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8 Questions to Help Decide If You Should be Raising Money Now

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A year ago I blogged about one of my most common mantras that applies to sales, biz dev & fund raising alike: "[Time is the Enemy of all Deals.](#)"

When times are really good for fund raising many teams delay to maximize their valuation. Sometimes this pays off, other times it doesn't. So how should you decide what to do?



I thought I'd try to offer a framework for thinking about the topic.

There is a natural tension between wanting to have cash in the bank now versus believing that our businesses will be more valuable in the future and therefore wanting to wait. This conversation seems to come up very frequently these days both with portfolio companies and with entrepreneurs just looking for mentorship.

This is not a black-and-white decision, but I have a bias toward two things: 1) taking action & 2) de-risking businesses. So here's my framework.

1. Are you in the "lean" phase?

I'm a very big believer in the "Lean Startup" principles as espoused by [Steve Blank](#) and [Eric Ries](#). For many businesses you should keep your costs low & your capital raises low until you discover whether you are really on to a big idea where there is market demand. When you see evidence that there is this so called "product / market fit" then you may be ready for larger amounts of capital.

In the seed phase startups are typically raising between \$500k-\$1m in today's market. In some circumstances this is now stretching up to \$2 million.

If you are able to raise money from credible sources at a reasonable dilution percentage then I personally favor getting the round done now and building your business. These are great times for raising money the moods in funding companies is cyclical and if you miss the window it may make the future more difficult. How long is the window open? Your guess is as good as mine. I only know that ... time is the enemy of all deals.

2. How much capital do I need to run my business effectively right now?

Every conversation about fund raising should start with what your current operational needs are and the stage of your business. If you're an experienced operator who sold his/her last business and you know a priori that you want to build a really big business--I understand the desire to start with \$5-10 million in capital even before you've proven your concept.

But this isn't the norm. For everybody else I think the conversation starts with how much you think you'll need for an 18 month period of time. Because times are slightly better now for fund raising I'd probably say two extra things: a) it may be worth a modest increase in your team size / activities / development IF you can raise more money to do this now & b) if you can raise more than you need right now (within reason) without too much extra dilution I would do so.

As I wrote about previously, "[when the hors d'oeuvres tray is passed, take two. Eat one, put one in your pocket.](#)" In other words, if optimizing around a \$1 million fund raise or a \$1.5 million I'd raise the larger amount but spend like you raised \$1 million. I do not endorse raising \$5 million for a business that doesn't yet warrant it.

3. How much dilution am I going to have to take now?

Stating the obvious, but much of the discussion will come down to the dilution you will face and the other terms you're offered in the fund raising agreement. I like to tell entrepreneurs that the "fairway" of fund raising is 25-33% per round. So if you can take 27% dilution for \$1.5 million and you're an early stage business this is probably a fair deal.

If you're "super hot" or "super experienced" you can end up with much less dilution--in some cases 12-15%. But this is the exception, not the rule.

So to give you a concrete example: let's say you're considering whether to raise \$3 million vs. \$5 million. You're offered a \$9 million pre-money to raise \$3 million (e.g. 25% dilution). Let's say you brought along other investors for \$2 million more at the same terms (e.g. \$5 million raised at a \$9 million pre-money valuation or 35.7% dilution), I would personally probably avoid the extra money because as an entrepreneur the dilution would put me out of my comfort zone.

However, if you could persuade investors that you had a pragmatic plan for the capital and could push the pre-money up slightly say to \$11 million pre (31% dilution) or \$12m pre (29% dilution) I personally would probably take the extra money. I might create a plan to spend \$4 million over a 15-18 month time horizon and keep \$1 million as a buffer.

How do you push valuation? Only ... ONLY ... if there's a sense of competition on the deal. You need to keep investors honest by being willing to talk with multiple parties. Respectfully, of course.

4. How many more rounds of capital will I need & what is my expected total future dilution?

Another key factor in fund raising and thinking about your dilution is how many future rounds you think you'll need to raise. I'm not talking about your Excel spreadsheets that show you that only \$4 million will get you to profitability (ha!). I'm talking about understanding the norms in the industry of what it historically takes to build a successful Internet business and where you think you fall on that spectrum given the kind of business you are.

This would weigh into my decision criteria if I were raising money now. You know you'll have more dilution in the future--how much?

5. What things could I do with capital today that might improve my market positioning?

I think many entrepreneurs under-estimate the benefit that capital early helps in being able to produce product and differentiate yourself in a nascent marketplace. Again, this is highly individualized so no generic advice can be offered. If you're too early in a market then no amount of early additional spend on R&D makes huge sense.

But if you're on the precipice of a big market opportunity then having more capital & resources can be critical. I recent dealt with a company that was offered \$4-5 million in funding and delayed its decision for nearly 5 months for a complex set of factors. What ended up happening was a critical project was delayed that cost the company some important business. They told me that they had regrets of having not raised the capital earlier.

The result? By waiting they probably did push up the valuation on their ultimate round slightly because valuations have gone up steadily since last year--so that's a positive. They missed out on some very important business--that's a much bigger negative in my opinion. The fact that the market got stronger in this period was not a factor within their control--in other words--it was lucky. If the market had gotten softer their outcome might have differed greatly. They did raise the money so for them all is working out.

6. What things might competitors do if I don't raise capital that might impact me in the interim period?

The other thing I ask entrepreneurs to consider is what will happen to competition in a market. It is true that you should mostly concern yourself with your customers, building a great product and providing excellent service. I tell entrepreneurs to mostly ignore the competition or at least not to overly obsess on them.

But I think it would be naive to completely ignore the market & competition. When competitors raise money and you don't the following happens (assuming all else equal on product development, which I know is not always the case):

- they have a PR advantage both in terms of perceived momentum and also money to spend on it
- they have a hiring advantage, both in terms of perception they're going somewhere and in terms of dollars to allocate to people
- they make it incrementally harder to fund raise. It's hard for many VCs to get excited about funding a company who is going to compete with somebody who just raised \$10 million from an A-list VC (although this can go the other way, also)
- they can develop a product advantage by building with 10 developers what you have 3 people dedicated towards
- mostly importantly they can gain a customer advantage through all of the above. They get the PR bump. They hire a team that spends more time with more customers. They evolve the product faster. It becomes a reinforcing cycle.

As I said, don't obsess with competition, but this should at least be a factor in your decision making on when to raise funds.

7. What might future markets hold in terms of valuations?

And of course there's another biggie--uncertainty about future fund raising. Today's \$15 million pre-money valuation might be tomorrow's \$20 million. But more likely it will be \$10 million. This is not a reflection of you--it's a reflection of market conditions. The market is over-valued in 2011 relative to norms. We've all seen this movie before, we just don't know when the film will end.

Anyone who meets with me privately these days gets this advice:

The market is whack right now. Use it to your advantage. Raise now. Make sure to raise at the "high end of normal" rather than "higher than normal." In the latter situation you'll run into problems later when you need to raise your next round--especially if you don't grow into your valuation.

So if what I perceive as "normal" now is that at your stage of development you would raise \$2 million at an \$8-10 million pre-money valuation, maybe raise \$4 million at a \$12-13 million. Just don't go crazy. That way you'll be well-positioned when things return to normal. And things ALWAYS return to normal.

8. What might future markets hold in terms of ability to raise capital?

And finally, it's worth noting, it's not all about valuation. Fund raising can be black-and-white. When the spigot slows, the water is gone all at once. As anyone raising money in April 2000, September 2001 or September 2008 can tell you that. Sometimes the question of "to raise now or raise later" becomes an existential question. It doesn't feel like that in February 2011. But it's never possible to predict when the party will end and the barman will go home. My strongest advice is this--do what you think is at the high end of fair, but don't "over optimize" for the perfect deal. Time is the enemy of all deals.



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