15 Key Questions Venture Capitalists Will Ask Before Investing In Your Startup

By Richard D. Harroch and Larry Kane

Venture capitalists make decisions constantly about whether or not to invest in various startups. The majority of the time, the answer is no. There can be many reasons for this decision, including that the startup is not within the firm's focus or stage of desired investment. But assuming the company is within the investment parameters of the fund, here are 15 key determining factors for whether a venture firm will or will not decide to invest in a startup that is seeking venture capital.

Ready to pursue VC funding? Be sure you understand the kinds of questions investors will ask.

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1. Is There a Great Management Team?

Many investors consider the team behind a startup more important than the idea or the product. The investors will want to know that the team has the right set of skills, drive, experience, and temperament to grow the business. Anticipate these questions:

- Who are the founders and key team members?
- What relevant domain experience does the team have?
- What key additions to the team are needed in the short term?
- Why is the team uniquely capable to execute the company's business plan?
- How many employees does the company have?
- What motivates the founders?
- How do you plan to scale the team in the next 12 months?

Ultimately, the investor will need to make a judgment about whether the founder and team will be enjoyable to work with. Does the investor believe in the team? Is the CEO experienced and willing to listen? Also, involving experienced advisors can be very helpful in the early stages to help bridge an early stage team that is still growing.

2. Is the Market Opportunity Big?

Most investors are looking for businesses that can scale and become meaningful, so make sure you address the issue right up front as to why your business has the potential to become really big. Don't present any small ideas. If the first product or service is small, then perhaps you need to position the company as a "platform" business allowing the creation of multiple products or apps. Investors will want to know the actual addressable market and what percentage of the market you plan to capture over time.

For most investors, a "big" market opportunity is in excess of $1 billion in sales annually.

3. What Positive Early Traction Has the Company Achieved?

One of the most important things for investors will be signs of any early traction or customers. A company that has obtained early traction will be more likely to obtain venture financing and with better terms. Examples of early traction can include the following:

- The creation of a beta or minimally viable product
- Initial or pilot customers, especially brand name customers
- Strategic partnerships
- Customer testimonials
- Admission into competitive programs such as Y Combinator or other technology accelerators or incubators

Investors will want to know, How can the early traction be accelerated? What has been the principal reason for the traction? How can the company can scale this early traction?

Don’t forget to show early buzz or press you have received, especially from prominent websites or publications. Feature the headlines in a slide on your investor pitch deck. List the number of articles and publications mentioning the company.

4. Are the Founders Passionate and Determined?

Many venture capitalists look for passionate and determined founders. Are they individuals who will be dedicated to growing the business and facing the inevitable challenges?

As Paul Martino, General Partner of Bullpen Capital, says:

“We have a saying at Bullpen that we like ‘blue collar’ CEOs. That means that we like to see nuts-and-bolts operators, not pie-in-the-sky dreamers. Demonstrate that you’ve spent time looking up our background and investment portfolio finding mutual interests. I like founders who (1) know their metrics cold; (2) have a clear idea of the business they’re in; and (3) know how to grow it. What gets my attention is a hard-nosed, determined founder who, with a few operational pointers combined with a solid, already existing plan, can get to an even bigger outcome. That’s the kind of ride I want to take.”

Deepak Kamra, General Partner of Canaan Partners, makes a related point:

“Yes, you need to appear professional if you are going to be starting a serious business, but you need to show some passion and enthusiasm. Startups are hard, and they take a long time, and you will need to show that you have the inner drive to get through the highs and lows. This doesn’t mean you have to jump up and down and wave your arms. Perhaps it’s a story about what is driving you to get into your business, why it’s personal, or why there is nothing else you would rather do than spend the next 5 to 10 years living and breathing this idea of yours.”

5. Do the Founders Understand the Financials and Key Metrics of Their Business?

Venture capitalists look for founders who truly understand the financials and key metrics of their business. You need to show that you have a handle on all of those and are able to articulate them coherently.

Mark Patricof, founder of Patricof & Co., says:

"Know exactly what you want to spend your money on. Don't tell me how long it will last; tell me what you want to prove. The most impressive entrepreneurs communicate the value of their businesses through numbers. A conversation centered on a company's revenue growth, sales funnel, and customer churn causes an immediate connection with investors because when entrepreneurs position themselves as metrics-driven, it's as though they've entered an investor's mind."

Josh Stein, General Partner of DFJ Ventures, says:

"Know your KPIs (Key Performance Indicators). Effective entrepreneurs understand what their top priorities are and manage their companies by focusing their teams around a handful of critical metrics that reflect those priorities. I'm always interested when a founder can articulate her KPIs, talk intellectually about her team executing to improve them, and has a clear sense of where those metrics can be in a year or two."

6. Has the Entrepreneur Been Referred to Me by a Trusted Colleague?

Venture firms get inundated with unsolicited executive summaries and pitch decks. Most of the time, those solicitations are ignored. The way to capture the attention of a venture capitalist is to get a warm introduction from a trusted colleague: an entrepreneur, a lawyer, an investment banker, an angel investor, or another venture capitalist.

7. Is the Initial Investor Pitch Deck Professional and Interesting?

The first thing the venture investor will expect is to see a 15-20 page investor pitch deck before taking a meeting. From the pitch deck, the investor hopes to see an interesting business model with committed entrepreneurs and big opportunity. So make sure you have prepared and vetted a great pitch deck. Looking at other pitch decks and executive summaries can help you improve your own. See How to Create a Great Investor Pitch Deck for Startups Seeking Financing.

8. What Are the Potential Risks to the Business?

Investors want to understand what risks there might be to the business. They want to understand your thought process and the mitigating precautions you are taking to reduce those risks. There inevitably are risks in any business plan, so be prepared to answer these questions thoughtfully:

- What do you see as the principal risks to the business?

- What legal risks do you have? Will the business model comply with applicable laws, including expanding privacy protections?
- What technology risks do you have?
- Do you have any regulatory risks?
- Are there any product liability risks?
- What steps do you anticipate taking to mitigate such risks?

Startups that can show they have reduced or eliminated product, technology, sales, or market risks will have an advantage in fund-raising.

9. Why Is the Company's Product Great?

The entrepreneur must clearly articulate what the company's product or service consists of and why it is unique, so entrepreneurs should expect to get the following questions:

- Why do users care about your product or service?
- What are the major product milestones?
- What are the key differentiated features of your product or service?
- What have you learned from early versions of the product or service?
- What are the two or three key features you plan to add?
- How often do you envision enhancing or updating the product or service?

10. How Will My Investment Capital Be Used and What Progress Will Be Made With That Capital?

Investors will absolutely want to know how their capital will be invested and your proposed burn rate (so that they can understand when you may need the next round of financing). It will also allow the investors to test whether your fund-raising plans are reasonable given the capital requirements you will have. And it will allow the investors to see whether your estimate of costs (e.g., for engineering talent, for marketing costs, or office space) is reasonable given their experiences with other companies. Investors want to make sure at minimum that you have capital to meet your next milestone so you can raise more financing.

11. Is the Expected Valuation for the Company Realistic?

If you tell an investor you want a $100 million valuation even though you started the business three weeks ago, or don't have much traction yet, the conversation will likely end very quickly. Often, it's best not to discuss valuation in a first meeting other than to say you expect to be reasonable on valuation. But the venture investor also doesn't want to waste a lot of time on a deal if the valuation expectations are unreasonable or not attractive.

Valuation at an early stage of a technology company is more of an art than a science. To help bridge the valuation gap for early stage startups, you often see investors looking for a convertible instrument with customary conversion discounts and valuation caps. These instruments, such as convertible notes and "SAFEs," have become quite common. For more information about this, be sure to read [A Guide to Venture Capital Financings for Startups](#).

12. Does the Company Have Differentiated Technology?

As most venture investors invest in software, internet, mobile, or other technology companies, an analysis of the startup's technology or proposed technology is critical. The questions the investors will pursue include:

- How differentiated is the company's technology?
- What competitive advantages will there be over existing technology?
- How easy will it be to replicate the technology?
- How costly will it be to build the technology into each product?

13. What Is the Company's Intellectual Property?

For many companies, their intellectual property will be a key to success. Investors will pay particular attention to your answers to these questions:

- What key intellectual property does the company have (patents, patents pending, copyrights, trade secrets, trademarks, domain names)?
- What comfort is there that the company's intellectual property does not violate the rights of a third party?
- How was the company's intellectual property developed?
- Would any prior employers of a team member have a potential claim to the company's intellectual property?
- Is the intellectual property properly owned by the company, and have all employees and consultants assigned the intellectual property over to the company?
- If the intellectual property was developed at a university or through government grants or with open source technology, how does the company have the right to use the technology?

14. Are the Company's Financial Projections Realistic and Interesting?

If you present investors with projections showing the company will achieve $5 million in revenue in five years, they will have little interest. Investors want to invest in a company that can grow significantly and become an exciting business. Alternatively, if you show projections in which the company predicts to be at $500 million in three years, the investors will just think you are unrealistic, especially if you are at zero in revenues today. Avoid assumptions in your projections that will be difficult to justify, such as how you will get to a 400% growth in revenue with only a 20% growth in operating and marketing costs.

In order to believe your financial projections, investors will want you to articulate the key assumptions you have and convince them those assumptions are reasonable. If you can't do that, then the investors won't feel you have a real handle on the business. Expect that investors will push back on the assumptions and they will want you to have a cogent, thoughtful response.

15. Is Your Legal Formation Clean and in Compliance with Applicable Laws?

Investors don't want to invest in a company that has legal issues with the founders or third parties, failed to properly issue stock or options, failed to make securities law filings, has unaccredited investors, or hasn't complied with employment laws—these are all red flags. Before pitching your business, you need to make sure the company is clean from a legal perspective. An experienced startup lawyer can help significantly. See 10 Big Legal Mistakes Made by Startups.

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