Beginner’s Guide to Raising Capital

Tyler Jensen
Beginner’s Guide to Raising Capital

Beginner’s Guide to Raising Capital is a comprehensive resource for learning the basics of the fundraising process. It contains actionable items to put new business on the path to reaching funding goals, and even covers tips for maintaining personal mental health as an entrepreneur. The end goal is to create a scalable, investor-ready startup — actively involved in the community and ready to #GetFunded.

The Startup Garage works with entrepreneurs in early stage, high-growth companies to attract investment and get out of the “garage.” We help startups achieve the milestones investors care about. Our team has helped raise over $200 million for startup businesses.
Beginner’s Guide to Raising Capital

**ABOUT THE AUTHOR**  
Bio: Tyler Jensen

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About the Author

“Starting a business is a very personal experience. I’m a serial entrepreneur and have started and helped start over one hundred businesses. I have a special interest in high-growth startups and have made it my objective to understand what it is investors look for when evaluating the potential of a business. My goal is to coach entrepreneurs in scaling their startups while maintaining the work/life balance and achieving personal goals. In this book, I share my business plan writing process to start you off in the right direction.”

-Tyler Jensen

TYLER JENSEN

In 2008, Tyler founded The Startup Garage to help entrepreneurs and business owners achieve success in their business ventures, as well as their lives. Tyler is a serial entrepreneur, having launched or help launch over 100 companies, including non-profits and social enterprises. He has developed an extensive network of business relationships focused on achieving the milestones investors care about.

Tyler heads up The Startup Garage team, which has helped raise over $200 million for startup businesses.
Introduction

Beginner’s Guide to Raising Capital is for anyone looking to better understand the best practices and processes of fundraising. Our goal in writing this is to create an essential resource for both the first time entrepreneur and the serial startup founder to reference when executing on raising capital in the real world.

While you may find there are sections that don’t apply specifically to your startup, the content as a whole presents the process of fundraising every entrepreneur should know. We encourage reading the whole thing!

This guide is structured based on the seven milestones we’ve identified as the key areas of focus when building a business; founder preparation, business planning, product development, team building, market traction, legal and operations.

MILESTONE #1: PREPARING YOURSELF

Here you will lay the foundation for building a successful startup around the key ingredient — YOU!

Entrepreneurship is an exciting and exhilarating experience. However, failing to properly assess yourself can lead to burnout in the future. We ask four important questions to ensure your personal foundation is solid.

MILESTONE #2: BUSINESS PLANNING

Many startups are entirely too product-focused. It is important to view your entity as a business that will continue to prosper. Walking through the basics will help you position your new venture the way investors want to see it — as profitable!

MILESTONE #3: PRODUCT DEVELOPMENT

Never assume that a product can sell itself or that the product development process is universal across all industries. This section will assist you in your research, specifically for your product and industry.
MILESTONE #4: TEAM BUILDING

From the very beginning, working on personal development is a must-do.

You will identify and improve personal strengths, and just as importantly identify the areas you’re weak. Being uncomfortably-honest with yourself will be greatly beneficial to your organization — helping to direct which areas to bring on team members.

You will continue to open and cultivate new relationships. Being strategic about this could open doors to things you’d never think of otherwise.

Here, we will help define individual leadership roles and titles within your organization.

MILESTONE #5: MARKET TRACTION

Whether or not you gain acceptance of your market will ultimately determine your success. Market traction comes in a variety of forms for different companies.

In this section we clarify what form this might take in terms of your specific startup, along with some proven ideas and tactics to present to potential investors.

MILESTONE #6: LEGAL

It is extremely important to protect yourself with all the proper legal documents. Here we cover the most commonly used legal documents in order to protect your startup business and attract capital.

MILESTONE #7: OPERATIONS

Ensure your startup is setup for success with efficient and effective systems.

This section will provide a comprehensive checklist for necessary operational systems and structures for your startup.

Congratulation! Familiarizing yourself with the important focus areas of capital raising brings you one step closer to reaching your goal.
Preparing for Fundraising

Raising capital for your startup can be an overwhelming and even mysterious project for most entrepreneurs. The intention of this eBook is to lay out the basics of the fundraising process so that you – the entrepreneur – understand the critical success factors and the best practices, and can develop reasonable goals and expectations about the process.

For a startup company, raising capital occurs in a series of different investments throughout stages of the business lifecycle. For example, let’s say there is a new tech startup that raises $25,000 in funding from their Friends, Family and other Co-Founders (FFF) so that they can get the business going. Within a year they may be making a profit, but they learn that they need additional funding so that they can continue to grow their business. At this point they seek out Angel Investors for a seed round up to $1,000,000, followed by a series of large investments that can be well over $2 to $10+ million from Venture Capitalist (VC) or Family Offices typically called Series A, B, etc. In its simplest form, the goal of your capital strategy is to reach a set of milestones that attract these different investors so you can eventually raise the next round of capital. This eBook will elaborate on these milestones in order to educate entrepreneurs on how to raise capital effectively.

It is impossible to discuss raising capital without putting into context the entire startup process. Raising capital is a by-product of adequately preparing your business and team. Angel Investors and VCs are in the business of investing in companies that present good “businesses to buy” (investment opportunities). Ideally they want companies with a high growth model and an early exit strategy along with a great product. Your job as an entrepreneur is to figure out what an investor wants to see in your business and to put those features in place. The best approach towards obtaining investment is to focus less on hard selling tactics and instead more on building a great investment opportunity and then deciding which investors are best for the company.

Want more information?

Access extensive capital raising info and advice on our blog.
TheStartupGarage.com/Blog
In this eBook, we will discuss the entire startup process inside the context of successfully raising capital. This is done by organizing the startup process into 7 major categories with groups of individual milestones under each category. Please refer to the following infographic for a high level description of the 7 major categories as they relate to each round of capital investment (one of the things to notice is that many of the milestones are prioritized and accomplished at the same time while others are done simultaneously).

The graphic below displays the funding milestones discussed in the last section. As you move up the rounds of funding, more and more will be expected to have been accomplished.

### THE STARTUP FUNDING MILESTONES FROM THE STARTUP GARAGE

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MILESTONE #1: PREPARING YOURSELF

“Twenty years from now you will be more disappointed by the things that you didn’t do than by the ones you did do. So throw off the bowlines. Sail away from the safe harbor. Catch the trade winds in your sails. Explore. Dream. Discover.”

– Mark Twain

Self-preparation often tends to be overlooked and undervalued, despite being arguably the most important milestone of them all. Preparing yourself and making sure your other co-founders are on the same page is extremely critical for building a successful startup. In the first few rounds of fundraising the investors determine how much they believe the current team will be able to build a successful company.
CAN YOU ANSWER THESE 4 IMPORTANT QUESTIONS?

1. How will your personal bills be paid during the first couple years of business operations where you probably won’t be able to take money out of the company?

2. Are you trying to grow as quickly as possible and prepare the company for a sale or IPO within 5 years? Or are you determined to build a solid business and work at it until you retire?

3. Does your company align with your passion, experience, and goals?

4. Is your target market large enough and business model appropriate to scale to a size that will achieve your personal financial goals as well as the financial goals of potential investors?

ENTREPRENEUR HEALTH

You will want to take a sober and realistic look at your current state of health. This includes mental, emotional, spiritual, and physical health. Are you and your co-founders currently in a state of health that will allow for the strenuous endeavor of starting a new company? Ask your friends and family if they believe you are ready for this.

PERSONAL SUPPORT TEAM

In addition to your health you will also want to take an assessment of your personal support team. This is different from your business support team which will be discussed later. This includes people like family, friends, doctors, coaches, trainers, pastors or spiritual leaders, and therapists. Each entrepreneurs’ personal support team will look a little different. When times get tough (which they will) having these relationships in place could mean the difference between overcoming obstacles and closing the business. Make sure to get their support in your new endeavor. If you find them lukewarm to the idea ask them why. They may see blind spots you are unaware of that would prevent you from being successful.
MILESTONE #2: BUSINESS PLANNING

“The only place where success comes before work is in the dictionary.”

–Vidal Sassoon

The second milestone is business planning, which – when done appropriately – will lead and direct your focus on the rest of the milestones. You will begin this milestone at the beginning and finish it last. In order to complete the business plan you must simultaneously complete many other milestones.

The entire business planning process that we have laid out will hopefully highlight the major gaps in your own business that must be achieved to raise investment.
BUSINESS PLANNING

“If you fail to plan, you are planning to fail.”
- Benjamin Franklin

Every entrepreneur should begin planning their business by researching the competition, the industry, and the market. This is one of the most time consuming pieces of the business planning phase and corners should not be cut. The information you learn here becomes the foundation for many decisions you will make later on. We’ve provided an overview of this research process below, but you can learn more about it on our eBook: Business Plan Basics.

COMPETITIVE ANALYSIS

The Competitive Analysis assesses the differences between your business and your competition, while detecting and examining the factors that cause these differences. This section is broken down into direct and indirect competitors, and it is intended to give you insight for how to go head-to-head with these competitors in order to acquire customers. It is also used to show your advantages over your customers as well as how you are differentiated from them.

INDUSTRY ANALYSIS

The Industry Analysis analyzes the conditions of your industry in its current moment. This includes the behavior and relations between competitors, suppliers, and consumers. It is vital to understand the different factors at work — political, economic, and environmental — within a given industry in order to create an effective strategic plan for any company. First, define what type of industry you are in, and then determine what sector of the industry you will operate within. Once you figure this out, you can determine the current and projected size of the industry and sector as well as start researching which factors can potentially impact your business, the other major players in the industry, and any relevant trends that will affect these industry players.
MARKET ANALYSIS

The Market Analysis is used to define and determine the potential appeal of numerous markets, and to understand those markets’ evolving opportunities and threats in relation to the strengths and weaknesses for a particular company. The focus of this section should be on the people you intend to sell your products/services to, known as your target market. This can include individual customers – known as business to customer (B2C) – or other businesses – known as business to business (B2B). In a way, the Market Analysis is the foundation of your business’ plan of attack.

PRODUCT DESCRIPTION

The Product Description clearly explains what products or services your business will offer. The information provided in this section will become the basis of your Marketing Plan. It’s never safe to assume that your product/service will sell itself, so make sure to include a thorough description using specifics and detailed language. It should be written so that the reader can easily understand what the product is and what it does (features). It should also include a comparison of your product to other similar products on the market. This is your opportunity to clearly define the advantages your product has over any competitors, as well as to highlight any weaknesses that you would like to improve upon.

FINANCIAL PROJECTIONS

"An entrepreneur without funding is a musician without an instrument."
- Robert A. Rice Jr.

You will need to create financial projections, which is where the remaining milestones come into play. Accurately projecting your financial statements is an extremely important part of your business plan. It gives insight on how your business will perform financially according to the current market assumptions and the business model you choose.

You will have to accomplish many of the other milestones in order to complete these accurately. For example, the first thing you need to do is create the revenue model, and you’re required to know your market size, marketing plan, and sales plan in order to do this (See how to create a revenue model blog post here for more information). Then,
when you’re putting together your sales projections, you will need to know your pricing strategy and cost of goods sold (COGS). This continues to occur in sections later on where you need to know your organizational chart and job descriptions so you can map out your 5 year personnel expenses.

You also need to create a 5 year month-to-month Balance Sheet, Income Statement – also referred to as the Profit and Loss (P&L) – and Cash Flow Statement. Other key metrics that should be included are startup expenses, marketing goals, unit sales and costs, and personnel expenses. You can learn more about this in our eBook Business Plan Basics.

Upon completion of the financials projections, you will be able to write the operations, management, sales, marketing, and financial summary sections of the business plan.

Take a look at our Sample Business Plan for a more thorough understanding of the various sections of the plan.

CAPITAL STRATEGY

"If you’re not learning while you’re earning, you’re cheating yourself out of the better portion of your compensation."

- Napoleon Hill
Once you complete your financial projections and your business plan you will find that you have an understanding of how much money you need and at what stage you need it. The next step is to develop your capital strategy, which includes asking yourself the following questions:

- What type of investment am I looking for? Debt or Equity?
- What type of investors am I seeking?
- What is the current valuation of my business?
- How much equity am I willing to give up?
- How can I find and approach investors? What do I say once I’m in a meeting?
- What legal documents will I need to close the deal? What are the terms of the deal?

Knowing the questions themselves is key at this stage. You will be able to find out many more details in the following eBooks once you are ready on each of those questions:
AMOUNT TO RAISE

Knowing how much capital to raise is difficult to determine because there really is no right answer. It’s all dependent on what type of industry you are in, what your personal and financial goals are, what stage your company is at in development, what your capital strategy is, etc. With that said, your financial projections will answer this question to the best of your ability based on the assumptions that you make throughout the projections (revenue growth model, COGS, personnel plan, marketing plan, operating expenses, etc).

DEBT/EQUITY

Similar to figuring out how much capital you need to raise, there is no right answer for determining the percentage of capital you raise through debt vs. equity. It all depends on what you are more comfortable with and the risks you are willing to take.

Because debt comes in the form of a loan, you are able to retain the equity share of the company, which doesn’t dilute your ownership. However, you must re-pay the loans with interest even if you go out of business (assuming the loan is a personal loan and not a business loan, which is usually the case for most entrepreneurs because these are the only type of loans you will have access to). Debt is a better choice for someone who is
looking to stay with the company long term, as opposed to an early exit strategy.

Equity on the other hand is capital that doesn’t have to be paid back. However, it will dilute your shares and lessen the amount you earn upon exit.

**TYPES OF INVESTORS**

**FAMILY, FRIENDS, AND FOUNDERS (FFF)**

Roughly 50% of startups receive investments/funding from friends and family members in the beginning of their venture. According to the Global Entrepreneurship Monitor (Babson & London School of Business), $50 billion to $75 billion is invested annually in this manner. This is over double the amount of capital invested annually by angel investors or venture capitalists (approximately $20 billion).

FFF capital should be used to achieve the milestones that will attract seed funding from angel investors. Likewise, angel funding should be used to achieve the milestones that will attract Series A funding from venture capitalists. Normal amounts raised from FFF range from $25,000 to $50,000. See our Guide to Friends, Family, and Founders for more information.

**ANGEI INVESTORS**

Angels can also be thought of as private investors that provide financial backing for startup companies. By definition, Angels are accredited investors, meaning their net-worth (either alone or combined with their spouse) exceeds $750,000 at the time of investment, or they have an annual income that exceeds $200,000 ($300,000 if combined with spouse) for the two preceding years.

Angels aren’t professional investors working for an outside company. Rather, they invest their own money into the startups, which is why they invest at earlier stages and don’t provide as much funding as a venture capitalist. Normal amounts raised from angels range from $250,000 to $750,000. It is also common for multiple Angels to pool their money together, either informally or formally via an Angel Investment Group.

See our eBook Guide to Raising Capital from Angel Investors for more information.
VC’S

Venture Capitalists (VCs) invest significantly more than FFF and Angel Investors, but they typically do it at a later stage when the company has a higher valuation. They can represent outside companies, groups of wealthy investors, investment banks, or other financial groups that pool investments or partnerships. The downside for entrepreneurs is that they usually require a higher level of inclusion in company decisions (if not majority control) and seek significant amounts of equity in the company. Normal amount raised from VCs range $3,000,000 to $10,000,000.

FAMILY OFFICES

A family office or better known as single family office (SFO) are private companies that manage the investments of certain families that have accumulated wealth or trusts over many generations. Unlike angels and VCs, family offices don’t have the hands-on experience with starting a business so they may not be able to provide the valuable guidance that many startups desperately need.

CROWDFUNDING

A major benefit to Crowdfunding platforms is that they can bring in investors who normally wouldn’t have uncovered the company on their own. Until fairly recently, you could only act as an equity investor if you were accredited (which requires an income of at least $200,000 per year). However, because of the JOBS act, regular people are now allowed to invest with more flexibility.
A truly successful crowdfunding campaign is one that has momentum and is being shared amongst many social channels. Another pro of crowdfunding is that it often established a degree of market traction when it comes to raising capital from more traditional sources. See our Crowdfunding 101 eBook for more information.

CORPORATE INVESTING

Many large corporations have investments groups that make strategic investments into early stage companies. Each group usually has clearly defined criteria in what, when, and how much they invest. You will have to do some good old fashioned research of companies that may be interested in investing in your startup.

ALTERNATIVE SOURCES OF CAPITAL

There are also a number of other alternative sources of capital including credit cards, inventory loans, etc. You can see dozens of these in the eBook Alternative sources of Capital.

VALUATION

Some say that valuing a company is more of an art than a science. Keep in mind that you may want to pitch the value at a higher amount to potential investors so that you can leave room for negotiations and settling on a number that your are still comfortable with. It’s also been said that a good rule of thumb is to value a company based on the sum of 2-3 years of net profits. This is a large topic and too big to be discussed in this beginners eBook.

OTHER INVESTOR DOCUMENTS

PITCH DECK

The Pitch Deck (also referred to as Investor Presentation, stack, or investor deck) is designed to accompany a formal presentation of your company to a group of investors to sell them on your business as an appealing, desirable opportunity to invest.
The goal is to present the business to potential investors in an effective format for receiving funding, while highlighting key points that they care about. At The Startup Garage, we create a set of approximately 10-15 slides that give a complete overview of your company, team, target market, competition and significant milestones, as well as your future plans and business funding needs that investors want to see. Take a look at our Sample Pitch Deck for a more thorough understanding of the various slides of the deck.

EXECUTIVE SUMMARY

The executive summary can end up being the most important part of any business plan. It gives a brief overlook of where the company is, where it is heading, and why it will be successful. It is intended to highlight the strengths and potential growth of the business and it appears first in a normal business plan. The reader can easily see a mission statement, the competitive edge, sales growth, financial projections, the management team, and the exit strategy. Take a look at our Executive Summary for a more thorough understanding of what to include.
ONE PAGE BUSINESS PLAN

The one page business plan is a great tool to quickly communicate your business concept when looking for funding. It is primarily used by high-growth startups as an efficient method for quickly communicating the business to their audience. They are typically expertly designed to show the viewer everything they need to know on a high level in an infographic-styled, easy to understand format. Take a look at our One Page Business Plan to better understanding what to include.

INVESTOR WEBSITE

A new trend is creating a private password protected website to host basic information about the investment opportunity and the previous documents discussed. You will be able to share this website and login information with accredited investors without generally soliciting the investment opportunity. Below are a number of options for this. We recommend at the minimum post on both Gust and AngelList. Don’t publish until you are ready for fundraising. The chances that you will find you lead investor on one of these is slim. Using them to manage the process is valuable and you may be able to find some investors to close out a round after you found a lead investor elsewhere. More details can be found later in this ebook.

Fundingpost.com - The mission of Funding Post is to introduce Entrepreneurs to interested Venture Capitalists and Angel Investors. The site claims to showcase company profiles to over 7,900 Angel Investors & Venture Capitalists worldwide. Fundingpost costs $100 for the first 3 months, then $33 per month after that.
Gust.com - Gust aims to help angel groups and venture capital funds collaborate with promising startups. From February 2013-February 2014, 1800+ startups have been funded through the Gust website. The site includes a community of accredited investors from over 80 countries, insight and education into the fundraising process, as well as tools that help you build a complete profile that will convey your message to investors effectively. Gust is free.

Angellist.com - AngelList is a site dedicated to being a matchmaking service for early stage investors and entrepreneurs. It allows startups to find capital, and gives investors access to up-and-coming businesses, and links talents to startups looking to hire. AngelList is free.

Seedinvest.com - SeedInvest is a platform that gives equity-based accredited investors the ability to participate in crowdfunding. It was founded by professional investors involved in the passage of the 2012 Jobs Act. Two other major reasons that SeedInvest attracts investors are because it doesn’t charge them to use the site, and it makes the investment process relatively seamless requiring just a few clicks. SeedInvest costs $250 per month along with a 7.5% placement fee on funds raised as well as up to $3500 in due diligence, escrow, and legal fees.

Onevest.com - Onevest is a startup investing tool that connects early stage startups with accredited investors. Founders are able to find funding and build a team all on the site. Onevest is free or you can pay a fundraising success fee and they will manage your campaign.

IDENTIFYING POTENTIAL INVESTORS

Networking is a crucial part for finding investors. There is no such thing as too much networking, so don’t hesitate to get out there and meet potential investors or individuals that can introduce you to potential investors. Your only focus shouldn’t be about selling your business, because cultivating personal relationships with potential investors and the other people you meet while networking will pay off in the future. Part of effectively building professional relationships includes always being positive and polite, and dressing to impress. You only have one opportunity to make your first impression. Additionally, you’ll want to ask questions and make yourself a resource for others as this is good common practice in the startup community and will increase your chances of people thinking of you when opportunities become available.
Unfortunately, you will face rejection from many potential investors. It doesn’t imply that your business opportunity isn’t legitimate; it just means that for whatever reason your business wasn’t the right fit for them. If someone turns down investing in your company, always ask if the person can refer an angel that would be interested. If you can manage this, you can also ask why they weren’t interested and use that to perfect your pitch.

You may also want to consider asking your bank if they have any connections to angels. It’s in the bank’s best interest to assist your company towards financial success, so it is very possible that they willing to share contacts within their network of investors with you.

You can also search for investment groups through Internet forums. If you reside close to a major city, you can likely find a local investment forum nearby. Investment forums are similar to angel groups in that many investors attend for the opportunity to invest in promising new companies. At these forums you may encounter advisors, customers, and other strategic partners along with the angels. It’s possible that they also host workshops for investor education, which could be beneficial for you to attend in order to get into the mindset of an investor and see what they are looking to learn.

CONTACTING

Once you find an investor that you want to partner with, you must approach them in a way that optimizes your potential to receive funding. Consider how you got the angel’s contact information to guide your first move. Did you already meet them at a networking event? In that case, you already have a sense for the way they wish to be contacted. Are they a referral from someone else you met? Ask that person who referred you for more information on the angel’s personality. Regardless of your means of communication, make sure you tailor your first communications to them.

*A good rule of thumb is to ask for 45 minutes of the angel’s time. They can extend or shorten the window if they think necessary.
PITCHING

ELEVATOR PITCH

Your elevator pitch is supposed to explain the value of your startup in the amount of time you spend on a normal elevator ride (not including the Empire State Building). You must come up with a clear way to communicate everything an investor would want to know to be interested in your business. Shoot for a 60-second pitch and try it out on some friends. It’s a handy tool to have available when you want to take maximum advantage of a brief moment to talk with someone who has resources that may help you.

INVESTOR PITCH

This is a more formal pitch usually pre scheduled with the investor and can be located in a formal business setting or a more informal lunch or tea setting. This pitch is usually accomplished with the CEO presenting the pitch deck and then followed by Q&A with the investor. These meetings usually last from 30 to 90 minutes.

QUICK PITCH

There are a number of Quick Pitch events and they usually last anywhere from 1 minute to 15 minutes. You will want to share the key information just more succinctly.

There are a number of other pitching opportunities each with their own rules and guidelines. Once you have your main pitch down you can adjust down to the time allowed.

DUE DILIGENCE

This is a comprehensive, thorough background check of investment opportunities, which allows angels the ability to assess the opportunities for a maximal return on investment (ROI). By working together as an angel group to conduct due diligence, angels with expertise in areas such as finance, law, or marketing can research and validate business planning documents as well as the other strategies presented by a startup.
NEGOTIATION STRATEGIES

When it comes to the part of the deal with your investor where a valuation must be determined, make sure you are prepared. Most likely the valuation will fall far below what you consider to be the value of your company, but there are many factors that contribute to an objective valuation. A valuation can assess your company’s liquidity, cash flow, and the value of similar companies. You also have to consider the value that the investor brings to the table, especially if they are well-connected, have a lot of experience and advice, and if they provide an opportunity to receive additional funding down the road.

TERM SHEET

A term sheet outlines the details of the investment you and the angel agree on. Some of the things you should include on a term sheet are:

- Type of financing: debt or equity?
- If you choose debt, will it be convertible? Secured or unsecured?
- If you choose equity, will the stock be common or preferred?
- The amount of financing
- Will the angel be active or silent after funding has been received?
- What happens if the company faces a liquidity event during the course of the investment? Who is paid and when?

Although there are many more here are some common terms that you will need to know:

LIQUIDATION PREFERENCES

A term used in Venture Capital that defines who gets paid how much when there is a liquidation event such as a sale of the company. Standard is a 1x which means the investor gets paid back exactly what they invested (1x) their investment first and then gets part of the profits from the sale. This reduces the risk for investors from not getting the original investment back. Investors are usually repaid before founders and other stock holders.
WARRANTS

A security derivate Issued by the company usually as an incentive to the investor. It is the right to purchase securities from the company at a specific price by a certain date. If the value of the company goes up above this price investors can purchase extra shares at a discounted price and make money.

PRE & POST MONEY VALUATION

Pre Money Value is the value of the company before the investment. If you have a pre money value of $2 million and get 1 million in investment your post money value is $3 million.

PAR VALUE, AUTHORIZED AND ISSUED SHARES

Par value is a simple but confusing attribute related to corporate stock. The value of the stock has very little to do with this par value. Rather, the par value relates to the number of shares of stock which are authorized to be issued in a company. For example, a corporation may “authorize” 1 million shares of common stock and 1 million shares of preferred stock for $0.0001 per share. Authorized shares, are the shares the company has “on-the- shelf” to issue to the shareholders. “Issued” shares are the shares which are actually purchased by the shareholders and which constitute and represent the capital stock of the company.

The stock cannot be sold for less than its par value. The price of issued shares is based on the value of the company divided by the number of issued shares of stock. For example, if ABC company is valued at $1 million and the company issues 200,000 shares of preferred
stock for one dollar per share, and 800,000 shares of common stock for $0.0001 per share, then the post-investment (“post-money”) valuation of the company would be $5 million, making the preferred shareholders, owners of 20% of the company’s equity.

STOCK AND UNITS

The ownership interest that is provided to and investor for investing cash in a business is an equity investment. In a corporation, the investor will typically receive “Stock” in exchange for their investment. In an LLC, the investor will typically receive a percentage interest, or a “Unit” in exchange for their investment. In an LP the investor will typically receive a “Limited Partnership Unit” for their investment.

PREFERRED STOCK

A company can issue new or “preferred” stock as another way to raise capital. Its owners will receive their dividends prior to common stock owners are paid after the company settles loan interest payments.

COMMON STOCK

Once a company is financially stable, they can issue common stock (also known as “ordinary shares”), usually with the help of an investment bank. Common shareholders are allowed to vote for the Board of Directors. However, when it comes to distributing profits they rank behind preferred stock owners or anybody who issues bonds/loans.

STOCK OPTIONS

Stock options can be used to incentivize talented senior management during the recruitment stage. If you create an Option Pool you can also set up an employee program that issues stock or bonuses based on performance in order to increase productivity and efficiency (this also could be used as an alternative to normal means of compensation). The value of the shares increase in alignment with investors’ expectations of earnings.
CLOSING THE DEAL

Closing the deal will be done when all of the business terms are in place, the legal documents are in place, and the investor is ready to write the check.

FOLLOW-UP

In order to maintain a good relationship with the angels you meet throughout the process of seeking financing, make sure to keep in touch with them after your conversations. For anyone who you have a meeting with, send them a handwritten thank you card. If they end up not funding you, you can keep them posted on your company’s progress. You never know, they may change their mind and provide you with funding in the future!

For an angel who does invest in your company, keep them updated on everything about your progress, for the better or the worse. Share your successes and milestones with them, but be honest about problems you are struggling with. They might be able to help you get through the rut. Be sure to thank your angel frequently for supporting your company and making your passion possible.
MILESTONE #3 : PRODUCT DEVELOPMENT

“I never perfected an invention that I did not think about in terms of the service it might give others... I find out what the world needs, then I proceed to invent.”

~ Thomas Edison

The Product Development process is very different depending on what type of business it is and whether it involves manufacturing, software, or services. Instead of trying to explain it all here we recommend checking out The Lean Startup by Eric Ries and The Lean Entrepreneur by Brant Cooper. These books will give you great insight on a scientific process to build your product and get market traction simultaneously on a limited budget and getting information quickly.
MILESTONE #4 : TEAM BUILDING

“Teamwork is the ability to work together toward a common vision. The ability to direct individual accomplishments toward organizational objectives. It is the fuel that allows common people to attain uncommon results.”

- Andrew Carnegie

You’re only as strong as your weakest link and building your team involves tapping your own network or reaching out to those you’ve never met. You must remember that you are building and cultivating a relationship, so calling someone out of the blue and requesting they join your “million dollar idea” won’t get you very far.

For first time entrepreneurs, the differences between founders, key hires, and the various boards may be confusing. Refer to the terms below for more information. Another important note is that when you start fundraising you will leverage your team and their relationships. As you build the team keep this in mind.
PARTNERS / CO-FOUNDERS

These are the people that are involved in the creation of a startup. They don’t necessarily have to be there since day one, but usually they are one of the primary people working on the company before its initial investment round. Additionally, these people usually hold an equity stake in the company.

KEY STAFF

Founders recruit these team members and they specialize in a vital part of the company. Their experience and knowledge make up for weaknesses that founders may have in certain areas. Key staff may or may not hold equity positions in the company depending on their level of expertise, the stage at which they join the company, and their salary requirements and whether the company can afford these requirements or not.

BOARD OF ADVISORS (BOA)

This is an informal group of business leaders who ideally have experience in your industry and can come together at regularly scheduled meetings to discuss strategy. Members typically receive no financial compensation and are neither legally obligated to your business, nor liable for its actions. These people may be potential members of your Board of Directors.

BOARD OF DIRECTORS (BOD)

This is a mandatory group for corporations. It is comprised of internal and external directors who are legally obligated to your company’s financial success. They meet at regularly scheduled meetings, which are laid out in the bylaws of the company. They may or may not receive compensation in the form of stock or cash.
BUSINESS ADVISORS AND MENTORS

These people will be business professionals, ideally with experience relating to your company in either the industry or the type of business. They receive no financial compensation and have no obligation to attend business meetings. Your relationship with them is informal and they can act as a consulting resource for specific issues you encounter.

PERSONAL SUPPORT TEAM

Generally, this is comprised of people you already know and you will consult with them for non-business related needs. However there is a chance that they can help with networking by introducing you to people in your chosen industry.

PROFESSIONAL SERVICE PROVIDERS

These people will be your go-to contacts for providing your company with specialized services. They have a unique skill set that is very technical. Examples include lawyers, accountants, engineers, etc. They are hired as contractors and can be turned to for advice, for which they will probably charge a fee for.
MILESTONE #5 : MARKET TRACTION

“I don’t know the key to success, but the key to failure is trying to please everybody.”

- Bill Cosby

Market traction comes in different forms for different companies; however, there are some proven ideas and tactics that can be helpful to understand this term.

The more you can prove your market traction, less risk is posed to potential investors and therefore the more value they put on the business. You can start by showing an existing competitor with a similar product that has proven traction, because this shows that there is an existing market.

Some challenges that entrepreneurs can also encounter is that they don’t necessarily have a completed product that can be tested or sold in the market or that their product/service is so unique that they are creating a new sector in the market. One way to overcome this hurdle could be through surveys with potential customers.
SURVEYS

You have to know what consumers want if you want to gain real market traction. By using surveys, you can gain insight into things like where there are gaps in the market, what pricing strategy would be acceptable, strengths/weaknesses of your competition, target demographics, and whether or not your brand is being recognized.

BETA TESTING

Beta testing is when you have real customers in real environments test your product or service before it is released to the general public. This approach can’t be replicated in a lab setting and it is done in order to gain insight into user reactions. Because it allows you to work out any kinks prior to launch, it can improve customer satisfaction, increase future sales and revenue, lower support costs, better product planning, and a more positive image. In Beta testing you can show whether potential customers are interested in the product you are offering. What this doesn’t do is prove that they are willing to pay money for your product.

Selling your first product is a big deal because it shows investors that you can produce, market, and sell your product. Gaining more sales in key markets pushes you to the next level. At each level you lower the risk for investors, while adding value to your business.

CROWDFUNDING

Pre-sale crowdfunding campaigns are another great way to prove market traction. If you’re able to pre-sell a significant amount of your products investors will perk up their ears. This is also a golden opportunity for promoting your company using word-of-mouth and social media channels where consumers will do the marketing for you.
Here some of the most popular crowdfunding sites:

- Kickstarter
- Indiegogo
- Rockethub
- Crowdfunder
- GoFundMe

LETTERS OF INTENT

If you are selling B2B then letters of intent could be captured. They are not binding, so these have very little value to investors, but they still are better than nothing. It shows you have the ear of major corporate purchasers.

CONTRACTS

When a startup approaches an investor with a contract in hand, normally they need the investor to provide capital so that they can fulfill a purchase order. This really stimulates an investor’s interest in the company because they can see that there is real demand for the product/service and an immediate ability for ROI.

COMPETITOR MARKET TRACTION

Having competitors is inevitable for all businesses; however, it is important to evaluate where you rank amongst them and what you do differently so that you can develop strategies to beat them. If you want to be a leader in your marketplace, you have to know who the key players are so that you can figure out their strengths and weaknesses and eventually position yourself to stand out.
MILESTONE #6: LEGAL FOUNDATION

“Morality cannot be legislated, but behavior can be regulated. Judicial decrees may not change the heart, but they can restrain the heartless.”

- Martin Luther King, Jr.

There are certain legal milestones that must be in place to attract capital. The following are a list of the most commonly used legal documents (note: below is not legal advice and we highly advise that you get an experienced attorney – we work with several great attorneys and are happy to refer one to you):

- Incorporation (Entity Structure)
  - Type
  - State
- Partnership Agreements
- Employment Agreements
There are number of different entity structures which may be considered when starting a new company. The three primary business structures used in entrepreneurial businesses are: 1) a limited liability company, 2) a corporation, and 3) a limited partnership.

**Limited liability company (“LLC”).** A limited liability company is the most common business structure used by entrepreneurs. It allows the entrepreneur a certain level of liability protection, and a significant tax advantage during the startup phase. The entity
created is governed according to state law, and each of the 50 states have their own legislation regarding the creation of a limited liability company. Besides the liability and tax benefits afforded through the limited liability company format, this type of entity is also the simplest type of company to maintain from a legal perspective. The entrepreneur files “articles of organization” with the state Secretary of State’s office and creates an “operating agreement” which controls the activities of the members of the LLC, including voting, profit distribution, dissolution, transfer of ownership, and management control.

**Corporations.** Corporations are also entities which are established according to state law. A corporation can be formed by filing “articles of incorporation” with the secretary of state’s office. Corporation law is also different in each of the 50 states. There are other documents that are typically required for the proper establishment of a corporation. These include: bylaws, organizational minutes, resolutions, and a shareholder’s agreement.

**“S corporations.”** Often times people refer to corporations with the letter S or the letter C. These references, pertaining to chapter headings in the United States Internal Revenue Code. Subchapter S of the code provides benefits to individuals when starting a new business. For example, at the beginning of a new business oftentimes there will be operating losses for extended period of time. Under subchapter S, the entrepreneur may write off these business losses on his or her personal income tax return. Incidentally, this same tax treatment is provided to the owners of an LLC.

**“C corporations.”** Corporations which alas to be taxed according to subchapter C of the code. These are typically companies that have developed a mature business. The tax rate for corporations tax under subchapter C can be favorable, however there is an issue with distributions of profits in a C Corporation which are made in the manner of dividends. What is known as “double taxation” can occur with a C Corporation, because the corporations profits are taxed first, and then the distributions in the manner of dividends to the shareholders are also taxed.

**Limited partnerships (“LP”).** Limited partnerships are commonly used in real estate investments, oil and gas investments, and in other businesses were the owners are looking for passive income. The components of the limited partnership, include the creation of a general partner who is responsible and liable, for the operation of the
business, and limited partners, who are insulated from liability and have no voting rights relative to the operation of the company. Limited partners also enjoy the ability to offset limited partnership profits or losses against other limited partnership interests on their tax returns.

Selection of the appropriate business entity is the first step of actually creating the business. This election process will also become critical in the design of the capital structure which will be used to attract investment capital. For example, entrepreneurs who are creating technology-related businesses, and who anticipate attracting venture capital for their company will need to consider the creation of a corporation taxed, according to subchapter C of the code. Additionally, venture capital typically also requires that a corporation be organized in the state of Delaware. The reason the state of Delaware is required, is that Delaware has developed the most favorable corporate law structure in the United States and has established a special court system that handles corporate litigation. Similarly, if the entrepreneur is creating a real estate development business, the investors will most likely require the creation of a limited partnership organized in the state in which the real estate is located. Generally however, entrepreneurs who have more traditional businesses in mind will select either a subchapter S corporation, or a limited liability company, organized in the state in which they will operate their business.
MILESTONE #7: OPERATIONAL SYSTEM

“Organizing is what you do before you do something, so that when you do it, it is not all mixed up.”

– A. A. Milne

These are the systems that take some time to set up in the beginning but make it possible to spend most of your time on the rest of the milestones and cannot be ignored.

Some examples of what needs to be organized are:

• Utilities
• Phones
• Computers
• File Server
• Employee Handbooks
• Paid Time Off (PTO)
• Insurance
• Office Setup & Supplies
• Printers/ Fax Machines / Scanners
• Accounting Systems

Although investors may not ask directly about these milestones it will be evident as to whether you have the skills to execute and build a growing organization.
NOW WHAT?

At this point I am assuming that you have achieved the proper business milestones or are getting very close, prepared the investor documents & website, and have taught yourself about the fundraising process. Therefore, it’s time to start fundraising.

The CEO should be leading the fundraising. Ultimately, investors bet on the jockey, not the horse. Meaning, they closely scrutinize the management team when considering an investment opportunity and that team is led by the CEO. Fundraising will take a significant amount of time (typically 3-9 months) until the deal is closed. As a result, the impact of having the CEO focused on fundraising needs to be discussed and planned for with the team. You don’t want all of the hard work to go down the drain because the CEO loses focus on the fundraising and proper plans were not put in place to prevent a leadership vacuum.

PREPARE YOUR FUNDRAISING PLAN

Build a “Prospect List” of potential investors/connectors.

- This starts with your BOA, BOD, management team, employees, personal/business network, etc. And, all of their contacts.

- If you have a list of potential investors that you are interested in meeting with, comb through it and check to see if you have any mutual connections. Before asking for an introduction, get together with your personal connection so that you can update them on how great your company is and the market potential. Even though you may want to remain casual because it is someone you know personally, treat the meeting in a professional manner and be specific in regards to who and how much money you are looking for. Hopefully, this will allow them to feel like they are not only benefitting you, but also the investor if they make an introduction to.

- Potential investors are generally accredited investors (if looking for angel round) or VC firms for larger rounds.
If your list is lacking or you feel you are going to need a deeper list, identify local fundraising related resources such as startup groups, your bank, your lawyer, etc. After you have explored potential investors through your personal network, your next approach will be to start attending events in your local area and creating company profiles on websites where investors look for their next ventures. Also search out startup launch events where investors most likely will be present. It might not be the best time to pitch your business to them as they are probably more concerned with the company that is launching; however it is an opportunity to make a connection at the very least.

In San Diego, where The Startup Garage is based out of, there are some notable groups that promote the startup community and contain many investor members:

- **Tech Coast Angels** - Contains 300 investor members in 5 regional areas covering throughout Southern California. They have already invested in 200 companies with $120 million in capital. They also can provide connections, knowledge, operational assistance, and mentoring legitimate startups/ entrepreneurs. Check their website for upcoming events.

- **San Diego Venture Group (SDVG)** - A non-profit that seeks to support and promote the venture capital and start-up community in San Diego. Its 800 members include venture capitalists, entrepreneurs, tenured executives, and other industry professionals. They also organize events and workshops designed to help startups get funded.

- **You can also looking into universities, non-profits, government initiatives, business plan competitions, pitches, Meetups, Angel Groups, VC firms, other investor related groups, and co-working spaces.** In fact, many co-working spaces and incubators regularly host pitch events. It allows their members to learn firsthand what works and what doesn’t.
• The Kaufmann Foundation has a weekly event called 1MillionCups that allows two entrepreneurs the opportunity to showcase their companies to an audience of mentors, advisors, and entrepreneurs. The goal is not to search for investors, but during the event entrepreneurs are able to gain valuable feedback.

• Searching Meetup.com using the keyword “pitch” is a good way to find events within your local community where you can either pitch your company or watch others pitch theirs. Either way it is likely that investors will be in attendance.

• Here is a link to a pitch night in San Diego at the CyberHive incubator and co-working space.

• Join these organizations newsletters and begin to attend their events to make additional contacts to add to your “prospect list.” Remember not to general solicit at these meetings.

GETTING INTRODUCTIONS

The best way to meet with an investor is to get an introduction. Try hard to get these by asking those on your prospect list. When you meet with an investor if they say they are not interested ask if they could introduce you to anybody that might be able to invest.

BUILD RELATIONSHIPS

Once the introduction is made, sending an email with an executive summary and request for meeting is common. At the meeting, present your pitch deck. If they are interested, they will likely request you to follow up with access to your investor site and/or business plan.

Many entrepreneurs get excited about the prospect of raising capital and do not actually interview the investor. Ask tough questions early on so you are not wasting your time. Investors generally know very quickly whether they are interested or not. Don’t waste a bunch of time trying to convince them that your business is so great. There are many reasons that investors may not be interested, even if they think you have a good business idea (unfamiliar industry, bad timing, doesn’t fit in with their current portfolio, etc.)
Some questions to ask the potential investor:

1. Are you actively investing?
2. When was your last investment?
3. What types of industries do you invest in?
4. What other resources would you be able to bring to the table if you were able to invest?
5. What stage of companies do you typically invest in?
6. What are the important milestones you want to see achieved before you invest?
7. Do you typically invest alone or in groups?
8. What is the range of your typical investments?
9. Are you in interested in investing in our company?

If after the first couple of meetings and review of the investor docs they are interested in investing they will typically due some more heavy due diligence. This may include product testing, meeting other team members reviewing contracts, etc. After due diligence you will need to negotiate the business terms of the investment (valuation, debt vs equity, amount, special terms, etc.). Depending on your level of experience this is a great place to have your lawyer who is familiar with fundraising help you get the terms agreed upon and the legal documents in place so they can write you a check.
CONCLUSION

Now that you have a basic understanding the Capital Raising Process, you probably realize that there are quite a bit of moving parts. Some have to be accomplished simultaneously and some finished before others are completed.

The Startup Garage helps startups achieve the milestones investors care about. Visit our blog, or connect on any of the platforms below.