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business support

WHAT INVESTORS LOOK FOR IN A STARTUP?

Understanding investor criteria for seed investment in a startup

An Acumenology Business Guide
Acumenology.co.uk

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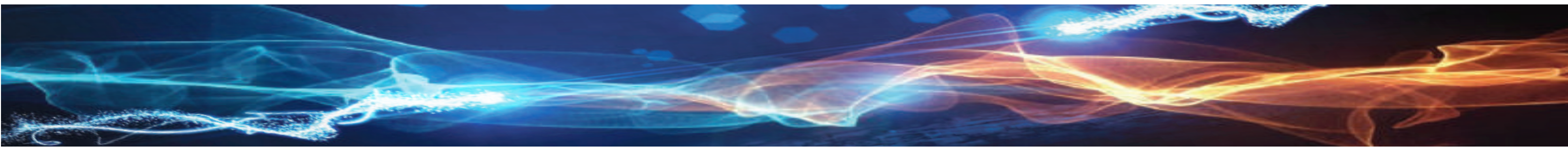

01

Introduction

Many startups need to go down the path of seeking seed investment from angel investors or VC's, and getting ready for this challenging process is going to be constantly on the mind of the entrepreneur.

It is important to understand from the outset that investors see hundreds of pitch decks and are very shrewd when it comes to investing.

They will undoubtedly have an extensive checklist and, since you are likely to get only one shot, it is essential you understand the information they need to see in order to assess the viability of any potential investment.

A common mistake by many entrepreneurs is to go straight into writing the pitch deck without giving due care and attention on ensuring they provide the information that investors need.

This results in the entrepreneur either having to scramble to fill in the missing information at the pitch deck stage or worse still the investor being underwhelmed and walking away.

Well before you even start thinking of writing your pitch deck, use the information we have provided to start getting ready to address the points mentioned.

The information we have provided is to help you identify and address the issues well before you start writing your pitch deck.

To further help you, Acumenology has produced a series of Business Guides on a range of relevant topics.
You can find these at: www.acumenology.co.uk/business-guides

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The information provided is not set out in any particular order of importance or sequence.

02

Management Team

The quality of the people driving the startup is critical to securing investment.

Investors need to assess whether, the team has the right set of skills, drive, experience, and temperament to execute the business plan.

A mediocre idea with an A team is more likely to succeed than a winning idea with an inadequate team.

Do not try and hide a weak link. The investor will find out.

Investors will need evidence that the team has:

- In-depth knowledge - of the market they are in
- Track record - in delivering success
- Flexibility - to be able to adjust if things aren't working
- Willingness to learn - will they take advice from external experts
- Passion, determination and commitment - money alone is not a strong enough motivator for success. The management team members need to show passion and commitment.

Getting a strong management team is a big challenge for startups but, it is an area that founders need to address early on or run the risk of investors walking away.

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Problem

Your startup is all about solving a problem and investors are looking to back teams that are solving a pain point round which a very widespread set of customers are desperate for a solution.

Ask yourself whether the problem you have identified is a real and significant issue that would attract investors. Clarity on identifying a 'real problem' and why the solution is needed in the first place should be provided.

A common mistake is not showing how your customers are deeply affected by the problem.

You will need to gather evidence to support your case rather than saying 'we believe there is a problem'.

There are problems that are well known that do not need evidence. For example, the fact that there is a housing shortage is well documented.

Remember, problem is the most important part of not only your pitch, but your business as well.

If you get the problem right, everything else will fall in line.

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Solution

Your solution is a simple explanation of what your product is and how it is going to solve the problem you have identified.

You will need to have identified and developed your value proposition and be able to show how it will transform the lives of potential customers.

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Competitor analysis & advantage

Detailed competitor analysis is important as investors want to determine whether the market is too crowded and that you can sufficiently differentiate your company.

They may also be looking to identify whether there are better-funded companies that are in a position to gain a significant share of the market.

Your competitor analysis also allows investors to better understand how you are positioning yourself in the market and your awareness of where you sit in relation to your competition.

It may also give additional insight into potential M&A / trade sale opportunities or targets as well as precedents on the fundraising or exit valuations that may be achievable.

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Market Size

Most investors will want to know about the market for the product or service you're selling.

They are looking for businesses that can scale, so make sure you can show why your business has the potential to become really big.

Not only are big markets more stable and less inclined to volatility, they are also able to support the operations of multiple growing companies. If the market is growing, even better

Be wary of presenting ideas where the market may be small as there may not be room for enough growth for the investor to get a return on investment.

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How is your product different, what makes it unique?

You must be able to clearly articulate what your product or service consists of and why it is unique.

There are several ways your offering may stand out.

- Product differentiation: You've got something completely different (and hard to replicate).
- Process differentiation: You are selling a new, more efficient way of doing things.
- Price point differentiation: You have found a way to sell a product or service for less or for more (i.e. premium pricing).
- Super niche differentiation: You've found a market that's a particularly good fit for you.

Your offering should also be able to answer some of the following questions.

- Why do users care about your product or service?
- What are the key differentiated features of your product or service?
- What have you learned from early versions of the product or service?
- What are the major product milestones?

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Business model

Whilst the market opportunity has to be compelling, investors must also believe the startup has the right approach, business model and capabilities to exploit it.

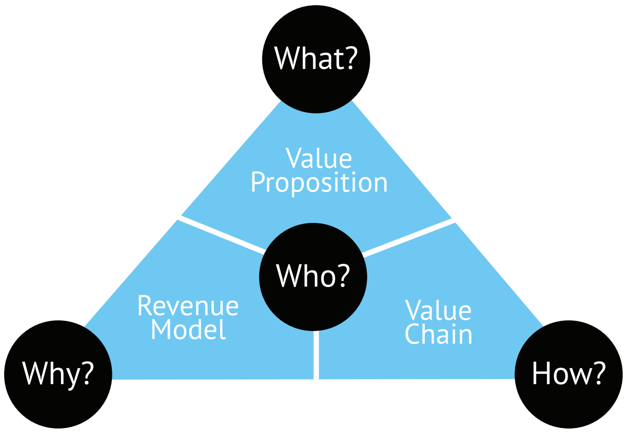
One of the most exciting, but often risky, propositions for investors is where a product or service shakes up an industry where disruption is long overdue.

Airbnb is a great example of disruption with the business taking a large chunk out of the hospitality market and creating a new dynamic in accommodation for global travellers.

Sometimes investors want to be part of the hottest high growth sectors and are simply looking for the best opportunities within it.

Once the turbulence of disruption subsides, newcomers who have fine-tuned the business model may come to the fore.

Current hot tickets for investors include the likes of fintech, edtech, healthtech, the IOT, energy storage and green battery solutions, startups entering a crowded marketplace have to prove without doubt that their solution is different to what is already available to customers.



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Traction achieved

One of the most important things an investor will look for is signs of early traction or customers.

A company that can show traction is more likely to be successful in raising funding with better terms.

Examples of early traction can include the following:

- The creation of a beta or ideally a minimally viable product
- Initial or pilot customers
- Strategic partnerships
- Customer testimonials
- Admission into technology accelerators or incubators

Investors will want to know:

- How can the early traction be accelerated
- What has been the principal reason for the traction?
- How can the company scale this early traction?

Don't forget to show any press received. Feature the headlines in a slide on your investor pitch deck and list the number of articles and publications mentioning the company.

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Intellectual Property

For many investors intellectual property will be a key factor in their decision making.
You need to have identified any potential IP and show have you have protected it.

Consider some of the following:

- What key intellectual property does the company have (patents, patents pending, copyrights, trade secrets, trademarks, domain names)?
- What comfort is there that the company's intellectual property does not violate the rights of a third party?
- How was the company's intellectual property developed?
- Is the intellectual property properly owned by the company, and have all employees and consultants assigned the intellectual property over to the company?

- If the intellectual property was developed at a university or through government grants or with open-source technology, how does the company have the right to use the technology?
- What actions have been taken to defend all IP?

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Potential risks to the business

Investors will want to understand potential risks to the business.

They will want to understand your thought process and the mitigating precautions you are taking to reduce those risks.

Inevitably every business has risks but you need to start understanding what they are and develop mitigating strategies.

Here are some thoughts to consider:

- What do you see as the principal risks to the business?
- What legal risks do you have?
- What technology risks do you have?
- Do you have any regulatory risks?
- Are there any product liability risks?
- What steps do you anticipate taking to mitigate such risks?

Startups that can show they have reduced or eliminated product, technology, sales, or market risks will have an advantage in fund-raising.

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Financials

Investors look for founders who understand the financials and key metrics of their business.

You need to be able communicate the value of your businesses through numbers - know the KPIs for your business and the sector you are in.

For example, for a SaaS company there are many well-known metrics on which a company is evaluated such as the five C's:

1. CMRR, ARR, & ARRR – Committed monthly recurring revenue, annual recurring revenue, and annual run rate revenue
2. Cash flow – Start with gross burn rate and net burn rate, then hopefully turn to free cash flow over time
3. CAC – Customer acquisition cost payback period.
4. CLTV – Customer lifetime value.
5. Churn & renewal rates – Logo churn, CMRR churn and CMRR renewed.

Here is an example

	CARR	CAC Payback	Net $ Churn	CLTV:CAC	Cash Flow
Good	50%	24	1-3%	3X	<1X
Better	50-100%	12-24	<1%	3-5X	1X
Best	100%+	<12	Net negative	5X+	>1X

Importantly, make sure you can back up everything with metrics and data

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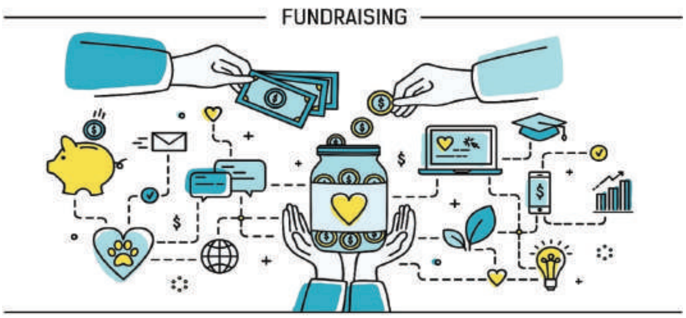
Use of funds

Investors will want to know how their capital will be invested and your proposed burn rate so that they can understand when the next round of financing may be required.

It will allow the investors to test whether your fund-raising plans are reasonable given your capital requirements.

It will also allow investors to see whether your estimate of costs (e.g., for talent, marketing, office space etc) is reasonable given their experiences with other companies.

Investors want to make sure the business has the capital to meet the next milestone, which may be raising the next round of financing.



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Valuation

Valuation at an early stage of a technology company is more of an art than a science.

It is said that often it is best not to discuss valuation in a first meeting other than to say you expect to be reasonable on valuation.

In order to bridge valuation gap investors may turn to convertible instrument with customary conversion discounts and valuation caps.
So, it is best to have done your homework and be prepared.

Instruments, such as convertible notes and SAFEs, "simple agreement for future equity" have become quite common.

For more information about this, be sure to read A Guide to Venture Capital Financings for Startups.

Be wary as an investor will not want to waste time if the valuation expectations are unreasonable.

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Elevator pitch

Whilst you may think that it is a tad early to start preparing your elevator pitch, doing so will help you focus on developing clarity and precision on key elements of your business

Developing the elevator pitch is a journey that should start early on.

Eventually, you will refine this to two pitches of different length to suit two different occasions

1. A one sentence pitch for when you are introduced to someone and you have to tell them what you do, say at a social event.
2. A one minute version for when you are required to give an overview of your business.

This initial pitch should start off to be no more that 120 words.

Develop the following:

- The problem you are solving – 40 words
- Target market and solution – 40 words
- Market size and commercialisation – 40 words

Remember it will take many attempts and practice makes perfect.

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Conclusion

As you will have gathered after reading this guide, there are a lot of elements that need to be thought about, issues addressed, and information collected, all of which is likely to take considerable time.

It is important that you are aware of this from the onset and start the process as soon as possible and not wait till you start preparing your pitch deck as doing so may lead to severe delays

Good luck!