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What founders need to ask their investors as they scale their companies

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Every founder should be thinking about the next step in their business, turning their company from a startup to a scaleup. To offer some insights into how entrepreneurs can make this leap, I turned to John Rafferty, a partner at the law firm of Morrison & Foerster, a firm that offers a special ScaleUp site that's filled with resources.

And for more on the topic of scaling your startup, join us Thursday night at Plug and Play in Sunnyvale for a special event sponsored by CDW dedicated to helping you grow your business. Click here for details and tickets, and get a special discount by entering "Smart17" into the promo code.

Rafferty responded to several questions I posed via email. Here's what he had to say:

If a founder is looking to venture capital or an angel investor to help raise funds for a scaleup, what are some important questions they should ask their potential investors?

A few of the most important questions a founder should ask potential venture capital or angel investors are the following:

What is the investor's ultimate expectations relating to liquidity of its investment in the company? It's important for the investor and the founder to have some alignment over the ultimate goal of the venture.

How involved in the company will the investor be? Some investors are extremely passive, while others are quite involved in providing leads on the commercial side of the business and providing overall guidance and advice to the founder as the business scales up. It's important that the founder have an understanding of what role, if any, the investor will have going forward with the company, so that there is no misunderstanding regarding expectations on either side.

Who will the founder's main point of contact be for the investor? This is the person



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representing the investor that the founder will be interacting with on a fairly regular basis, and it's important for the founder to feel comfortable with that individual. This is particularly true with venture capital investors (rather than angel investors) where there is typically a few different individuals at the venture capital firm involved with any particular investment made by the firm.

What are some key factors founders need to consider if they're in scaleup, as opposed to startup, mode?

Key factors a founder needs to consider as the company scales up center around protection of the company's existing assets, namely 1) intellectual property and 2) existing employees. As a company grows and hires more employees, trade secrets and confidential information of the company become available to more employees, particularly as the company increases its hiring efforts to support growth.

At the same time, retaining key existing employees remains quite important, as those employees that have been with the company for some time have the type of experience and institutional knowledge that often is extremely difficult for a company to replace. As a result, while funds may be allocated by a founder to hiring new employees, a founder will also want to consider how to allocate resources to help retain existing employees.

What are some hidden obstacles founders face as they try to scaleup?

One hidden obstacle a founder faces is to be careful not to devote all of the founder's time to fundraising efforts rather than the operation of the business. On the other hand, a related hidden obstacle founders face is not to start fundraising efforts too late when the company's existing runway is close to being depleted.

The fundraising process can overtake everything else the founder is doing with respect to the business, so the founder does need to balance his or her fundraising efforts with operational matters that require the founder's attention. But at the same time, a founder needs to make sure that fundraising efforts are initiated well before the company is nearing complete depletion of its cash resources, as the deal terms with potential investors often become much more investor friendly as the company becomes more desperate for a cash infusion.

Do you have a favorite piece of advice you give to every founder who is in scaleup mode?

A very wise friend of ours provided a brilliant question for any founder of a growing business: why would someone join your startup as employee #100. We think this requires deep thought by a founder, and the response helps differentiate winners and losers in human capital, financial capital and overall success.