's perspective:** Remember that investors are looking for companies that can generate a strong return on their investment. Consider how your startup fits into their overall investment strategy and be prepared to explain why your company has the potential to be a successful and profitable venture.

- 9. Dress appropriately:** While it's important to be comfortable and confident, it's also important to dress appropriately for the meeting. Dress in professional attire that reflects your respect for the investor's time and shows that you take the meeting seriously.

- 10. Follow up:** After the meeting, send a thank you email to the investor and follow up with any additional information or answers to questions that were raised during the meeting. This can help you stay top of mind and show that you're responsive and engaged.



The Importance of Zoom Etiquette

Covid may well be behind us, but one of the clearest marks left by the pandemic is the role of Zoom. Now many first (and last) meetings have switched to video, meaning 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 another layer of prep work.

Video communication brings new challenges. What percent 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-canceling 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 your 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. Virtual eye contact is also made by looking into the camera rather than the person's eyes on the screen. This can often be difficult to adjust to

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. Do a dress rehearsal

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. Double your amount of meetings because VCs 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.

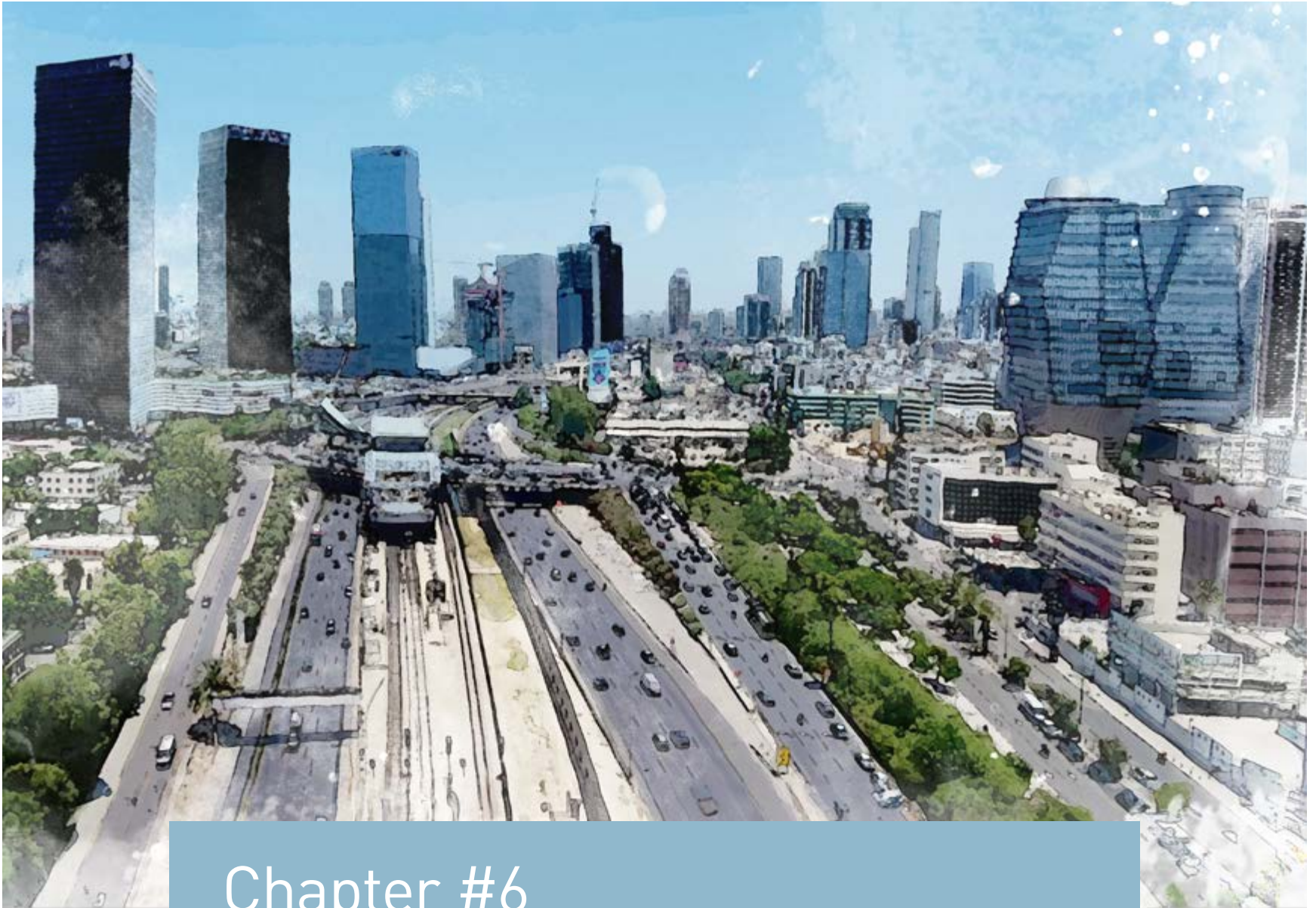
The Importance of Team Dynamics

When founders have their first meeting with an investor, they should keep in mind the importance of team dynamics. This includes highlighting the strengths of the team, discussing how team members complement each other, addressing any potential weaknesses, explaining the team's decision-making process and how conflicts are resolved, discussing the company culture and how it contributes to the team's success, and showing that the team is adaptable and can handle unexpected challenges.

Overall, the founders should emphasize that they have a strong and well-rounded team that can work together effectively and adapt to changes as needed. By doing so, they can instill confidence in investors that their team is capable of executing the company's vision.

Final preparation tips

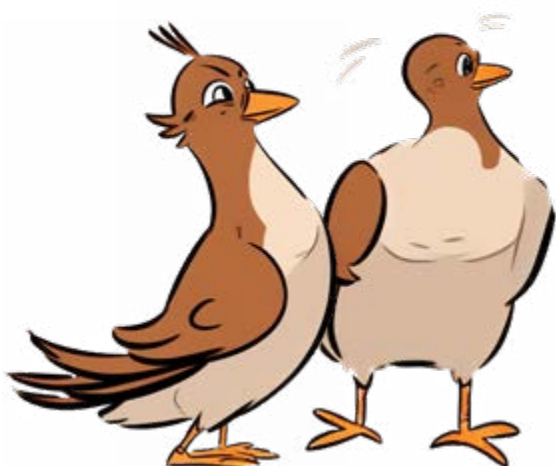
- 1.** Check who is on the calendar invite. Make sure you do your homework on each attendee and their respective roles within the organization.
- 2.** Look at the time that elapsed between the moment you agreed to have a meeting, and the calendar invite. Unless there is a stated excuse (travel, vacation, 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 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.** Set your phone to "Do Not Disturb" 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.



Chapter #6

VC Meeting Dynamics 101

VC meeting dynamics can be summarized as a delicate balance between preparation, communication, and rapport-building.



When founders pitch their business ideas to venture capitalists (VCs), they need to have a clear and concise pitch deck that highlights the key aspects of their business, including their market potential, competitive advantage, and growth strategy. VCs, on the other hand, should come to the meeting prepared with thoughtful questions that demonstrate their knowledge of the industry and their interest in the business.

It's important for both parties to actively listen and engage in a dialogue that explores the nuances of the business and the potential for success. Additionally, building rapport and establishing trust is critical for a successful partnership, as both parties will be working closely together to achieve shared goals.

VC meetings may seem daunting at first, but with preparation, communication, and rapport-building, founders and VCs can lay the foundation for a fruitful and long-lasting partnership.

1. 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?”

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.

2. 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.

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.

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

3. Respond to questions

VCs will take notes and ask questions. Direct your responses to whoever leads the conversation. If you're feeling confident in your presentation, you will have the mental headspace to better answer questions. Even curveballs. 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.

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.

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.

4. 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.



5. Skilfully handle the “ask”

Towards the end of your presentation/conversation is the “ask,” the moment where you specify how much capital you're looking to raise.

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 an offer, and/or knows about other high quality investors who have given you an offer and doesn't have time to investigate further.

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 about 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.

6. End on a positive note

In any case, take the time to end things on a positive and graceful manner. To be clear, closing down your laptop, getting up, and walking out of the room 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.

7. BONUS TIP: Small Talk

A great way to begin or end your meeting is with small talk.



Therefore, we asked ChatGPT for some suggestions for how they would engage in small talk. If it can you most certainly can!



As an AI chatbot, my goal would be to create small talk that is natural, engaging, and relevant to the conversation at hand. Here are some ways that an AI chatbot like me might create small talk:



- 1. Greet the user:** I might start the conversation by greeting the user and asking how they're doing. This sets a friendly tone and can help establish rapport.
- 2. Ask open-ended questions:** To keep the conversation going, I might ask open-ended questions that encourage the user to share more about themselves or their interests. For example, I might ask, "What did you do over the weekend?" or "Do you have any exciting plans coming up?"
- 3. Use relevant small talk prompts:** Depending on the context of the conversation, I might use relevant small talk prompts to keep the conversation going. For example, if we're discussing the weather, I might comment on the recent temperature change or ask if they enjoy certain weather conditions.
- 4. Share interesting facts:** As an AI chatbot, I have access to a wide range of information. If appropriate to the conversation, I might share interesting facts or trivia that could spark further conversation.
- 5. Use humor:** Like humans, AI chatbots can use humor to create a more enjoyable conversation. I might use puns, jokes, or amusing anecdotes to add some levity to the conversation. However, as an AI chatbot, I'm programmed to be mindful of not offending the user with inappropriate humor.



Chapter #7

A Successful Due Diligence Process

The point of the due diligence process is to reach an investment decision. Your job is to understand each VC 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 eliminate the fear of risk, so that the VC says “yes” at the end of the process.

Bandwidth

If a VC with two Partners and one associate is performing due diligence on 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 understand 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.

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".

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.

Intuition

VCs are a bit like seasoned chefs. Just like a chef quickly sizes up ingredients to whip up a dish, VCs use their intuition to suss out startups and their potential. This intuition is a mix of experience, market savvy, and a knack for spotting patterns. It's like their secret sauce to make quick calls on a startup's prospects, team chemistry, and growth potential, often with only a snapshot of information.

But hey, don't let that intimidate you. This VC intuition is not some superpower they're born with. It's something they've developed over time, like perfecting a recipe. It's all about understanding the market, staying on top of tech trends, and recognizing a scalable business model when they see one.

As an entrepreneur, when gearing up for your first seed round, it's key to know that VCs lean on their intuition when deciding where to invest. So, make sure you're telling a compelling story about your vision, market opportunity, and a solid team. Who knows, you might just tickle their intuition the right way!

Remember, while their intuition is important, it's not infallible. They can miss the mark or make a poor investment decision. But more often than not, this intuition helps them navigate the high-stakes world of venture capital. It's a handy tool in their toolkit, guiding them to potentially rewarding startups.

In a nutshell, while hard facts and data are important, intuition—cooked up from years of experience, market know-how, and a knack for pattern spotting—plays a pretty big role in their decisions. It doesn't mean they skip doing their homework, but it's like a compass guiding them in the potentially profitable direction.

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.

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; they 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 there are 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 our 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.

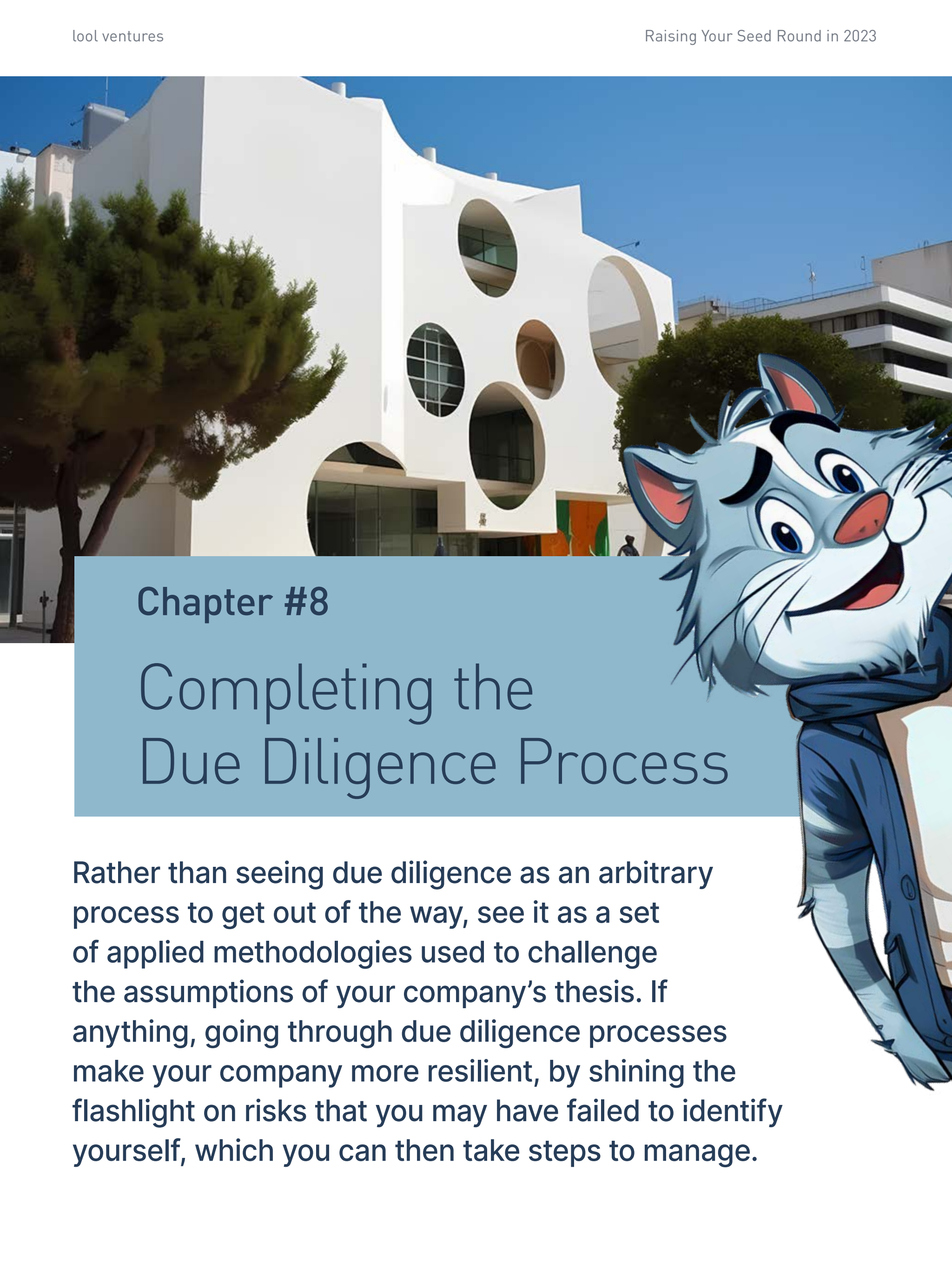
It still blows our mind that less than 10% of Israeli entrepreneurs use Docsend. There is always a risk of data leakage, but sending the data over email maximizes the risk, rather than minimizing it. For any sensitive data, you can add a confidentiality footnote to send a subconscious reminder to the VC.

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

The background of the slide features a photograph of a modern, white building with several large, circular, irregularly placed windows. To the left of the building is a large, dark green tree. On the right side of the slide, there is a cartoon illustration of a blue cat character with large eyes, a wide smile, and a blue scarf. The cat is looking towards the left.

Chapter #8

Completing the Due Diligence Process

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.

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.

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.

Risk Factors in 2023

The 2023 financial and political climate is likely to impact VC risk assessment in several ways:

1. Increased scrutiny on the business

model: With greater economic uncertainty, seed VCs may be more focused on startups with a strong and proven business model that is able to generate revenue quickly. Startups with untested business models or that require significant capital investment may be viewed as higher risk

2. Focus on startups with resilience: The 2023 financial climate may lead seed VCs to prioritize startups that have the ability to adapt and pivot their business models in response to changing market conditions. Startups that are able to demonstrate resilience and agility in the face of uncertainty may be viewed as more attractive investment opportunities.

3. Greater emphasis on market potential: Seed VCs may be more cautious in their

risk assessment of startups that operate in sectors that are highly sensitive to economic fluctuations. Startups that operate in industries with greater resilience or that target growing markets may be viewed as lower risk.

4. Preference for startups with strong founding teams: Early-stage VCs may place greater emphasis on the strength and experience of the founding team. Startups with experienced founders who have a track record of success may be viewed as lower risk.

5. Leveraging AI without falling into the hype trap: While in 2023 there is no question that GenAI will be a major disruptive technology, most VCs will be reluctant to invest in startups who promote their use of a 3rd party GenAI as their main differentiator and value proposition.

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 we 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”?” Here are a few reasons why:

- 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?
- 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.
- 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.
- 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. We break down the market into four sections for clarity:

1. The problem

- The problem you're solving
- The underlying causes of problem
- The type and 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)

- The way individuals and organizations address the 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

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 five, you may or may not hit the \$200M mark. But, if you project \$20M in sales on year five, 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 outsourcing 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.

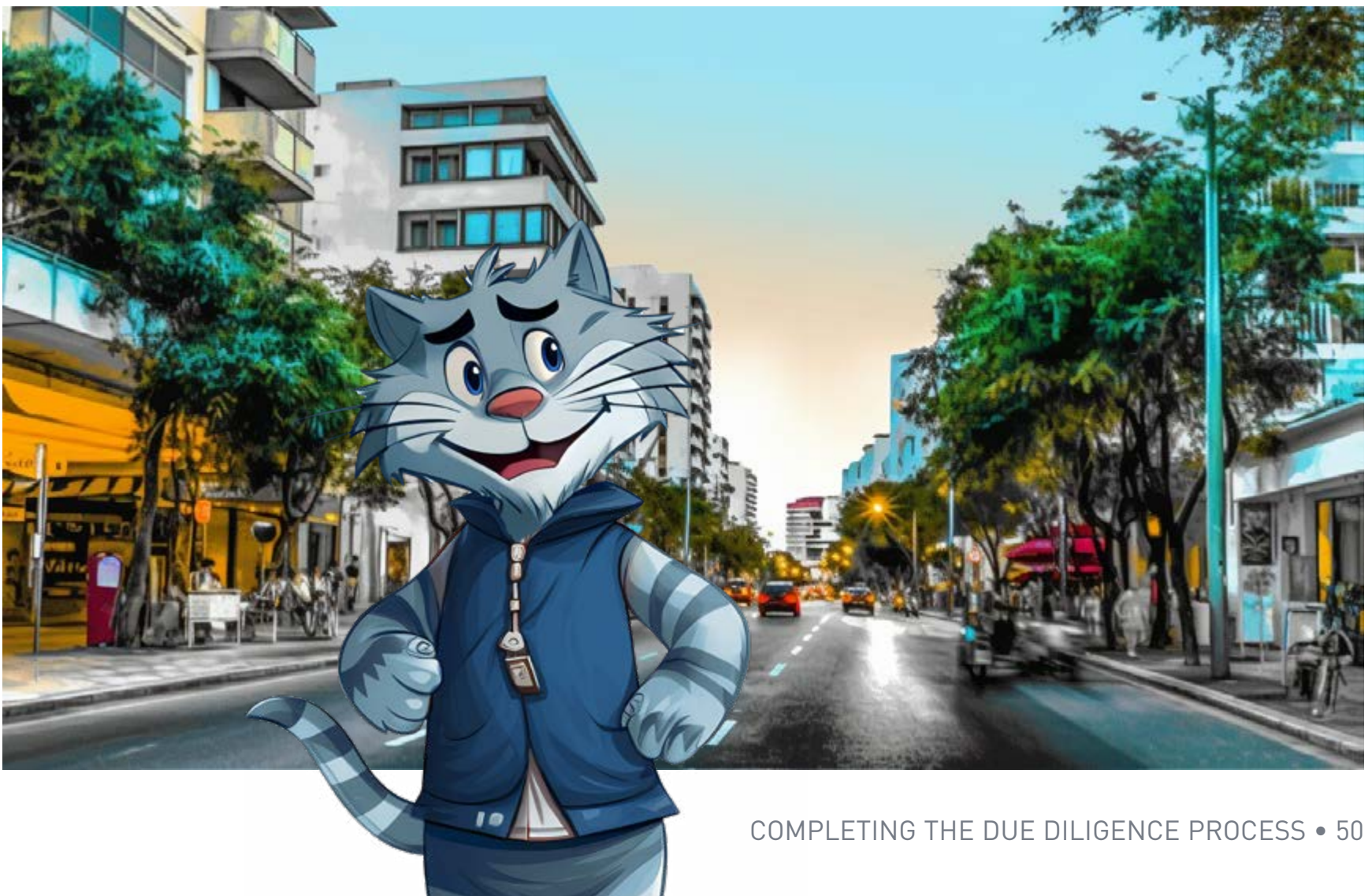
Solution

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 our 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 effects, and DNA are critical for VCs to understand.

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.

We cover Network Effects with [James Currier](#) in this [podcast](#), so we 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 choose 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, we 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 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. We 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.

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.

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.

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 we 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, We 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 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.

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 to 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 when building a successful company.

Cap Table

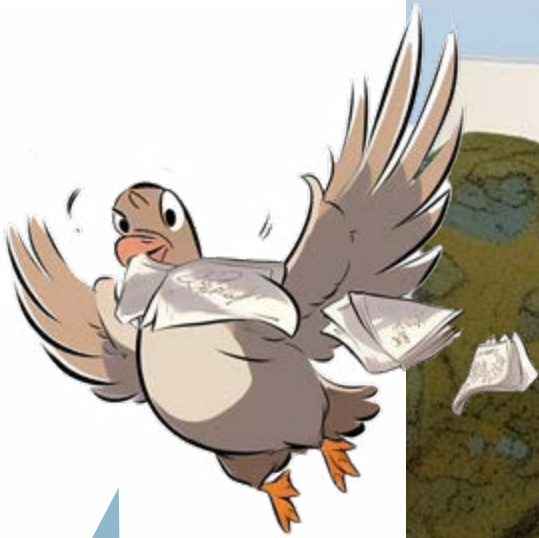
This final element of due diligence aims to understand any previous financings and the way you've negotiated ownership between your co-founders, early employees, and existing investors.

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.



Congrats! If you've made it this far, you definitely have an advantage over other founders when it comes to raising from VCs. And we hope that this advantage has gotten you to the stage where you've received your first term sheet, which we discuss in the next chapter.



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.**

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

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 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 we 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 no 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

Playing Hardball

Term sheet negotiation is a critical part of the fundraising process for any startup. The terms agreed upon in a term sheet can have a significant impact on the future of the company, including the amount of equity founders will retain, the amount of control they will have over the business, and the potential returns for investors.

Founders who do not take the negotiation process seriously may be at a disadvantage, potentially agreeing to unfavorable terms that could limit the company's growth and success. By taking the time to fully understand the terms being offered, seeking the advice of legal and financial advisors, and negotiating in good faith, founders can ensure that they secure the best possible deal for their company and position themselves for long-term success. Additionally, by demonstrating a willingness to engage in the negotiation process and build a collaborative partnership with the VC, founders can build strong relationships with investors that can provide valuable support and guidance throughout the life of the company.

When engaging in negotiation founders should consider several key factors:

- 1. Valuation:** The valuation of the company is a critical factor in any term sheet negotiation. Founders should ensure that the valuation being offered is fair and reasonable based on the company's current stage of development and potential for growth.
- 2. Equity stake:** The equity stake being offered to the VC in exchange for their investment is another important consideration. Founders should ensure that the equity stake being offered is appropriate given the size and stage of the company, and that it aligns with the company's goals and objectives.
- 3. Liquidation preferences:** Liquidation preferences are a key term that can impact the value of the company and the returns that investors receive. Founders should carefully review the liquidation preferences being offered and seek to negotiate terms that are fair and reasonable.
- 4. Anti-dilution protections:** Anti-dilution protections are designed to protect the value of the VC's investment in the event of future funding rounds that may dilute the value of their equity stake. Founders should understand the anti-dilution protections being offered and seek to negotiate terms that are fair and reasonable.
- 5. Board composition and control:** The composition and control of the company's board of directors is another important consideration in any term sheet negotiation. Founders should ensure that they maintain sufficient control over the company and that the board composition is aligned with their vision and goals for the business.
- 6. Exit strategy:** Founders should consider the VC's expectations for exit and ensure that the terms being offered are aligned with their own goals and objectives. This may involve negotiating on the timing and structure of any potential exit, as well as the expectations for returns.

Overall, founders should approach term sheet negotiations with a clear understanding of their goals and objectives for the company, as well as a willingness to be flexible and collaborative in order to build a successful partnership with the VC.

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.

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.

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 discipline, 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 #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 (c) 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.

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 #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.

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

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 #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.

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.

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, we will cover how to negotiate the term sheet, to close the deal, and also how to manage a process where you’ve been fortunate enough to receive term sheets.





Chapter #10

Show Me the Money

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:

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 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, our best advice is to find a trusted mentor.

After weighting and scoring the four 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. Note though that it is not ideal to begin a partnership deal where the 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.

5. First things first

After signing your term sheet, the first thing you should do is build a game plan across three 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 we borrowed from Ben Horowitz's "[The Hard Thing About Hard Things](#)" is to impose fake deadlines onto the closing process, so as 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.

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?

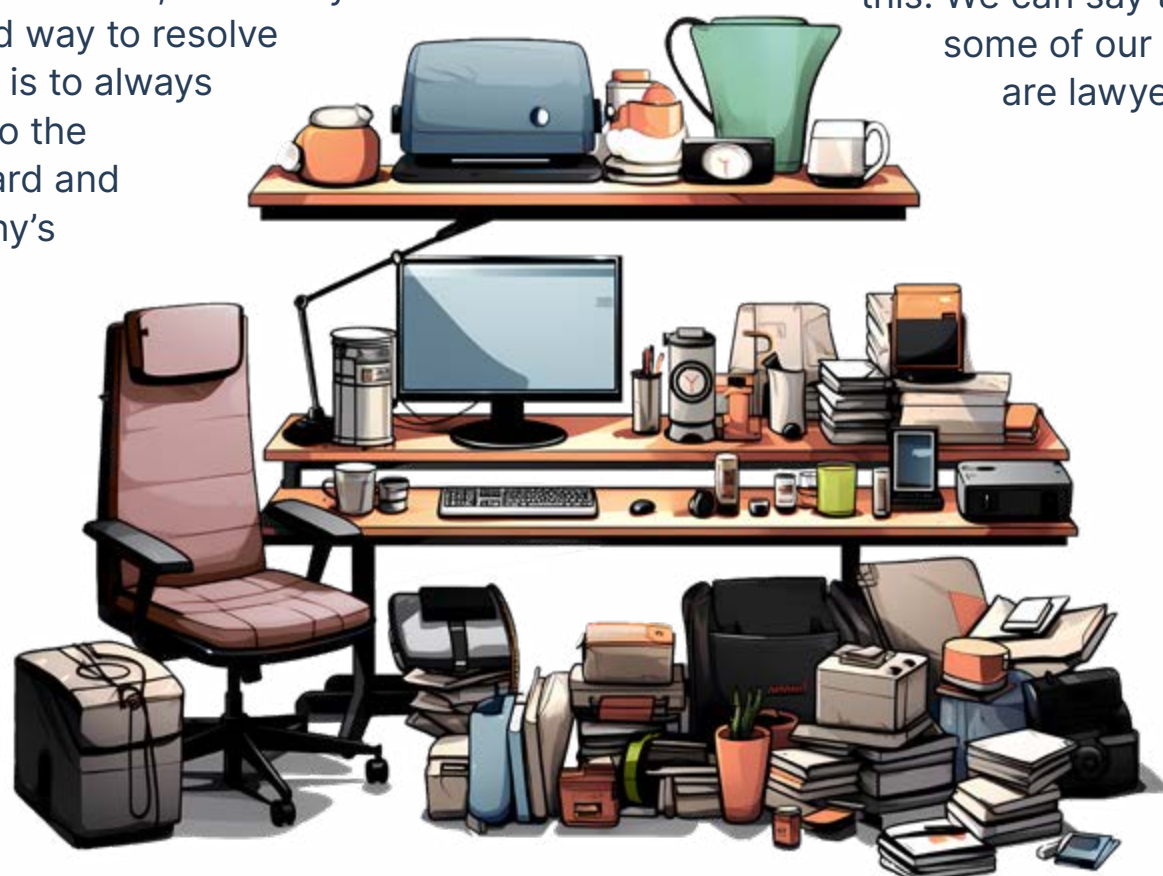
As much as possible, avoid things like excessive veto rights, uncommon liquidation preferences, named rights, and any other factor that might make the company less attractive or function less effectively in the future.

2. Does it create or enhance misalignment of interests?

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 cliches

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 we 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)/Col (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/Col 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/Cols 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 others, 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.



What's Next?

Alright, founders, you've finally signed that term sheet! Congrats, you've made it to the big leagues! Now it's time to put on your big kid pants and get down to business. Here's what you should be thinking about in your first 100 days:

- 1. Building a kick-ass team:** Think of it like assembling your own personal Avengers squad, minus the superhero suits (although, let's be real, that would be pretty cool). You want people who are smart, dedicated, and willing to get their hands dirty. Bonus points if they're also good at trivia night.
- 2. Setting measurable goals:** Now's the time to get specific. How many widgets are you going to sell in the next quarter? How many high-fives can you give out in a day? These are the questions that matter.
- 3. Streamlining your processes:** Think of this as your own personal Marie Kondo moment. Does your sales process spark joy? Does your customer service process need some KonMari love? Perhaps it's time to tidy up and make sure everything is running like a well-oiled machine.
- 4. Engaging with your peeps:** No, not the marshmallow kind (although those are pretty good too). We're talking about your customers and partners. Get out there and get to know them! Wine and cheese tastings are optional, but highly recommended.
- 5. Keeping your eye on the prize:** It's easy to get bogged down in the day-to-day grind, but don't forget about the big picture. Stay focused on your long-term goals, and don't let anyone or anything distract you from achieving them.



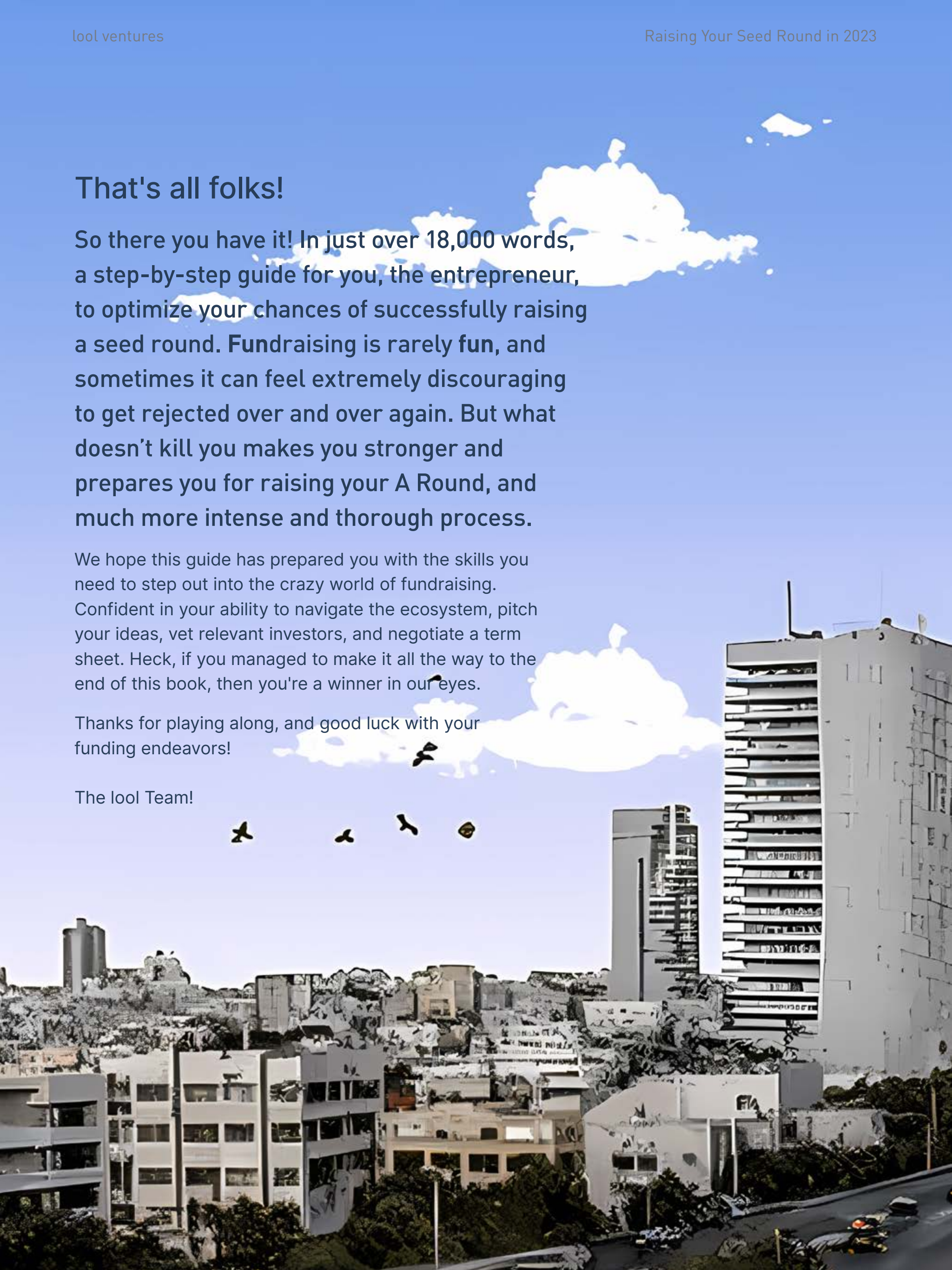
That's all folks!

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. 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.

We hope this guide has prepared you with the skills you need to step out into the crazy world of fundraising. Confident in your ability to navigate the ecosystem, pitch your ideas, vet relevant investors, and negotiate a term sheet. Heck, if you managed to make it all the way to the end of this book, then you're a winner in our eyes.

Thanks for playing along, and good luck with your funding endeavors!

The lool Team!





We are Israel's seed fund.

We love meeting and working with founders ready to change the world. If you think we can make a difference together, contact us at hello@lool.vc.

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