8 Things VCs Want to See in Your Startup Before They Invest

by Dennis Hammer

At some point, your startup may need money to grow—beyond what your friends and family can provide. You'll need venture capital.

VCs expect a substantial return on their investment, so they're willing to write *big* checks—the kind that can transform your business. Good investors also bring expert advice and helpful introductions to potential customers, rockstar teammates, and more.

In return, you're agreeing to earn them a large multiple on their money, typically within 5 to 7 years.

Before they open their wallets, VCs will do their due diligence. They'll ask you tough questions and expect solid answers. A VC who invested in one of my previous startups told me that he needs to believe that every one of his portfolio companies has the potential to go public—even though most of them never do.

In today's post, we're going to talk about the eight things VCs look for in a startup.

1. Momentum
2. Data and Evidence
3. Strong Management
4. Ownership for Sale
5. Healthy and Growing Market
6. Unique Product
7. Matching Philosophy
8. A Plan to Spend the Money

1. Momentum

Momentum is also called "traction," "progress," or "motion." It's an important quality VCs want to see in your startup, but it's also the most nebulous because each VC has his or her own definition.

Some simply mean sales. Others want to see you progressing along some type of plan, whatever that is. Some want to see iterative product development. Others want to see a methodical growth process.

Only about 2.5% of angel-funded startups ever go on to raise venture capital, so it's critical to show VCs that your company has substance and velocity.

Image: navfund.com

A lot of times when a VC says they "just don't see the momentum" or want to wait until you've "gained some traction," they just mean they're not ready to invest. They haven't seen whatever quality they're looking for that makes them feel comfortable.

It's sometimes tough to help VCs see momentum during your first pitch, especially if they've never heard about you before. Startup entrepreneur and investor Mark Suster recommends seeing VCs early and multiple times:

"If I see your alpha product then I can judge how it develops over time," he says. "If you have 2 developers and the next time I see you it's a team of 6 with a new head of products I can see momentum. If you have beta customers, new pricing plans, different positioning, more market insights, good press coverage—whatever—these are all signs that the ball is moving forward. And it is that momentum that is easier to judge than a single data point."

An early meeting with a VC is also a chance to ask what they would need to see in order to invest. Now you have a roadmap to follow. Keep checking back in along the way to update them on your progress. That way they get to know you over time, and they can see that you're hustling. You'll stand out from their other potential investments.

2. Data and Evidence

When you're asking someone to write you a big check, feelings and "gut instinct" aren't enough. VCs want to see hard data and metrics that support your claims—and they want to see how these numbers have improved over time. They're looking for evidence that you'll grow quickly enough to meet their investment criteria.

Here are some important metrics you may want to track:

- Monthly recurring revenue (MRR)
- Annual recurring revenue (ARR)
- Daily or Monthly Active Users (DAU or MAU)
- Churn and renewal rates
- Cash flow (burn rate and runway time, too)
- Customer acquisition cost (CAC)
- Customer lifetime value (LTV)

That list isn't exhaustive, of course. You'll have to decide what's relevant about your product. If a VC asks you to support a claim but you don't have the answer, tell him/her you'll get back to them with the figure. Make sure you have that number on hand for every other VC meeting moving forward.

You'll also need data about things outside your business. VCs want to know about your market (see below), your customer, and your product.

3. Strong Management

VCs want to invest in companies that scale quickly. That requires a team of talented people who know how to manage that type of rapid growth without burning through cash unnecessarily—and who can adjust the business model as needed. This means VCs are more concerned about the team than the idea or product.

The first time you pitch a VC, they'll be asking themselves, "Is this person a leader? Can they make hard decisions? Are they passionate and driven?"

"Tell me about your team and what you've done before," says venture capitalist Jeff Thermond. "Again, as an entrepreneur, it seems counterintuitive not to go straight to your great idea first. But, the vast majority of startups pivot their product or market focus at some point in the lifecycle of the company. What usually doesn't pivot is the team."

When you build your pitch deck, consider putting your team's bios up front (the key decision makers, big-name advisors, and maybe one or two other team members who bring exceptional skills or experience). Explain why your team is right to build a solid company.

4. Ownership for Sale

VCs want to own enough of your company to keep them interested, but not *so much* that you lose interest because you don't have a meaningful stake in the company anymore.

VCs typically want 20-25%, and sometimes as much as 35%, but it depends on the firm. They know they won't hit big with every company in their portfolio. The winners have to pay for the losers, so VCs need to own enough of the winners to make big moneys.

It's best not to go into your VC meetings with a hard percentage in mind. If you tell investors "We're willing to sell 20%, no more, no less," you're likely to alienate some VCs (unless you have awesome momentum, in which case you have more negotiating power). But don't be afraid to ask if they have a minimum ownership level.

Keep in mind that if you do well, current investors will likely want to buy more. Most funds keep money in reserve—called "dry powder"—for further investment in their winners. If you need more money in the future, you should call your current investors first.

Most importantly, don't be afraid to be protective of your share. If you truly think the company will be worth something substantial one day, investors will expect you to fight to keep as much of it as you can. Your reluctance to sell more than you absolutely need to works in your favor. It's better for investors if you keep enough ownership that you stay interested. You'll need to

devote 110% to your startup for it to succeed, so make sure you have what you need to stay motivated.

5. Healthy and Growing Market

VCs want to know whether there's a healthy market for your product. Even better – they want to know there's a *growing* market. The thinking is that "anyone can make money in a great market." If the market is too small—or shrinking—VCs won't trust they'll get a solid return on their investment.

How big of a market do they want to see? That's a tough question. It'll depend on their goals. A VC firm that specializes in healthcare companies will have a different definition for "big" than a firm that specializes in manufacturing, for instance.

"There's no firm definition, but generally speaking we're talking about $1 billion globally," says Allan Wille, co-founder of Klipfolio.

You'll also need to distinguish between the total available market vs. segmented portions that provide more opportunities. For instance, you might plan to eventually serve all size businesses in a market, but initially focus on companies with less than 50 people.

6. Unique Product

Defensible businesses are more attractive to VCs.

Remember, they want to go big. VCs aren't looking for companies that scrape out a little bit of market share. They want to invest in highly scalable companies that disrupt entire markets.

"Venture capitalists are looking to fund projects that are unique and can't be easily replicated," says Charley Polachi, partner at Polachi Access Executive Search. "Ideally, the technology or

service can be patented or trademarked to give the startup some breathing room and really allow the business some time to gain traction and market share."

What makes a product unique? It could solve a new problem, solve an old problem in a new way, offer a different price point, or serve a special niche. The more ways you can differentiate yourself from your competition, the better.

A defensible business is one that's hard for competitors to duplicate. It usually comes down to network effects, otherwise known as market share. Uber has lots of competitors but is still a popular VC investment because it is the leader in many markets.

Facebook paid $22 billion for WhatsApp because of how many users it had. How much would Facebook pay for the functionality of WhatsApp without the users? Nothing. Features can be copied, but your customer base can't.

7. Matching Philosophy

Every VC firm has an investing philosophy.

By specializing, they gain experience and niche-specific knowledge that helps them pick better investments. They learn the competitors, the technology space, and the customers. They learn what a profitable company *looks like.* This helps them make smarter decisions over time.

Some VC firms stick to certain industries, like transport, construction, retail, etc. Others focus on causes, like social issues or the environment. Some VCs only invest in companies at a certain stage.

Intel Capital, for example, is the investment arm of Intel. Since Intel makes semiconductor chips, their investment company invests into companies that use semiconductors. Basically, Intel's investment portfolio helps build companies that will buy Intel products. It's a waste of time to approach Intel Capital unless your startup will drive semiconductor sales.

8. A Plan to Spend the Money

Perhaps the most important question the VC will ask is "What do you plan to do with the money?"

Will you hire more engineers? Hire more salespeople? Invest in marketing? Acquire a small company for their tech?

We actually don't like these types of answers. Everyone knows you'll spend the money on salaries, technology, marketing, and maybe acquisitions.

Instead, we recommend telling the VCs what you'll accomplish with their money. Something like, "We're raising $1 million, which will give us 12 months of runway. During this time we'll triple our daily active users and 5x our monthly recurring revenue.

Whatever your plan, make sure it's clear, actionable, and supported by data. Outline the steps you'll take, even if they're vague. If you expect to come across obstacles, document those predictions too.

Check out our 10xU milestones slide template for a deeper dive.

Always Be Forthcoming and Transparent

VCs aren't just checkbooks—they're partners. Sure, the cash helps, but VCs can also give useful guidance and make valuable introductions.

When you pitch VCs, it's important to be honest, even about your flaws and challenges. Put everything on the table to help them make the best decision. If you mislead them in any way, you'll sour the relationship. If they learn you lied after they invest, you'll probably get hit with a lawsuit. At the very least, you won't get the help you need to build a world-class business.

It's also important to make sure you can work with them. You're getting into a long-term relationship, so make sure that you get along before you sign on the dotted line.

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