A Fundraising Survival Guide

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Raising money is the second hardest part of starting a startup. The hardest part is making something people want: most startups that die, die because they didn't do that. But the second biggest cause of death is probably the difficulty of raising money. Fundraising is brutal.

One reason it's so brutal is simply the brutality of markets. People who've spent most of their lives in schools or big companies may not have been exposed to that. Professors and bosses usually feel some sense of responsibility toward you; if you make a valiant effort and fail, they'll cut you a break. Markets are less forgiving. Customers don't care how hard you worked, only whether you solved their problems.

Investors evaluate startups the way customers evaluate products, not the way bosses evaluate employees. If you're making a valiant effort and failing, maybe they'll invest in your next startup, but not this one.

But raising money from investors is harder than selling to customers, because there are so few of them. There's nothing like an efficient market. You're unlikely to have more than 10 who are interested; it's difficult to talk to more. So the randomness of any one investor's behavior can really affect you.

Problem number 3: investors are very random. All investors, including us, are by ordinary standards incompetent. We constantly have to make decisions about things we don't understand, and more often than not we're wrong.

And yet a lot is at stake. The amounts invested by different types of investors vary from five thousand dollars to fifty million, but the amount usually seems large for whatever type of investor it is. Investment decisions are big decisions.

That combination—making big decisions about things they don't understand—tends to make investors very skittish. VCs are notorious for leading founders on. Some of the more unscrupulous do it deliberately. But even the most well-intentioned investors can behave in a way that would seem crazy in everyday life. One day they're full of enthusiasm and seem ready to write you a check on the spot; the next they won't return your phone calls. They're not playing games with you. They just can't make up their minds. [1]

If that weren't bad enough, these wildly fluctuating nodes are all linked together. Startup investors all know one another, and (though they hate to admit it) the biggest factor in their opinion of you is the opinion of other investors. [2] Talk about a recipe for an unstable system. You get the opposite of the damping that the fear/greed balance usually produces in markets. No one is interested in a startup that's a "bargain" because everyone else hates it.

So the inefficient market you get because there are so few players is exacerbated by the fact that they act less than independently. The result is a system like some kind of primitive, multi-celled sea creature, where you irritate one extremity and the whole thing contracts violently.

Y Combinator is working to fix this. We're trying to increase the number of investors just as we're increasing the number of startups. We hope that as the number of both increases we'll get something more like an efficient market. As t approaches infinity, Demo Day approaches an auction.

Unfortunately, t is still very far from infinity. What does a startup do now, in the imperfect world we currently inhabit? The most important thing is not to let fundraising get you down. Startups live or die on morale. If you let the difficulty of raising money destroy your morale, it will become a self-fulfilling prophecy.

Bootstrapping (= Consulting)

Some would-be founders may by now be thinking, why deal with investors at all? If raising money is so painful, why do it?

One answer to that is obvious: because you need money to live on. It's a fine idea in principle to finance your startup with its own revenues, but you can't create instant customers. Whatever you make, you have to sell a certain amount to break even. It will take time to grow your sales to that point, and it's hard to predict, till you try, how long it will take.

We could not have bootstrapped Viaweb, for example. We charged quite a lot for our software—about $140 per user per month—but it was at least a year before our revenues would have covered even our paltry costs. We didn't have enough saved to live on for a year.

If you factor out the "bootstrapped" companies that were actually funded by their founders through savings or a day job, the remainder either (a) got really lucky, which is hard to do on demand, or (b) began life as consulting companies and gradually transformed themselves into product companies.

Consulting is the only option you can count on. But consulting is far from free money. It's not as painful as raising money from investors, perhaps, but the pain is spread over a longer period. Years, probably. And for many types of startup, that delay could be fatal. If you're working on something so unusual that no one else is likely to think of it, you can take your time. Joshua Schachter gradually built Delicious on the side while working on Wall Street. He got away with it because no one else realized it was a good idea. But if you were building something as obviously necessary as online store software at about the same time as Viaweb, and you were working on it on the side while spending most of your time on client work, you were not in a good position.

Bootstrapping sounds great in principle, but this apparently verdant territory is one from which few startups emerge alive. The mere fact that bootstrapped startups tend to be famous on that account should set off alarm bells. If it worked so well, it would be the norm.
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Bootstrapping may get easier, because starting a company is getting cheaper. But I don't think we'll ever reach the point where most startups can do without outside funding. Technology tends to get dramatically cheaper, but living expenses don't.

The upshot is, you can choose your pain: either the short, sharp pain of raising money, or the chronic ache of consulting. For a given total amount of pain, raising money is the better choice, because new technology is usually more valuable now than later.

But although for most startups raising money will be the lesser evil, it's still a pretty big evil—so big that it can easily kill you. Not merely in the obvious sense that if you fail to raise money you might have to shut the company down, but because the process of raising money itself can kill you.

To survive it you need a set of techniques mostly orthogonal to the ones used in convincing investors, just as mountain climbers need to know survival techniques that are mostly orthogonal to those used in physically getting up and down mountains.

1. Have low expectations.

The reason raising money destroys so many startups' morale is not simply that it's hard, but that it's so much harder than they expected. What kills you is the disappointment. And the lower your expectations, the harder it is to be disappointed.

Startup founders tend to be optimistic. This can work well in technology, at least some of the time, but it's the wrong way to approach raising money. Better to assume investors will always let you down. Acquirers too, while we're at it. At YC one of our secondary mantras is "Deals fall through." No matter what deal you have going on, assume it will fall through. The predictive power of this simple rule is amazing.

There will be a tendency, as a deal progresses, to start to believe it will happen, and then to depend on it happening. You must resist this. Tie yourself to the mast. This is what kills you. Deals do not have a trajectory like most other human interactions, where shared plans solidify linearly over time. Deals often fall through at the last moment. Often the other party doesn't really think about what they want till the last moment. So you can't use your everyday intuitions about shared plans as a guide. When it comes to deals, you have to consciously turn them off and become pathologically cynical.

This is harder to do than it sounds. It's very flattering when eminent investors seem interested in funding you. It's easy to start to believe that raising money will be quick and straightforward. But it hardly ever is.

2. Keep working on your startup.

It sounds obvious to say that you should keep working on your startup while raising money. Actually this is hard to do. Most startups don't manage to.

Raising money has a mysterious capacity to suck up all your attention. Even if you only have one meeting a day with investors, somehow that one meeting will burn up your whole day. It costs not just the time of the actual meeting, but the time getting there and back, and the time preparing for it beforehand and thinking about it afterward.

The best way to survive the distraction of meeting with investors is probably to partition the company: to pick one founder to deal with investors while the others keep the company going. This works better when a startup has 3 founders than 2, and better when the leader of the company is not also the lead developer. In the best case, the company keeps moving forward at about half speed.

That's the best case, though. More often than not the company comes to a standstill while raising money. And that is dangerous for so many reasons. Raising money always takes longer than you expect. What seems like it's going to be a 2 week interruption turns into a 4 month interruption. That can be very demoralizing. And worse still, it can make you less attractive to investors. They want to invest in companies that are dynamic. A company that hasn't done anything new in 4 months doesn't seem dynamic, so they start to lose interest. Investors rarely grasp this, but much of what they're responding to when they lose interest in a startup is the damage done by their own indecision.

The solution: put the startup first. Fit meetings with investors into the spare moments in your development schedule, rather than doing development in the spare moments between meetings with investors. If you keep the company moving forward—releasing new features, increasing traffic, doing deals, getting written about—those investor meetings are more likely to be productive. Not just because your startup will seem more alive, but also because it will be better for your own morale, which is one of the main ways investors judge you.

3. Be conservative.

As conditions get worse, the optimal strategy becomes more conservative. When things go well you can take risks; when things are bad you want to play it safe.

I advise approaching fundraising as if it were always going badly. The reason is that between your ability to delude yourself and the wildly unstable nature of the system you're dealing with, things probably either already are or could easily become much worse than they seem.

What I tell most startups we fund is that if someone reputable offers you funding on reasonable terms, take it. There have been startups that ignored this advice and got away with it—startups that ignored a good offer in the hope of getting a better one, and actually did. But in the same position I'd give the same advice again. Who knows how many bullets were in the gun they were playing Russian roulette with?

Corollary: if an investor seems interested, don't just let them sit. You can't assume someone interested in investing will stay interested. In fact, you can't even tell (they can't even tell) if they're really interested till you try to convert that interest into money. So if you have hot prospect, either close them now or write them off. And unless you already have enough funding, that reduces to: close them now.

Startups don't win by getting great funding rounds, but by making great products. So finish raising money and get back to work.

4. Be flexible.

There are two questions VCs ask that you shouldn't answer: "Who else are you talking to?" and "How much are you trying to raise?"

VCs don't expect you to answer the first question. They ask it just in case.
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They do seem to expect an answer to the second. But I don't think you should just tell them a number. Not as a way to play games with them, but because you shouldn't have a fixed amount you need to raise.

The custom of a startup needing a fixed amount of funding is an obsolete one left over from the days when startups were more expensive. A company that needed to build a factory or hire 50 people obviously needed to raise a certain minimum amount. But few technology startups are in that position today.

We advise startups to tell investors there are several different routes they could take depending on how much they raised. As little as $50k could pay for food and rent for the founders for a year. A couple hundred thousand would let them get office space and hire some smart people they know from school. A couple million would let them really blow this thing out. The message (and not just the message, but the fact) should be: we're going to succeed no matter what. Raising more money just lets us do it faster.

If you're raising an angel round, the size of the round can even change on the fly. In fact, it's just as well to make the round small initially, then expand as needed, rather than trying to raise a large round and risk losing the investors you already have if you can't raise the full amount. You may even want to do a "rolling close," where the round has no predetermined size, but instead you sell stock to investors one at a time as they say yes. That helps break deadlocks, because you can start as soon as the first one is ready to buy.
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5. Be independent.

A startup with a couple founders in their early twenties can have expenses so low that they could be profitable on as little as $2000 per month. That's negligible as corporate revenues go, but the effect on your morale and your bargaining position is anything but. At YC we use the phrase "ramen profitable" to describe the situation where you're making just enough to pay your living expenses. Once you cross into ramen profitable, everything changes. You may still need investment to make it big, but you don't need it this month.

You can't plan when you start a startup how long it will take to become profitable. But if you find yourself in a position where a little more effort expended on sales would carry you over the threshold of ramen profitable, do it.

Investors like it when you're ramen profitable. It shows you've thought about making money, instead of just working on amusing technical problems; it shows you have the discipline to keep your expenses low; but above all, it means you don't need them.

There is nothing investors like more than a startup that seems like it's going to succeed even without them. Investors like it when they can help a startup, but they don't like startups that would die without that help.

At YC we spend a lot of time trying to predict how the startups we've

funded will do, because we're trying to learn how to pick winners. We've now watched the trajectories of so many startups that we're getting better at predicting them. And when we're talking about startups we think are likely to succeed, what we find ourselves saying is things like "Oh, those guys can take care of themselves. They'll be fine." Not "those guys are really smart" or "those guys are working on a great idea."
[6]
When we predict good outcomes for startups, the qualities that come up in the supporting arguments are toughness, adaptability, determination. Which means to the extent we're correct, those are the qualities you need to win.

Investors know this, at least unconsciously. The reason they like it when you don't need them is not simply that they like what they can't have, but because that quality is what makes founders succeed.

Sam Altman
has it. You could parachute him into an island full of cannibals and come back in 5 years and he'd be the king. If you're Sam Altman, you don't have to be profitable to convey to investors that you'll succeed with or without them. (He wasn't, and he did.) Not everyone has Sam's deal-making ability. I myself don't. But if you don't, you can let the numbers speak for you.

6. Don't take rejection personally.

Getting rejected by investors can make you start to doubt yourself. After all, they're more experienced than you. If they think your startup is lame, aren't they probably right?

Maybe, maybe not. The way to handle rejection is with precision. You shouldn't simply ignore rejection. It might mean something. But you shouldn't automatically get demoralized either.

To understand what rejection means, you have to understand first of all how common it is. Statistically, the average VC is a rejection machine. David Hornik, a partner at August, told me:

The numbers for me ended up being something like 500 to 800 plans received and read, somewhere between 50 and 100 initial 1 hour meetings held, about 20 companies that I got interested in, about 5 that I got serious about and did a bunch of work, 1 to 2 deals done in a year. So the odds are against you. You may be a great entrepreneur, working on interesting stuff, etc. but it is still incredibly unlikely that you get funded.

This is less true with angels, but VCs reject practically everyone. The structure of their business means a partner does at most 2 new investments a year, no matter how many good startups approach him.

In addition to the odds being terrible, the average investor is, as I mentioned, a pretty bad judge of startups. It's harder to judge startups than most other things, because great startup ideas tend to seem wrong. A good startup idea has to be not just good but novel. And to be both good and novel, an idea probably has to seem bad to most people, or someone would already be doing it and it wouldn't be novel.

That makes judging startups harder than most other things one judges. You have to be an intellectual contrarian to be a good startup investor. That's a problem for VCs, most of whom are not particularly imaginative. VCs are mostly money guys, not people who make things. [7]
Angels are better at appreciating novel ideas, because most were founders themselves.

So when you get a rejection, use the data that's in it, and not what's not. If an investor gives you specific reasons for not investing, look at your startup and ask if they're right. If they're real problems, fix them. But don't just take their word for it. You're supposed to be the domain expert; you have to decide.

Though a rejection doesn't necessarily tell you anything about your startup, it does suggest your pitch could be improved. Figure out what's not working and change it. Don't just think "investors are stupid." Often they are, but figure out precisely where you lose them.

Don't let rejections pile up as a depressing, undifferentiated heap. Sort them and analyze them, and then instead of thinking "no one likes us," you'll know precisely how big a problem you have, and what to do about it.

7. Be able to downshift into consulting (if appropriate).

Consulting, as I mentioned, is a dangerous way to finance a startup. But it's better than dying. It's a bit like anaerobic respiration: not the optimum solution for the long term, but it can save you from an immediate threat. If you're having trouble raising money from investors at all, it could save you to be able to shift toward consulting.

This works better for some startups than others. It wouldn't have been a natural fit for, say, Google, but if your company was making software for building web sites, you could degrade fairly gracefully into consulting by building sites for clients with it.

So long as you were careful not to get sucked permanently into consulting, this could even have advantages. You'd understand your users well if you were using the software for them. Plus as a consulting company you might be able to get big-name users using your software that you wouldn't have gotten as a product company.

At Viaweb we were forced to operate like a consulting company initially, because we were so desperate for users that we'd offer to build merchants' sites for them if they'd sign up. But we never charged for such work, because we didn't want them to start treating us like actual consultants, and calling us every time they wanted something changed on their site. We knew we had to stay a product company, because only that scales.

8. Avoid inexperienced investors.

Though novice investors seem unthreatening they can be the most dangerous sort, because they're so nervous. Especially in proportion to the amount they invest. Raising $20,000 from a first-time angel investor can be as much work as raising $2 million from a VC fund.

Their lawyers are generally inexperienced too. But while the investors can admit they don't know what they're doing, their lawyers can't. One YC startup negotiated terms for a tiny round with an angel, only to receive a 70-page agreement from his lawyer. And since the lawyer could never admit, in front of his client, that he'd screwed up, he instead had to insist on retaining all the draconian terms in it, so the deal fell through.

Of course, someone has to take money from novice investors, or there would never be any experienced ones. But if you do, either (a) drive the process yourself, including supplying the paperwork, or (b) use them only to fill up a larger round led by someone else.

9. Know where you stand.

The most dangerous thing about investors is their indecisiveness. The worst case scenario is the long no, the no that comes after months of meetings. Rejections from investors are like design flaws: inevitable, but much less costly if you discover them early.

So while you're talking to investors, constantly look for signs of where you stand. How likely are they to offer you a term sheet? What do they have to be convinced of first? You shouldn't necessarily always be asking these questions outright—that could get annoying—but you should always be collecting data about them.

Investors tend to resist committing except to the extent you push them to. It's in their interest to collect the maximum amount of information while making the minimum number of decisions. The best way to force them to act is, of course, competing investors. But you can also apply some force by focusing the discussion: by asking what specific questions they need answered to make up their minds, and then answering them. If you get through several obstacles and they keep raising new ones, assume that ultimately they're going to flake.

You have to be disciplined when collecting data about investors' intentions. Otherwise their desire to lead you on will combine with your own desire to be led on to produce completely inaccurate impressions.

Use the data to weight your strategy.
You'll probably be talking to several investors. Focus on the ones that are most likely to say yes. The value of a potential investor is a combination of how good it would be if they said yes, and how likely they are to say it. Put the most weight on the second factor. Partly because the most important quality in an investor is simply investing. But also because, as I mentioned, the biggest factor in investors' opinion of you is other investors' opinion of you. If you're talking to several investors and you manage to get one over the threshold of saying yes, it will make the others much more interested. So you're not sacrificing the lukewarm investors if you focus on the hot ones; convincing the hot investors is the best way to convince the lukewarm ones.

Future

I'm hopeful things won't always be so awkward. I hope that as startups get cheaper and the number of investors increases, raising money will become, if not easy, at least straightforward.

In the meantime, the brokenness of the funding process offers a big opportunity. Most investors have no idea how dangerous they are. They'd be surprised to hear that raising money from them is something that has to be treated as a threat to a company's survival. They just think they need a little more information to make up their minds. They don't get that there are 10 other investors who also want a little more information, and that the process of talking to them all can bring a startup to a standstill for months.

Because investors don't understand the cost of dealing with them, they don't realize how much room there is for a potential competitor to undercut them. I know from my own experience how much faster investors could decide, because we've brought our own time down to 20 minutes (5 minutes of reading an application plus a 10 minute interview plus 5 minutes of discussion). If you were investing more money you'd want to take longer, of course. But if we can decide in 20 minutes, should it take anyone longer than a couple days?

Opportunities like this don't sit unexploited forever, even in an industry as conservative as venture capital. So either existing investors will start to make up their minds faster, or new investors will emerge who do.

In the meantime founders have to treat raising money as a dangerous process. Fortunately, I can fix the biggest danger right here. The biggest danger is surprise. It's that startups will underestimate the difficulty of raising money—that they'll cruise through all the initial steps, but when they turn to raising money they'll find it surprisingly hard, get demoralized, and give up. So I'm telling you in advance: raising money is hard.

Notes

[1]
When investors can't make up their minds, they sometimes describe it as if it were a property of the startup. "You're too early for us," they sometimes say. But which of them, if they were taken back in a time machine to the hour Google was founded, wouldn't offer to invest at any valuation the founders chose? An hour old is not too early if it's the right startup. What "you're too early" really means is "we can't figure out yet whether you'll succeed."

[2]
Investors influence one another both directly and indirectly. They influence one another directly through the "buzz" that surrounds a hot startup. But they also influence one another indirectly through the founders. When a lot of investors are interested in you, it increases your confidence in a way that makes you much more attractive to investors.

No VC will admit they're influenced by buzz. Some genuinely aren't. But there are few who can say they're not influenced by confidence.

[3]

One VC who read this essay wrote:

"We try to avoid companies that got bootstrapped with consulting. It creates very bad behaviors/instincts that are hard to erase from a company's culture."

[4]
The optimal way to answer the first question is to say that it would be improper to name names, while simultaneously implying that you're talking to a bunch of other VCs who are all about to give you term sheets. If you're the sort of person who understands how to do that, go ahead. If not, don't even try. Nothing annoys VCs more than clumsy efforts to manipulate them.

[5]
The disadvantage of expanding a round on the fly is that the valuation is fixed at the start, so if you get a sudden rush of interest, you may have to decide between turning some investors away and selling more of the company than you meant to. That's a good problem to have, however.

[6]
I wouldn't say that intelligence doesn't matter in startups. We're only comparing YC startups, who've already made it over a certain threshold.

[7]
But not all are. Though most VCs are suits at heart, the most successful ones tend not to be. Oddly enough, the best VCs tend to be the least VC-like.

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