

**THE RUNWAY**

**October 2018**

**CAPITAL STRATEGY TEMPLATE**

**HOW DO YOU MAKE MONEY?**

My customers are (very brief description)

and pay ($x) per (time period)

the terms of sale are (annual, up front)

We grow customers by (referrals, sales on commission)

and our GP margin is (x%)

1. **WHERE do you want to end up in 10 years’ time?**

*You need to start with a sense of where you want to be in 10 years’ time. It is a critical to have this sense of an end point when it comes to scaling the brilliant idea that is your business. You need to know what capital and capability you need to make an exponential impact. In many ways you raise capital to buy the capability. Even more pointed than where do you want to be in 10 years’ time is “how wealthy do you want to be?”. Where and how do you see your venture having an exponential impact? How much of your business do you want to own as it grows? Will you find the capital and capability in a trade sale or an IPO? Each will take you down a different path and require different strategies.*

1. **HOW are you going to fund your growth?**

*Do I need to raise capital at all? Do I have a forecast showing how any capital raised will be deployed? Model the drivers and variables of revenue streams and costs, with leeway, to determine the raise amount. Will the raise amount last until either the next capital raise or until profitability? What different scenarios are there (modify raise amounts including zero, hiring plans, revenue projections). Can I raise capital in smaller chunks? Should those chunks be linked to milestones, and if so, what are they? Consider founder dilution and effects of funding rounds on the cap table (founder + ESOP + seed + Series A, etc).*

1. **WHERE or FROM WHOM will I find that capital?**

*Target investors/people most likely to be interested in your company. Consider grants, economic development loans. Conduct due diligence on investors – who will be deploying funds when you need it; who has the expertise, board directors, and investor- or industry-network you need to “add value” beyond capital? Talk to investees about what investors are like to work with when things are going well and when things are not going well?*

1. **WHAT TERMS are needed to attract capital?**

*Debt or equity? Find the valuation sweet spot (\*\*see below) between being low enough to attract capital and allow you to be able to meaningfully raise the valuation for the next capital round but high enough to prevent too much founder dilution. Make term sheets as comprehensive as possible to mitigate problems in definitive document drafting stage, and particularly because term sheets often have exclusivity/no shop provisions. Avoid stacked convertible notes with varying caps, which reduce transparency for both founders and investors. Generally, at early stage investments, simplicity is key. Preference multiples, ratchets, etc. are generally not appropriate in early stage financings and can harm a company’s future funding prospects.*

1. **Other key points**

*Clean up the cap table and shareholders agreement before raising – too many shareholders make information requests, investor communications, and diversity of perspective a logistical nightmare. Know what to strip out of your shareholder’s agreement in preparation for the next raise. A “clean” cap table also indicates a deliberate capital structure and strategy. It will be expected that you resist founder dilution – investors want founders to have enough skin the game.*

\*\* Finding the valuation sweet spot

Some of the key things investors look for when investing are also relevant for founders to consider when valuing their own company in the course of funding. These include:

* The experience and/or past successes of the founders (whether in the current business or in others)
* The size of the market opportunity
* The IP already developed, and which is ideally wholly owned by the company (if ownership of the IP sits with the founder, investors will want this transferred into whichever entity they are investing into)
* Any initial testing results, use cases, or traction for the product or service (revenue, partnerships, satisfied customers, favourable publicity, etc.) showing progress towards an MVP
* The recurring revenue opportunity of the business model
* The capital efficiency of the business model (i.e., will the company need to burn through significant capital before reaching profitability?)
* Valuations of comparable companies
* Whether the company is being pursued by other investors / industry players
* The current economic climate (valuations tend to be correlated with the strength of the economy)

**WORKED EXAMPLE OF CAPITAL RAISING STAGES**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Stage 1** | **Stage 2** | **Stage 3** | **Stage 4** | **Stage 5** | **Stage 6** |  |
| **Company Progress** | Product | *idea* | prototype | MVP |  |  |  |  |
|  | People | *just me* | 2 founders | founders + 2 staff |  |  |  |  |
|  | Revenue | *$0* | $0 | $500,000 |  |  |  |  |
|  | Net Profit Pre-Raise | $0 | $0 | $0 |  |  |  |  |
| **Funding** | Amount Raised | $0 | $50,000 |  |  |  |  |  |
|  | Pre-Money Value | $0 | $0 |  |  |  |  |  |
|  | Founders' Post-Raise % | 100% | 85% | 68% | 54% | 44% | 35% | *dilute by 20% each round* |
|  | Target Investor | not raising | uncle jimmy | angel / local | venture |  |  |  |

**Your crack at it…**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
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