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Entrepreneurs Look to Angels and Micro-VCs for Cash

Glenn Luinenburg | 2/5/18

You don't need me to tell you it's a rough world out there for startups. Venture capitalists have been unusually stingy lately, hanging on to billions of dollars they'd typically be channeling into promising young companies.

When those investors do open their wallets, they're shunning risky investments in favor of what the Wall Street Journal called "the upper echelon of highly valued startups" such as Airbnb and WeWork. You could make a good case that these investors are taking the "venture" out of "venture capital."

Where does that tightfistedness leave cash-starved entrepreneurs? Praying for relief and looking to the heavens—for angels, of course. Entrepreneurs who are scraping together critical early-stage capital are more reliant than ever on angel investors, institutional angel funds, and micro-VC funds. These sources have become the new speculators in an ultra-cautious investment climate.

I'm seeing more seed and angel grants being made by micro-VCs and institutional-fund investors. These professionals work on behalf of third-party investors such as limited partners and pension or endowment funds. Their goal is to build a diversified portfolio of startups that spreads their risk over a larger base. This approach makes good sense when you consider that investors have done a pretty lousy job of picking winning individual companies for investment.

Wise entrepreneurs won't view angel or seed-round funding—typically $500,000 to about $2.5 million—as a consolation prize. Rather, it's a springboard to bigger bucks down the line. If they wisely deploy their angel or seed-round dollars, entrepreneurs will be well positioned to attract bigger investors with deeper pockets for a Series A round. A typical Series A round, which should keep a startup humming for six months to two years, has been clocking in at around $8 million, according to CB Insights data.

If you're courting micro-VCs or institutional fund investors—or if you're fortunate enough to have them be wooing you—you'll quickly discover that they're an experienced and discriminating bunch. Before they invest, they want to see a strong management team, a product, a market, evidence of the product market's fit, and that all-important traction.

But if you pass muster, you're golden. Because when a micro-VC or institutional fund investor has vetted a startup and invested, that lead investment validates the company for individual investors. Once a flagship investor is on board, you'll have a much easier time closing out your round.

The best time to position your company to secure its next round of funding is always well before you need that money. You can enhance your startup's attractiveness to all kinds of early-stage investors by heeding four key rules:

Balance your dollars and deadlines: I've seen more than one company burn through its angel round before completing its beta product. Don't be them. And don't confuse careful budgeting with traction. We all know startups that get their software out the door, only to discover they've built something that no one wants. That's the last thing a Series A investor wants to see.

Get your team in place and keep them there: Brilliant ideas and product roadmaps are worthless without the human capital to implement them. Investors will scrutinize your leadership, so be certain that your management team includes not just innovators but also focused executors.

Investors will consider what you have done to incentivize key players to stick around for the long haul. They don't want to invest in a company that is likely to lose its most talented individuals to the next hot startup. Most often, these incentives come in the form of stock options or other equity grants that vest over a period of years.

Don't give away the store: Relinquishing more than 15 to 25 percent of your company to your investors is risky. If your investors clamor for so much ownership that they can control your business decisions, they're indicating a lack of confidence in your leadership and vision. And that's just the beginning: Down the line, prospective investors may shy away from companies with unbalanced ownership structures. They may fear that founders will be less motivated to stick around as the value of their equity is diminished.

Prospective investors may also be concerned about the control and governance of a company controlled by investors. Will those investors have your company's best interests and long-term prospects at heart? Or are they merely focused on the fastest exist strategy so they can see returns?

Use your money wisely: Before you seek a round of financing, think about what's down the line. An entrepreneur may say he needs $2 million to create a beta product with significant traction. He'll want to raise $1 million now and then seek the rest in six months when he has a better valuation and, ideally, less dilution. That's a risky strategy because too much can go wrong.

When you're collecting capital, always raise enough to securely propel your business to its next funding milestone.

—Glenn Luinenburg is a trusted advisor to tech startups, late-stage private companies and pubic companies. Based in Silicon Valley, he's completed hundreds of VC financings and counseled founders on IPOs, acquisitions, seed financings and growth equity rounds.