

# How to Convince Investors

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When people hurt themselves lifting heavy things, it's usually because they try to lift with their back. The right way to lift heavy things is to let your legs do the work. Inexperienced founders make the same mistake when trying to convince investors. They try to convince with their pitch. Most would be better off if they let their startup do the work — if they started by understanding why their startup is worth investing in, then simply explained this well to investors.

Investors are looking for startups that will be very successful. But that test is not as simple as it sounds. In startups, as in a lot of other domains, the distribution of outcomes follows a power law, but in startups the curve is startlingly steep. The big successes are so big they dwarf the rest. And since there are only a handful each year (the conventional wisdom is 15), investors treat "big success" as if it were binary. Most are interested in you if you seem like you have a chance, however small, of being one of the 15 big successes, and otherwise not.

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(There are a handful of angels who'd be interested in a company with a high probability of being moderately successful. But angel investors like big successes too.)

How do you seem like you'll be one of the big successes? You need three things: formidable founders, a promising market, and (usually) some evidence of success so far.

## Formidable

The most important ingredient is formidable founders. Most investors decide in the first few minutes whether you seem like a winner or a loser, and once their opinion is set it's hard to change. [2]

Every startup has reasons both to invest and not to invest. If investors think you're a winner they focus on the former, and if not they focus on the latter. For example, it might be a rich market, but with a slow sales cycle. If investors are impressed with you as founders, they say they want to invest because it's a rich market, and if not, they say they can't invest because of the slow sales cycle.

They're not necessarily trying to mislead you. Most investors are genuinely unclear in their own minds why they like or dislike startups. If you seem like a winner, they'll like your idea more. But don't be too smug about this weakness of theirs, because you have it too; almost everyone does.

There is a role for ideas of course. They're fuel for the fire that starts with liking the founders. Once investors like you, you'll see them reaching for ideas: they'll be saying "yes, and you could also do x." (Whereas when they don't like you, they'll be saying "but what about y?")

But the foundation of convincing investors is to seem formidable, and since this isn't a word most people use in conversation much, I should explain what it means. A formidable person is one who seems like they'll get what they want, regardless of whatever obstacles are in the way. Formidable is close to confident, except that someone could be confident and mistaken. Formidable is roughly justifiably confident.

There are a handful of people who are really good at seeming formidable — some because they actually are very formidable and just let it show, and others because they are more or less con artists.

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But most founders, including many who will go on

to start very successful companies, are not that good at seeming formidable the first time they try fundraising. What should they do?

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What they should not do is try to imitate the swagger of more experienced founders. Investors are not always that good at judging technology, but they're good at judging confidence. If you try to act like something you're not, you'll just end up in an uncanny valley. You'll depart from sincere, but never arrive at convincing.

Truth

The way to seem most formidable as an inexperienced founder is to stick to the truth. How formidable you seem isn't a constant. It varies depending on what you're saying. Most people can seem confident when they're saying "one plus one is two," because they know it's true. The most diffident person would be puzzled and even slightly contemptuous if they told a VC "one plus one is two" and the VC reacted with skepticism. The magic ability of people who are good at seeming formidable is that they can do this with the sentence "we're going to make a billion dollars a year." But you can do the same, if not with that sentence with some fairly impressive ones, so long as you convince yourself first.

That's the secret. Convince yourself that your startup is worth investing in, and then when you explain this to investors they'll believe you. And by convince yourself, I don't mean play mind games with yourself to boost your confidence. I mean truly evaluate whether your startup is worth investing in. If it isn't, don't try to raise money.

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But if it is, you'll be telling the truth when you tell investors it's worth investing in, and they'll sense that. You don't have to be a smooth presenter if you understand something well and tell the truth about it.

To evaluate whether your startup is worth investing in, you have to be a domain expert. If you're not a domain expert, you can be as convinced as you like about your idea, and it will seem to

investors no more than an instance of the Dunning-Kruger effect. Which in fact it will usually be. And investors can tell fairly quickly whether you're a domain expert by how well you answer their questions. Know everything about your market.

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Why do founders persist in trying to convince investors of things they're not convinced of themselves? Partly because we've all been trained to.

When my friends Robert Morris and Trevor Blackwell were in grad school, one of their fellow students was on the receiving end of a question from their faculty advisor that we still quote today. When the unfortunate fellow got to his last slide, the professor burst out:

Which one of these conclusions do you actually believe? One of the artifacts of the way schools are organized is that we all get trained to talk even when we have nothing to say. If you have a ten page paper due, then ten pages you must write, even if you only have one page of ideas. Even if you have no ideas. You have to produce something. And all too many startups go into fundraising in the same spirit. When they think it's time to raise money, they try gamely to make the best case they can for their startup. Most never think of pausing beforehand to ask whether what they're saying is actually convincing, because they've all been trained to treat the need to present as a given — as an area of fixed size, over which however much truth they have must needs be spread, however thinly.

The time to raise money is not when you need it, or when you reach some artificial deadline like a Demo Day. It's when you can convince investors, and not before.

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And unless you're a good con artist, you'll never convince investors if you're not convinced yourself. They're far better at detecting bullshit than you are at producing it, even if you're producing it unknowingly. If you try to convince investors before you've convinced yourself, you'll be wasting both your time.

But pausing first to convince yourself will do more than save you from wasting your time. It will force you to organize your thoughts. To convince yourself that your startup is worth investing in, you'll have to figure out why it's worth investing in. And if you can do that you'll end up with more than added confidence. You'll also have a provisional roadmap of how to succeed.

## Market

Notice I've been careful to talk about whether a startup is worth investing in, rather than whether it's going to succeed. No one knows whether a startup is going to succeed. And it's a good thing for investors that this is so, because if you could know in advance whether a startup would succeed, the stock price would already be the future price, and there would be no room for investors to make money. Startup investors know that every investment is a bet, and against pretty long odds.

So to prove you're worth investing in, you don't have to prove you're going to succeed, just that you're a sufficiently good bet. What makes a startup a sufficiently good bet? In addition to formidable founders, you need a plausible path to owning a big piece of a big market. Founders think of startups as ideas, but investors think of them as markets. If there are  $x$  number of customers who'd pay an average of  $\$y$  per year for what you're making, then the total addressable market, or TAM, of your company is  $\$xy$ . Investors don't expect you to collect all that money, but it's an upper bound on how big you can get.

Your target market has to be big, and it also has to be capturable by you. But the market doesn't have to be big yet, nor do you necessarily have to be in it yet. Indeed, it's often better to start in a small market that will either turn into a big one or from which you can move into a big one. There just has to be some plausible sequence of hops that leads to dominating a big market a few years down the line.

The standard of plausibility varies dramatically depending on the age of the startup. A three month old company at Demo Day only needs to be a promising experiment that's worth funding to see how

it turns out. Whereas a two year old company raising a series A round needs to be able to show the experiment worked.

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But every company that gets really big is "lucky" in the sense that their growth is due mostly to some external wave they're riding, so to make a convincing case for becoming huge, you have to identify some specific trend you'll benefit from. Usually you can find this by asking "why now?" If this is such a great idea, why hasn't someone else already done it? Ideally the answer is that it only recently became a good idea, because something changed, and no one else has noticed yet.

Microsoft for example was not going to grow huge selling Basic interpreters. But by starting there they were perfectly poised to expand up the stack of microcomputer software as microcomputers grew powerful enough to support one. And microcomputers turned out to be a really huge wave, bigger than even the most optimistic observers would have predicted in 1975.

But while Microsoft did really well and there is thus a temptation to think they would have seemed a great bet a few months in, they probably didn't. Good, but not great. No company, however successful, ever looks more than a pretty good bet a few months in. Microcomputers turned out to be a big deal, and Microsoft both executed well and got lucky. But it was by no means obvious that this was how things would play out. Plenty of companies seem as good a bet a few months in. I don't know about startups in general, but at least half the startups we fund could make as good a case as Microsoft could have for being on a path to dominating a large market. And who can reasonably expect more of a startup than that?

## Rejection

If you can make as good a case as Microsoft could have, will you convince investors? Not always. A lot of VCs would have rejected Microsoft.

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Certainly some rejected Google. And getting rejected will put you in a slightly awkward position, because as

you'll see when you start fundraising, the most common question you'll get from investors will be "who else is investing?" What do you say if you've been fundraising for a while and no one has committed yet?

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The people who are really good at acting formidable often solve this problem by giving investors the impression that while no investors have committed yet, several are about to. This is arguably a permissible tactic. It's slightly dickish of investors to care more about who else is investing than any other aspect of your startup, and misleading them about how far along you are with other investors seems the complementary countermove. It's arguably an instance of scamming a scammer. But I don't recommend this approach to most founders, because most founders wouldn't be able to carry it off. This is the single most common lie told to investors, and you have to be really good at lying to tell members of some profession the most common lie they're told.

If you're not a master of negotiation (and perhaps even if you are) the best solution is to tackle the problem head-on, and to explain why investors have turned you down and why they're mistaken. If you know you're on the right track, then you also know why investors were wrong to reject you. Experienced investors are well aware that the best ideas are also the scariest. They all know about the VCs who rejected Google. If instead of seeming evasive and ashamed about having been turned down (and thereby implicitly agreeing with the verdict) you talk candidly about what scared investors about you, you'll seem more confident, which they like, and you'll probably also do a better job of presenting that aspect of your startup. At the very least, that worry will now be out in the open instead of being a gotcha left to be discovered by the investors you're currently talking to, who will be proud of and thus attached to their discovery.

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This strategy will work best with the best investors, who are both hard to bluff and who already believe most other investors are conventional-minded drones doomed always to miss the big outliers. Raising money is not like applying to college, where you can assume that if you can get into MIT, you can also get into Foobar State.

Because the best investors are much smarter than the rest, and the best startup ideas look initially like bad ideas, it's not uncommon for a startup to be rejected by all the VCs except the best ones. That's what happened to Dropbox. Y Combinator started in Boston, and for the first 3 years we ran alternating batches in Boston and Silicon Valley. Because Boston investors were so few and so timid, we used to ship Boston batches out for a second Demo Day in Silicon Valley. Dropbox was part of a Boston batch, which means all those Boston investors got the first look at Dropbox, and none of them closed the deal. Yet another backup and syncing thing, they all thought. A couple weeks later, Dropbox raised a series A round from Sequoia.

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## Different

Not understanding that investors view investments as bets combines with the ten page paper mentality to prevent founders from even considering the possibility of being certain of what they're saying. They think they're trying to convince investors of something very uncertain — that their startup will be huge — and convincing anyone of something like that must obviously entail some wild feat of salesmanship. But in fact when you raise money you're trying to convince investors of something so much less speculative — whether the company has all the elements of a good bet — that you can approach the problem in a qualitatively different way. You can convince yourself, then convince them.

And when you convince them, use the same matter-of-fact language you used to convince yourself. You wouldn't use vague, grandiose marketing-speak among yourselves. Don't use it with investors either. It not only doesn't work on them, but seems a mark of incompetence. Just be concise. Many investors explicitly use that as a test, reasoning (correctly) that if you can't explain your plans concisely, you don't really understand them. But even investors who don't have a rule about this will be bored and frustrated by unclear explanations.

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So here's the recipe for impressing investors when you're not already good at seeming formidable:

If you're saying something you know is true, you'll seem confident when you're saying it. Conversely, never let pitching draw you into bullshitting. As long as you stay on the territory of truth, you're strong. Make the truth good, then just tell it. Make something worth investing in.

Understand why it's worth investing in.

Explain that clearly to investors.

## Notes

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There's no reason to believe this number is a constant. In fact it's our explicit goal at Y Combinator to increase it, by encouraging people to start startups who otherwise wouldn't have.

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Or more precisely, investors decide whether you're a loser or possibly a winner. If you seem like a winner, they may then, depending on how much you're raising, have several more meetings with you to test whether that initial impression holds up.

But if you seem like a loser they're done, at least for the next year or so. And when they decide you're a loser they usually decide in way less than the 50 minutes they may have allotted for the first meeting. Which explains the astonished stories one always hears about VC inattentiveness. How could these people make investment decisions well when they're checking their messages during startups' presentations? The solution to that mystery is that they've already

made the decision.

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The two are not mutually exclusive. There are people who are both genuinely formidable, and also really good at acting that way.

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How can people who will go on to create giant companies not seem formidable early on? I think the main reason is that their experience so far has trained them to keep their wings folded, as it were. Family, school, and jobs encourage cooperation, not conquest. And it's just as well they do, because even being Genghis Khan is probably 99% cooperation. But the result is that most people emerge from the tube of their upbringing in their early twenties compressed into the shape of the tube. Some find they have wings and start to spread them. But this takes a few years. In the beginning even they don't know yet what they're capable of.

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In fact, change what you're doing. You're investing your own time in your startup. If you're not convinced that what you're working on is a sufficiently good bet, why are you even working on that?

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When investors ask you a question you don't know the answer to, the best response is neither to bluff nor give up, but instead to explain how you'd figure out the answer. If you can work out a preliminary answer on the spot, so much the better, but explain that's what you're doing.

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At YC we try to ensure startups are ready to raise money on Demo Day by encouraging them to ignore investors and instead focus on their companies till about a week before. That way most reach the stage where they're sufficiently convincing well before Demo Day. But not all do, so we also give any startup that wants to the option of deferring to a later Demo Day.

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Founders are often surprised by how much harder it is to raise the next round. There is a qualitative difference in investors' attitudes. It's like the difference between being judged as a kid and as an adult. The next time you raise money, it's not enough to be promising. You have to be delivering results.

So although it works well to show growth graphs at either stage, investors treat them differently. At three months, a growth graph is mostly evidence that the founders are effective. At two years, it has to be evidence of a promising market and a company tuned to exploit it.

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By this I mean that if the present day equivalent of the 3 month old Microsoft presented at a Demo Day, there would be investors who turned them down. Microsoft itself didn't raise outside money, and indeed the venture business barely existed when they got started in 1975.

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The best investors rarely care who else is investing, but mediocre investors almost all do. So you can use this question as a test of investor quality.

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To use this technique, you'll have to find out why investors who rejected you did so, or at least what they claim was the reason. That may require asking, because investors don't always volunteer a lot of detail. Make it clear when you ask that you're not trying to dispute their decision — just that if there is some weakness in your plans, you need to know about it. You won't always get a real reason out of them, but you should at least try.

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Dropbox wasn't rejected by all the East Coast VCs. There was one firm that wanted to invest but tried to lowball them.

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Alfred Lin points out that it's doubly important for the explanation of a startup to be clear and concise, because it has

to convince at one remove: it has to work not just on the partner you talk to, but when that partner re-tells it to colleagues.

We consciously optimize for this at YC. When we work with founders create a Demo Day pitch, the last step is to imagine how an investor would sell it to colleagues.

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