E-Book

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How Venture-Backed Companies Can Remain Funding Ready

An e-book exploring the differences between private equity and venture capital, along with steps VC-backed firms can take to be funding ready at all times.

Most start-up businesses need capital in order to grow

Capital comes in two main forms: debt and equity. Debt is money that's borrowed from a lender or raised from a bond issuance that must be repaid with interest. Meanwhile, there are two different kinds of equity: private equity (PE) and venture capital (VC).

PE and VC investors have different objectives. Private equity investors want to invest in businesses that are profitable, while venture capital investors want to invest in businesses that are going to grow. There's a big difference between the two.

"But doesn't every business want to be profitable?" you might be thinking? Yes, but profitability isn't always the main objective, especially during the early stages of a startup company.

Technology giants like Amazon and Google are good examples of companies that operated at a loss for years so they could invest all of their cash back into the business in order to grow.

These companies and their investors were taking the long view: They weren't worried about becoming profitable right out of the gate. Instead, they wanted to grow as much and as fast as possible so they could eventually dominate their industries. They knew that if they could become the dominant online retailer and search engine, profits would soon follow. Of course, this strategy worked well for both of them.

Also, market capitalization — which is a main focus for VC investors — is calculated as a multiple of revenue, not earnings. So, the faster a company grows, the higher its sales and market cap will be.

Stages of Venture Capital Financing

Venture capital is usually raised in stages because successful growth companies always need more money to keep growing. Think of it like pouring gasoline on a fire: The more capital a business has, the more salespeople it can hire and the more it can invest in technology, research and development, and new product development to spur growth.

The first stage is called the pre-seed stage

Here, there may not even be a real business yet — it might just still be an idea or concept in an entrepreneur's mind. Funding at this stage usually comes mainly from family and friends or out of an entrepreneur's own pocket, not from venture capital investors.

The next stage, or the seed stage, is the first stage where venture capitalists might get involved. There still might not be a lot of revenue but there's strong evidence that the seeds of a successful business have been planted. Real (not prototype) products and services are being delivered to the marketplace and a management team is in place that's capable of executing the business plan.

The next stage of funding is called Series A

At this stage, VC investors want to see a real, operating business with repeatable sales and marketing processes that can acquire customers on a consistent basis. The business should be utilizing financial modeling and long-range planning and have adequate internal controls, along with a fundraising project plan and investor presentation.

Series B, Series C and so forth

The subsequent funding stages after Series are called B, C, Venture capital investors will have specific expectations at each funding stage.

Always Be Funding Ready

The biggest thing to keep in mind when it comes to venture capital financing is the importance of being funding-ready at all times. Remember that as long as you intend to keep growing, you will always need more capital — so you should always be ready to proceed to the next stage of funding.

This capital is usually raised in stages, as described above. Unfortunately, four out of five companies that receive pre-seed and seed funding never make it to Series A. And nine out of 10 companies that receive pre-seed and seed funding don't achieve a successful exit.

Successful Due Diligence & Audit

The key to making it to the next funding stage is remaining funding-ready at all times. This starts with preparing for financial due diligence and auditing during the pre-seed and seed stages. These steps typically include the following:

- Gather formation documents (e.g., articles of incorporation, bylaws, shareholder agreements).
- Identify and build relationships with professional services providers (e.g., CPA, banker, attorney, insurance broker).
- Prepare revenue and gross profits by product offering.
- Obtain audited financial statements for the last two (private company buyer) or three (public company buyer) years.
- Consult with an audit firm about complex accounting requirements (e.g., revenue recognition, leases, stock options, convertible debt).

It's also critical to adopt financial best practices during the pre-seed and seed funding stages. This starts with building a top-notch financial and accounting system with well-organized financial files. Your system should include monthly reporting and establish strong internal controls over financial reporting while accommodating corporate tax requirements and deadlines. Also, invest in an appropriate enterprise resource planning (ERP) system for your needs.

8 Steps to Remain Funding Ready

Here are eight more steps you can take to remain funding-ready at all times:

1. **Implement accurate budgeting and forecasting.** These provide the foundation for successful financial management. Investors want to compare current and previous periods so budgets and sales forecasts should be prepared on a monthly, quarterly and annual basis. There should also be common definitions of finance functions across the various time periods.
2. **Establish sound collection practices.** This is especially critical for early-stage venture-backed companies. Statistically speaking, the longer invoices go uncollected, the less likely they are to ever be converted to cash. Therefore, early-stage companies should implement policies and procedures designed to ensure prompt collection of accounts receivable.

3. Utilize financial metrics, benchmarking and data analytics. Sometimes referred to as key performance indicators, or KPIs, these are quantifiable statistics that help define and measure progress toward key business objectives and other critical success factors. Common financial metrics include debt-to-equity, accounts receivable (AR) and accounts payable (AP) days, days sales outstanding (DSO) and inventory turnover.
4. Incorporate cash flow management. Startups can burn through cash quickly, making cash flow management critical. The key is to decide which expenses are essential and will lead to increased market share and growth and which expenses are wasteful. Devise monthly cash flow plans to make sure your business remains liquid at all times.
5. Create a formal sales compensation structure. Sales is the main engine that will drive growth, so your sales comp plan needs to be structured and formalized no later than the Series B funding stage. Most sales comp plans today include a base salary plus benefits in addition to commissions and bonuses to incent and reward top salespeople for high performance
6. Create a fundraising project plan and investor presentation. At each funding stage, investors will want to see how you plan to raise enough capital to carry the company through to the next stage. Prepare a formal presentation with these details that you can share with investors during your "pitch" meetings.
7. Use GAAP accounting and revenue recognition. Series A and Series B investors will expect to see financial statements prepared in accordance with generally accepted accounting principals, or GAAP. At this stage, GAAP reporting should be timely and accurate.
8. Prepare for potential international expansion. Depending on your products/services and your industry, Series B and Series C investors may inquire about how your company can tap growth opportunities overseas. So prepare an international expansion plan that details these opportunities, along with the potential risks and costs of overseas expansion and any statutory international compliance requirements.

Using FaaS to Build an Optimized Finance and Accounting Team

Building a strong finance and accounting team is critical to maintaining funding readiness. This can be done internally or on an outsourced basis. Outsourcing using Finance as a Service (FaaS) tends to be far more effective for companies that are preparing for growth beyond their seed stage.

Building an optimized finance and accounting team in-house typically takes from 12 to 18 months, but an outsourced FaaS approach can accomplish this in as little as 30 to 90 days. With FaaS, growing companies will get the benefit of having a remote and skilled finance team along with a pre-integrated, enterprise-grade finance & accounting software stack. All of this is delivered at a fraction of the cost compared to starting from scratch and building the entire finance function in-house. With the FaaS model you have an efficient, cost-effective and scalable finance function.

Consero can help you build an optimized finance and accounting team using FaaS so you remain funding ready at each stage. Contact us to request a consultation at https://conseroglobal.com/request-a-consultation/ and together we'll discuss your situation in more detail.