Venture fundraising landscape Q3-23

Prepared by BDO Growth Advisory

In collaboration with

Focal

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Contents

Foreword

BDO are proud to have sponsored Focal's Summer and Winter demo days. We are a trusted advisor to founders, providing a range of services to help their businesses succeed.

The intention of this report is to provide insights into the present venture landscape and advice to benefit both founders and investors.

We approached 40 early-stage investors and have compiled the answers for those need-to-know questions that founders should be aware of ahead of pursuing a fundraise.

The findings of this report were informed by survey responses from UK-based investors, surveyed in September 2023.

Focal operates one of the world's largest startup demo days, powered by 200+ leading VC funds (Bessemer, Point Nine, Balderton, Atomico, Episode 1, dmg ventures, to name a few) and garnering 2k+ applicants per demo day.

We live by a mantra of collaboration over competition and are devoted to making the fundraising process dramatically more efficient and accessible.

To that end, we are delighted to work closely with BDO, which shares our vision for fundraising. This report is an important contribution to levelling up the fundraising process and we hope it becomes a key resource for founders.

BDO Growth Advisory – Specialist Growth Capital Fundraising Advisors

About BDO Growth Advisory

We're a specialist team within BDO, exclusively focused on supporting businesses seeking to fundraise from a variety of sources including venture capital, banks, specialist lenders, and private equity.

The team comprises a mixture of former investors and advisors granting us a unique investor lens and enabling us to expertly help businesses maximize the chance of securing a successful fundraise.

Please reach out to us if you would like our support or if you just want a friendly chat about your current or future fundraise.

Thank you for reading the report. We hope you find the information contained within insightful, and that it serves as a valuable guide during your fundraising journey.

Survey participants

The UK VC investor landscape is split between both tax led funds (SEIS/VCT/EIS) and non-tax led structures.

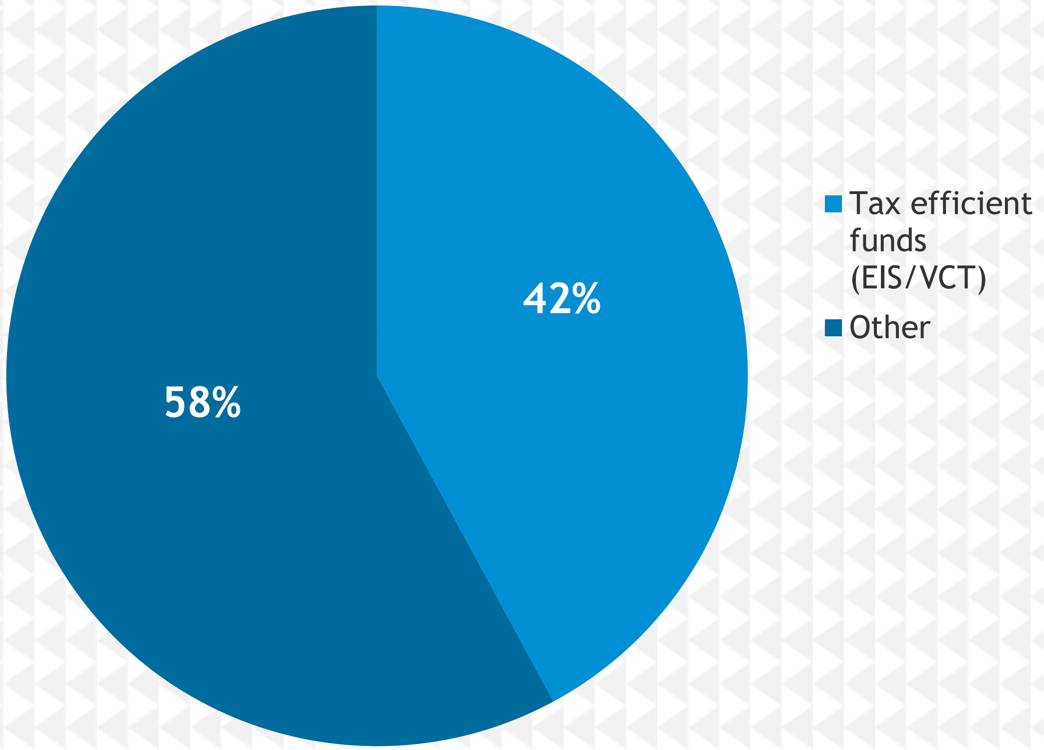
The following three pages illustrate the types of funds that participated in this survey including what their investment criteria are and how much they can invest in Q3-23.

42% of survey respondents required investments to qualify for VCT or EIS funding whilst the remainder were also willing to invest in non-qualifying investments.

For founders: Guidance of what businesses qualify for tax efficient investment and how to register for it can be found at:

SEIS, EIS and VCT tax relief – Tax – BDO.

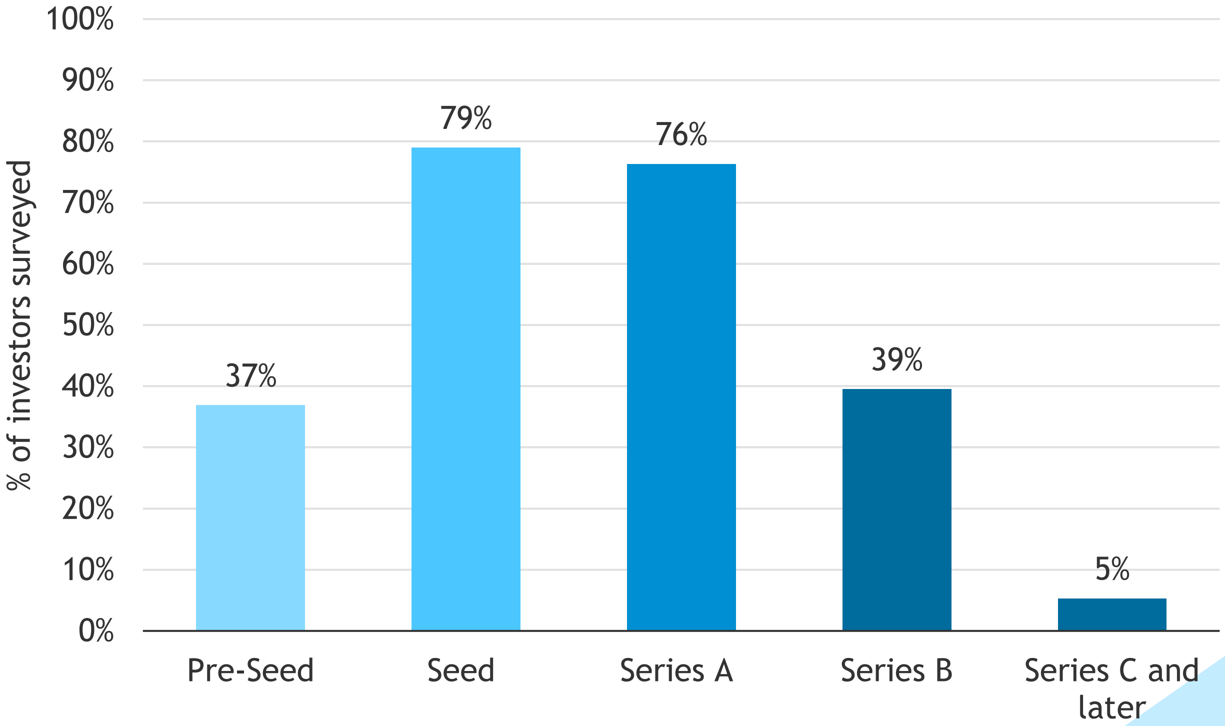
EIS/VCT requirement



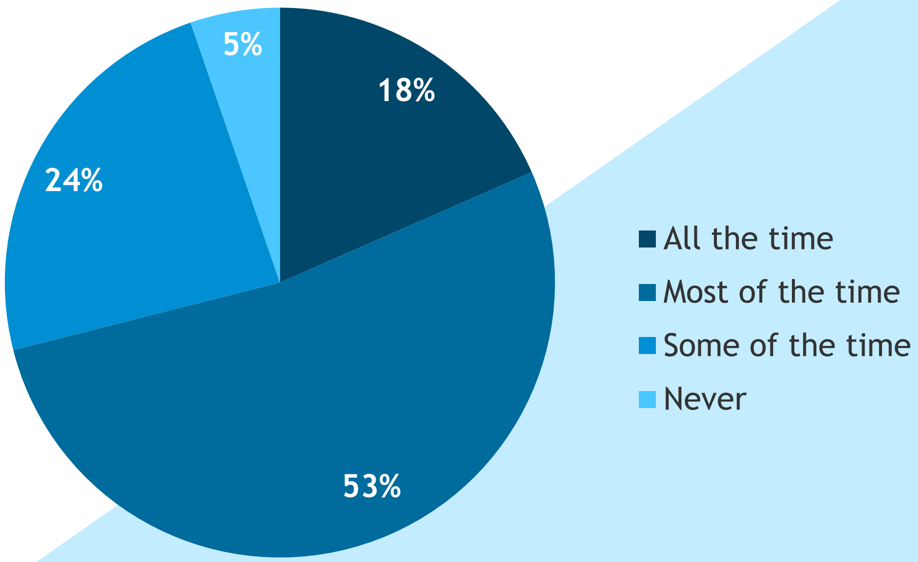
Survey participants

The majority of participants invest in Seed and Series A rounds.

Stages of investment



Propensity to make follow-on investments



95% of respondents make follow on investments at least some of the time.

71% make them most or all the time.

Survey participants

There are a wide variety of sectors that investors are looking to deploy into.

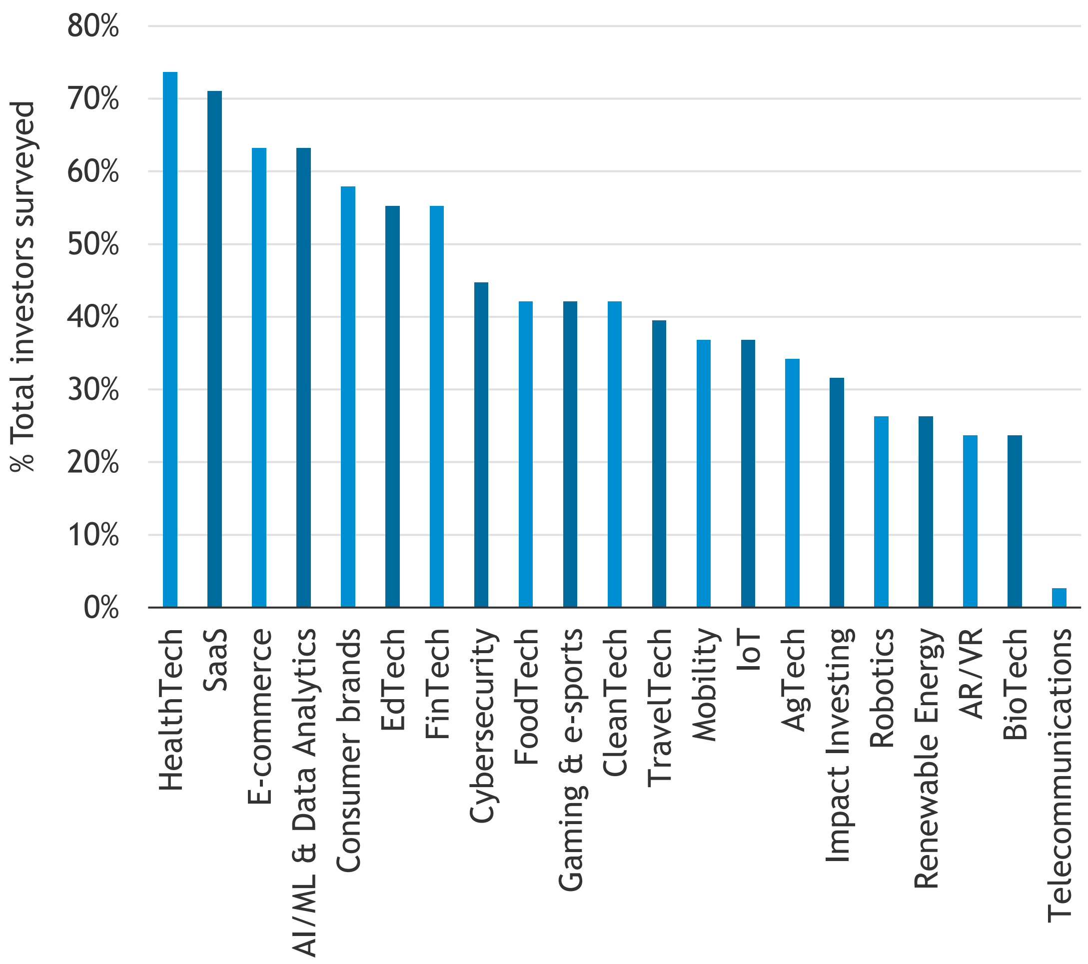
Sectors of interest

Sectors attracting most investor interest in Q3-23 include:

- HealthTech (sought by 74% of funds)
- SaaS (71%)
- E-commerce (63%)
- AI/ML/DA (63%) and;
- Consumer brands (58%).

71% of the surveyed funds expressed interest in the Software as a Service (SaaS) sector. This may be attributed to SaaS being a overarching feature across numerous sectors rather than a distinct sector of its own.

AI/ML (63%) has been a hot sector this year but also polarizing. Whilst some funds have been enticed by the growth potential of these businesses, others have reservations about the high multiples at which these are trading and the difficulties in appraising these businesses.



Deal process

How long does a deal process take? When should a company start looking for investment?

The following pages will discuss what the deal process looks like in the current economic climate including how long it takes and the number of meetings required to make an initial offer.

Our conversations with founders have highlighted that many don't appreciate just how long it can take to fundraise in the current climate. Many have commenced fundraising too late and with inadequate cash reserves. This can expose them to financial pressure and ultimately force them to accept less favourable investment terms than they otherwise would have – or worse, run out of cash completely before closing a round.

For Series A or later stage investments, we now recommend founders begin preparing to raise when they still have 8-12 months of runway left (Seed fundraises can be quicker). Whilst many startups fundraise in a shorter time than this, it prudently allows for a slow fundraise and a cash buffer with which to execute an alternative strategy, should they ultimately fail to raise.

Series A+ investment timeline

11 months of runway left

4-5 weeks
- Prepare model, pitch deck and dataroom.

2-3 weeks
- Investor outreach with teaser deck
- Initial investor meetings.

4 weeks
- Circulate full deck and model
- Subsequent meetings including management presentations
- Offers received and negotiated.

8-10 weeks
- Due diligence (legal, financial, commercial, tech and management)
- Legal documents prepared
- Investor approval and funds secured.

4-6 months
- Buffer period
- Allows time to plan and execute a Plan B if no funding secured.

Runway ends

Deal process

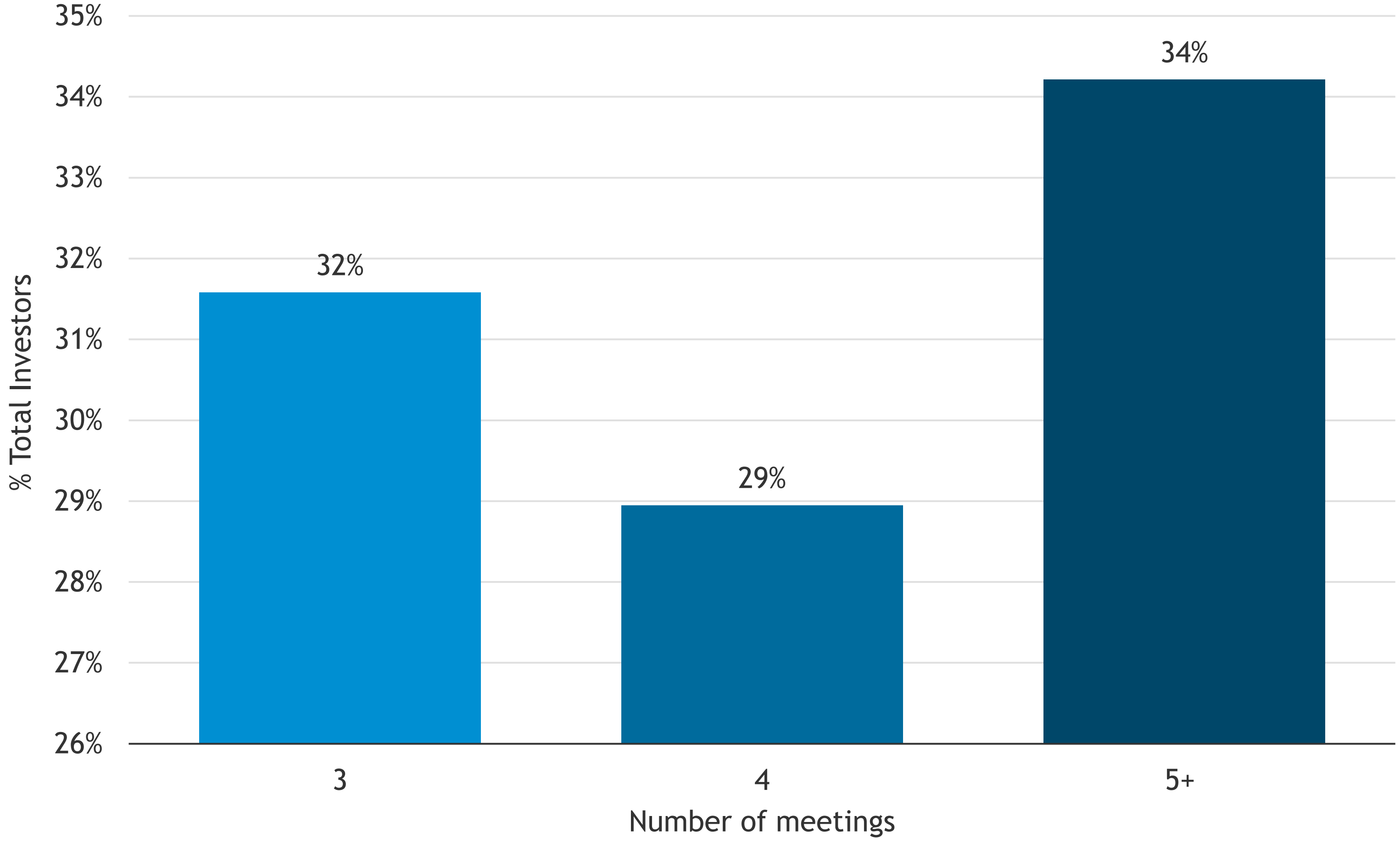
How many meetings should founders expect with an investor before receiving an indicative offer?

34% of the investors featured in this survey typically require five meetings or more.

In contrast, for pre-seed investors, 50% will have three meetings or less reflecting the reduced complexity of early-stage businesses and the reduced time needed to get comfortable with an investment case.

Founders should expect a fairly informal first meeting, for example a chat over a coffee. This generally gives us a better understand of what a founder is looking for in an investment partner and what their ambitions for the businesses are. As conversations progress, meetings typically become more focused on specific topics and areas of growth, which ultimately help build conviction around a potential investment

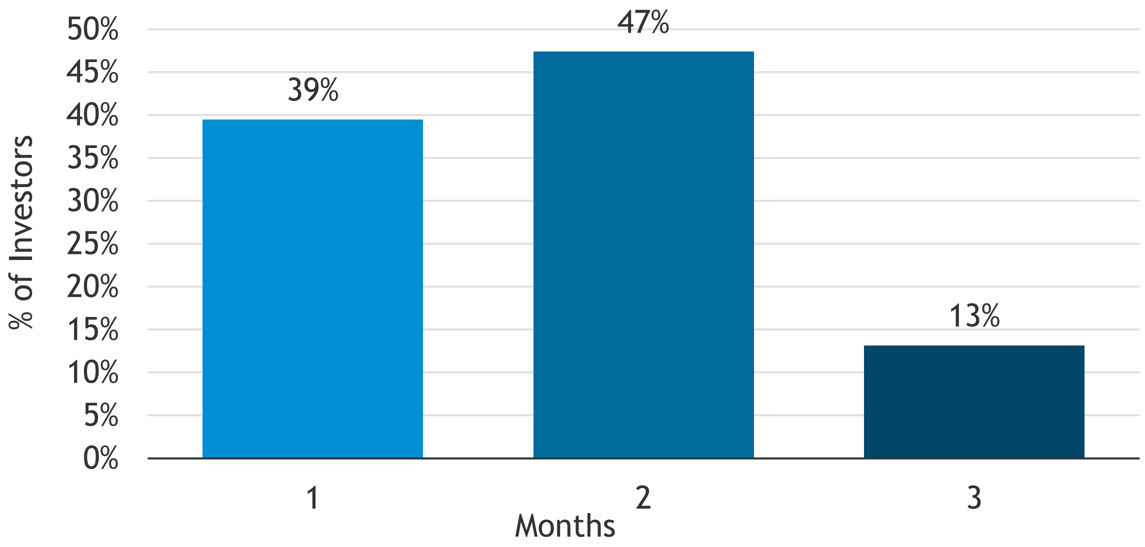
Ben Pitt
Investor at YFM



Deal process

The length of a deal process is dependent on several factors. The funding stage is a key determinant.

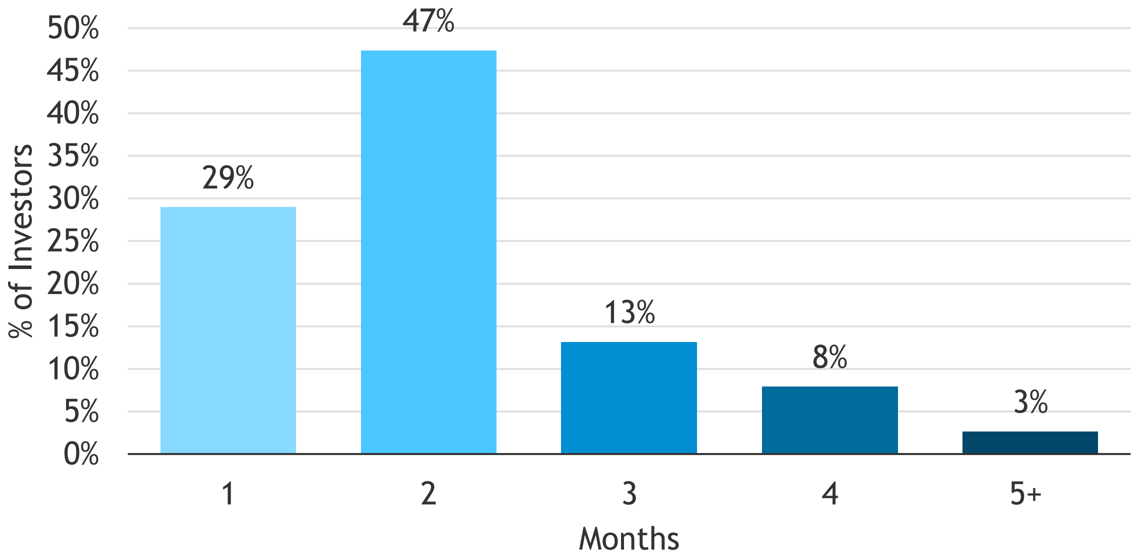
Time taken from first conversation to term sheet offer



This chart illustrates the time required between first conversation and the offer of a term sheet.

For pre-seed investments, 50% require just one month, 36% take two months and 14% take three. In contrast, for Series A+ rounds, 31% take one month, 52% take two and 17% take three months.

Time taken from exclusivity to completion



The chart illustrates how long fundraising typically takes from exclusivity to completion.

Whilst 76% of funds typically get through this stage in one-two months, 3% can take five or more months. For pre-seed businesses, 50% require just one month, reflecting the reduced level of diligence required given the typical age and size of the businesses in this bracket.

Deal process

Founders should expect investors to conduct various due diligence before completion of a deal.

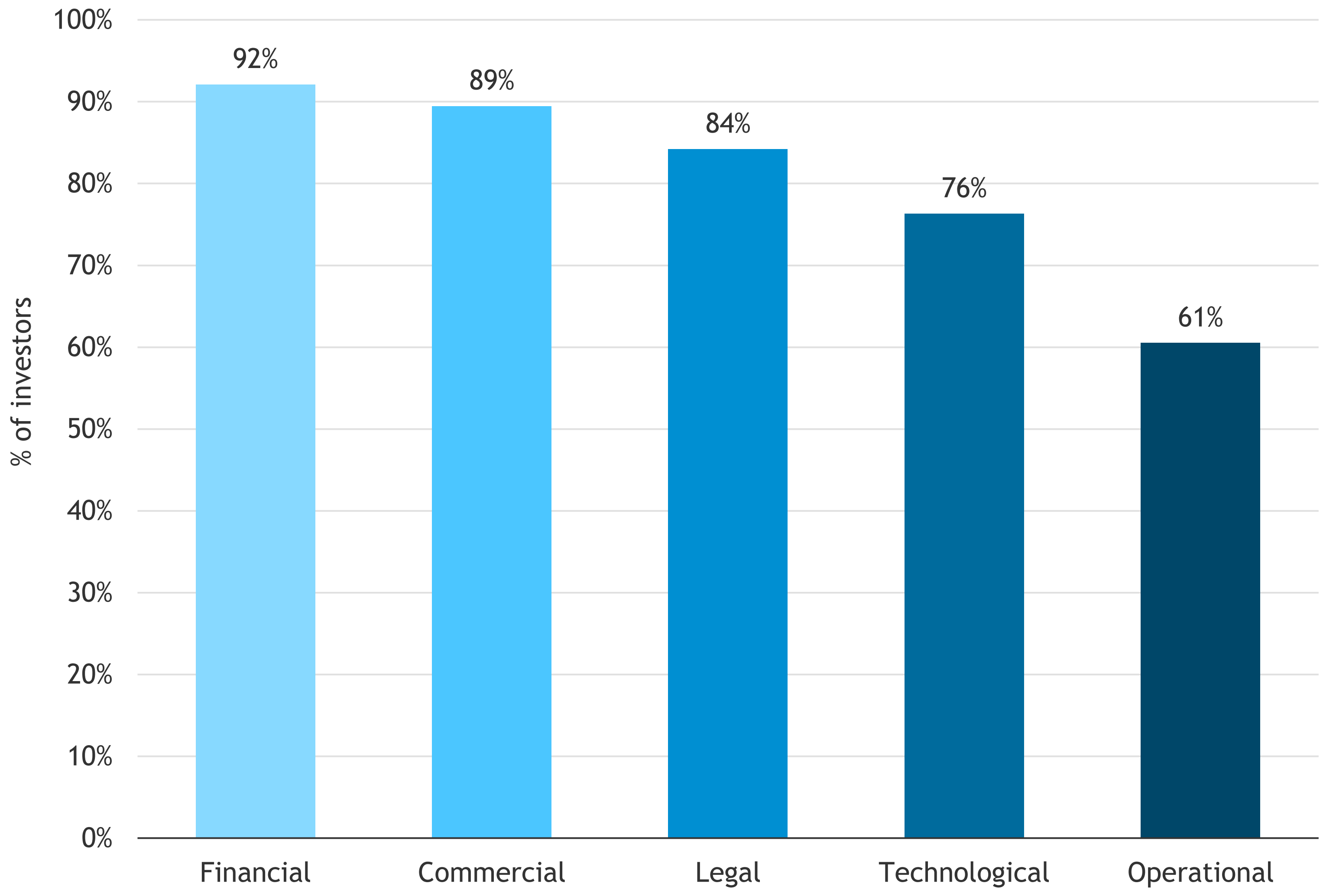
Types of diligence carried out

Regardless of whether the round is pre-seed, seed series A+, financial and commercial diligence is conducted by 92% and 89% of investors respectively.

In contrast, other diligence categories are employed more frequently as rounds progress from pre-seed to Series A+.

“Founders can best prepare for due diligence by ensuring that their data rooms are up to date, comprehensive and ready for viewing early on in their investment journey. The DD process can typically take anywhere from two to 12 weeks depending on the stage of investment, complexity of the business and the readiness of the information required.”

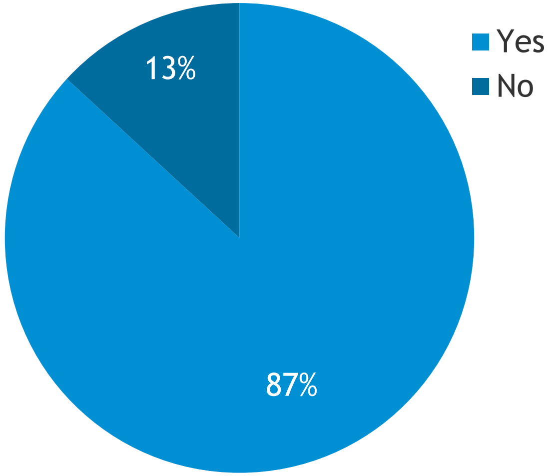
Nico MacDonagh
Investor at VGC Partners



Deal Structuring

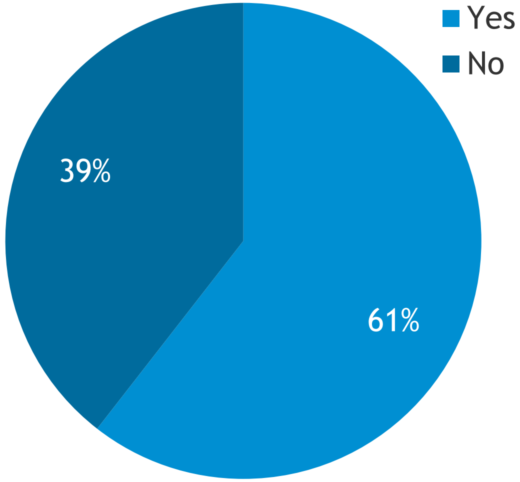
How investments are made, and the instruments used in early-stage deals.

Investors using instruments other than ordinary shares* when making investments.



87% of investors seek to use structuring when making investments. This is slightly less common in pre-seed rounds (79%) than in series A+ rounds (90%).

Investors who have used convertible/ASA instruments in the last 12 months



61% of investors have invested via a convertible/ASA structure or similar in the last 12 months. This was more common in seed investors (70%) than in pre-seed (64%) or series A+ (52%).

*What are the instruments other than ordinary shares?

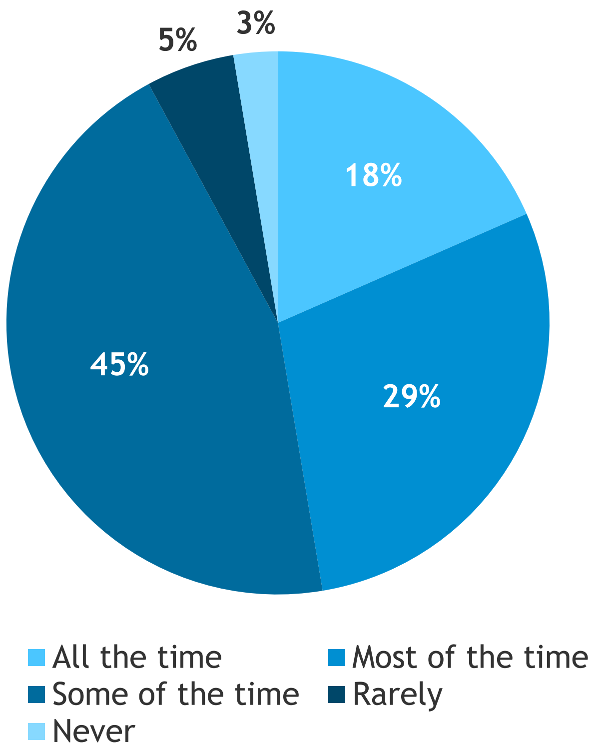
Investors typically use instruments such as participating preference shares, non-participating preference shares and convertibles. They are used to strike a balance between downside and upside potential and will be determined on a deal by deal basis. It is important for both founders and investors to acknowledge the impact that the deal structure has to each party to achieve alignment from the beginning of the relationship.

The definitions of the most common instruments (as mentioned above) used from pre-seed to series can be found in the appendix.

To discuss instruments and deal structuring, please contact BDO – growthadvisory@bdo.co.uk

Deal Structuring

Investors likelihood to co-invest on initial investments



Just 3% of investors will never co-invest whilst 18% always co-invest and 29% expect to co-invest most of the time.

Co-investing provides VCs with a number of advantages including allowing them to participate in larger and more attractive deals by partnering with other investors, leveraging the expertise and networks of their co-investors and most importantly, sharing the risk of the investment.

However, it is not without its challenges too, particularly in respect of aligning interests, specific terms and managing relationships and expectations.

"A diverse group of investors can bring a range of insightful perspectives to the table, as well as more people to lean on at future fundraisings! There are, of course, a few downsides. One which may seem trivial but is often overlooked is getting all parties to agree on the legal docs at investment. It can be a painful and expensive process. Agree on an action plan with your lawyers upfront on how to efficiently incorporate comments from multiple groups of investors!"

Taos Edmondson
Principal at DMG Ventures

"A strong syndicate of investors can add significant value versus just having one investor. However, it is important to understand whether a VC will still offer their full suite of value-add even if they don't have as large stake in the business as they'd normally target."

Hector Mason
General Partner at Episode 1 Ventures

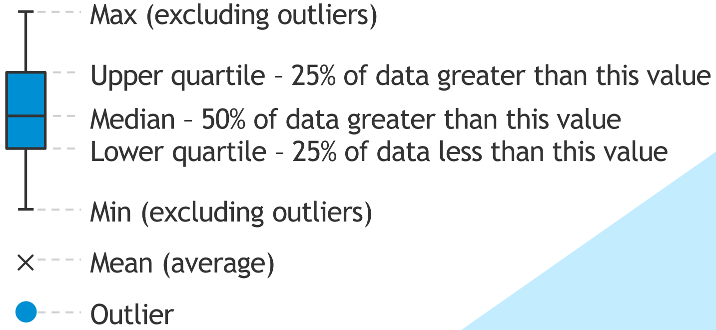
Founder Expectations

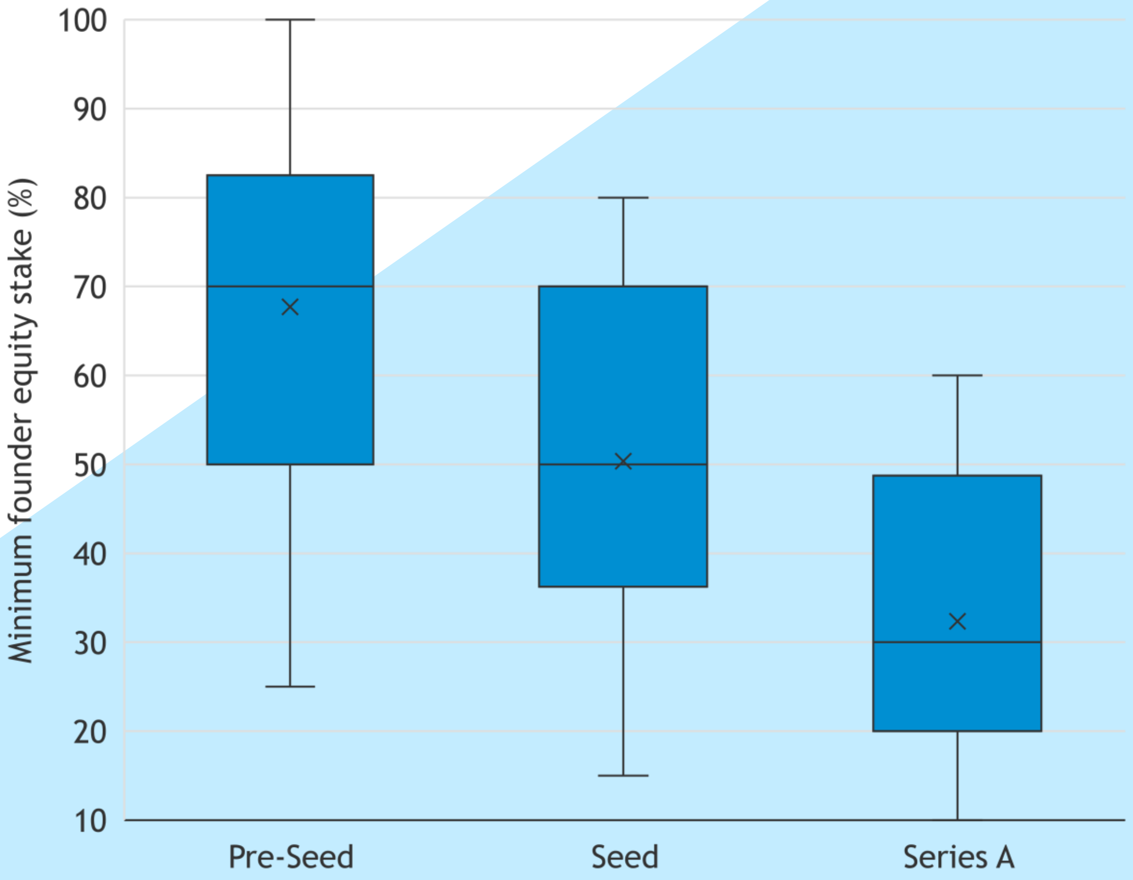
Investors are mindful of the equity that founders hold in their businesses.

Minimum acceptable founder equity stakes at the various investment stages

Investors will want to ensure that at the point of investment and considering potential further dilution from subsequent rounds, founders have a sufficient equity stake to ensure they remain fully committed and incentivised to grow the Company.

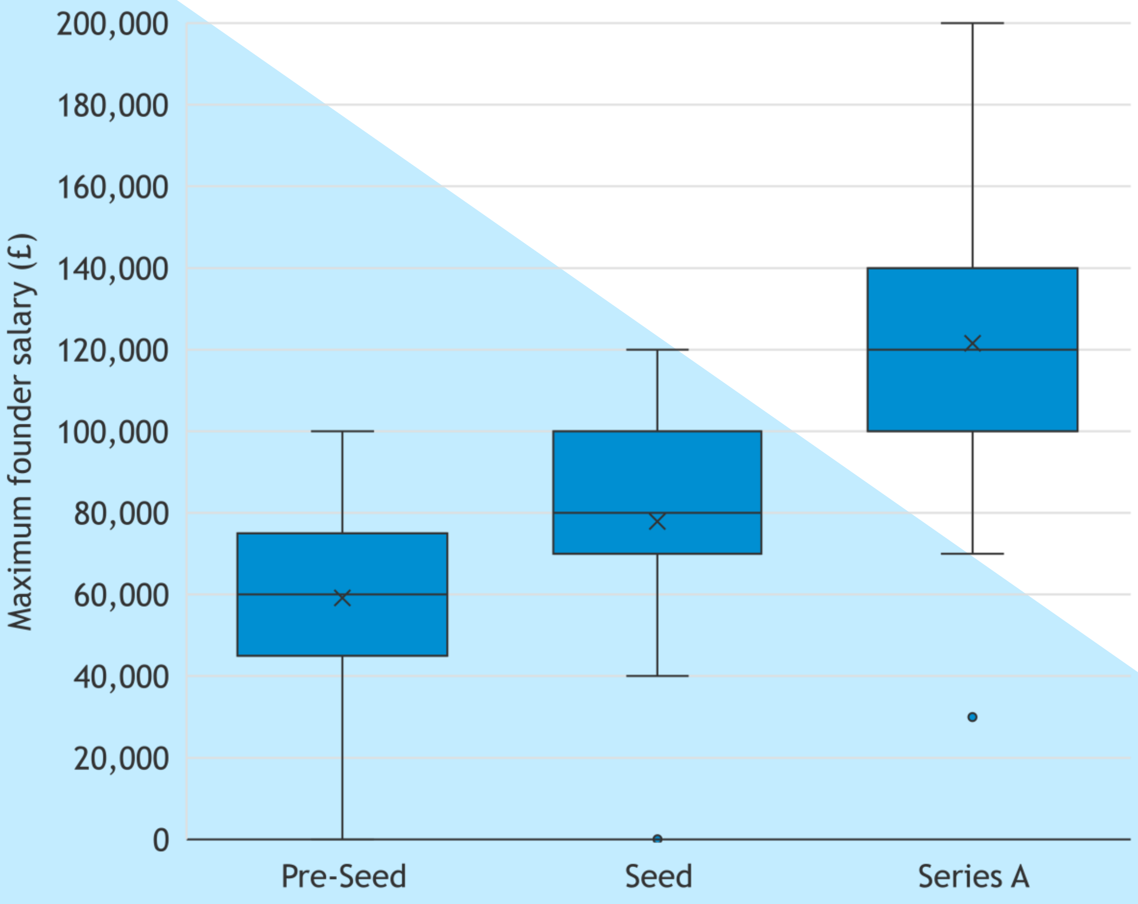
When asked what the minimum founder-equity-stake an investor would be comfortable with pre-investment, pre-seed investors' answers mostly ranged from 50% to 83% (with an average of 70%), seed investors' answers ranged from 36% to 70% (with an average of 50%), and finally, Series A investors' answers ranged from 20% to 49% (with an average of 30%).





Founder Expectations

When forecasting, founders should consider their salary expectations.



Maximum founder salaries at the various investment stages

While investors will want management to be sufficiently incentivised to grow the business as previously described, they are also cognisant of the fact that founder salaries decrease the cash available to invest in growing the business.

When asked what the maximum salary they would expect for a founder at the different stages of investment, pre-seed investors' answers ranged from £0 to £100,000 (with an average of £59,130), seed investors' answers ranged from £0 to £120,000 (with an average of £77,931), and finally, Series A investors' answers ranged from £30,000 to £200,000 (with an average of £121,515).

£59k Pre-Seed – Average Founder Salary

£78k Seed – Average Founder Salary

£122k Series A – Average Founder Salary

Management Criteria

Most investors would want at least two members of the c-suite in place at the time of making an investment

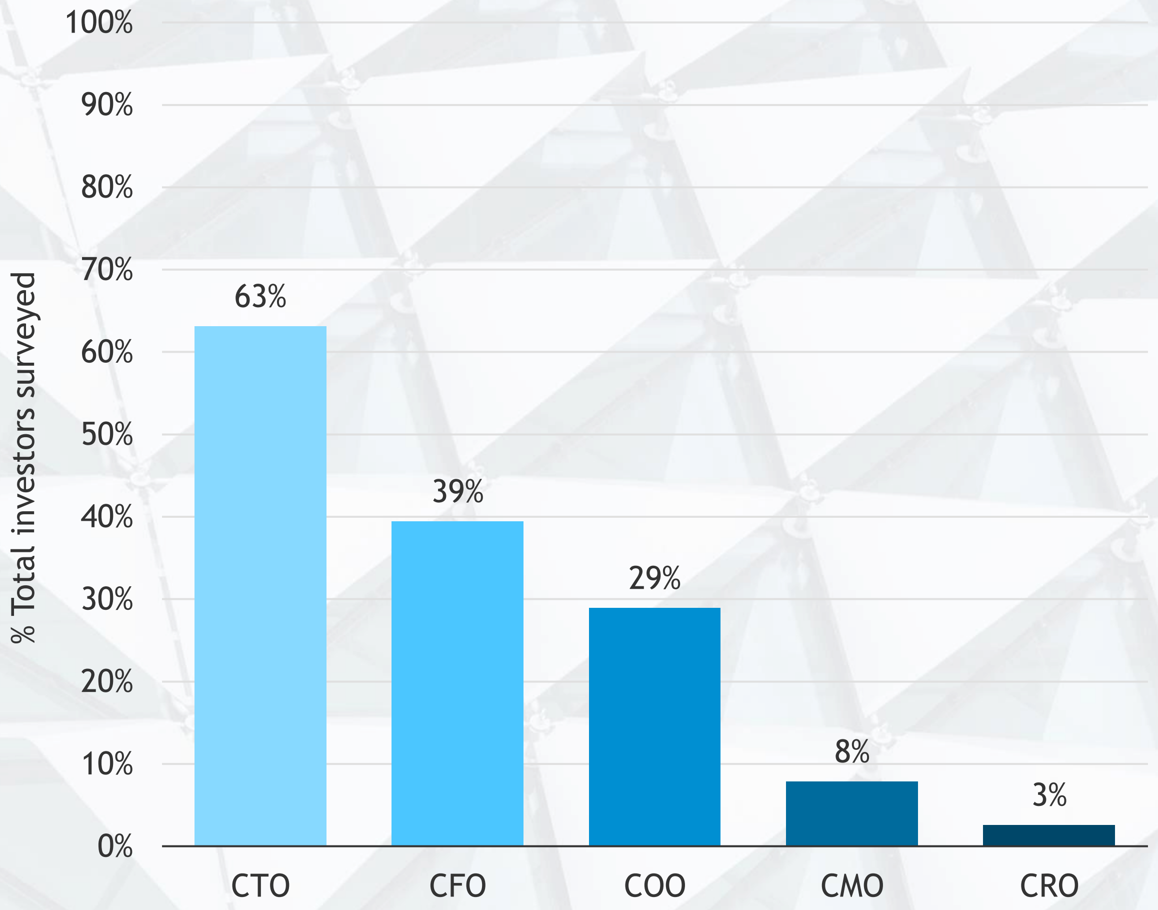
C-suite appointments expected at the time of investment

As you prepare for a larger funding round, and in particular a Series A round, investors will expect the senior management team to have grown around the CEO as the business has scaled.

If these people are not in place already, they are likely to expect a recruitment roadmap which clearly outlines who the key hires will be and the roles they will fulfil.

"It's important that the founder has considered the C-suite that is needed to deliver on the next phase of growth before meeting investors. We rarely invest in a business with a fully formed c suite in place and a key part of our initial DD will be the hiring plan, and understanding why the company needs specific roles and skillsets. To the extent possible, having some senior hires already integrated into the business is a strong positive indicator as it shows the founder can share responsibilities which will be crucial as the business scales."

Ben Leslie
Investment Director at Puma Private Equity



Investment Criteria

Revenue at the time of reaching out to investors is important to gain the most traction

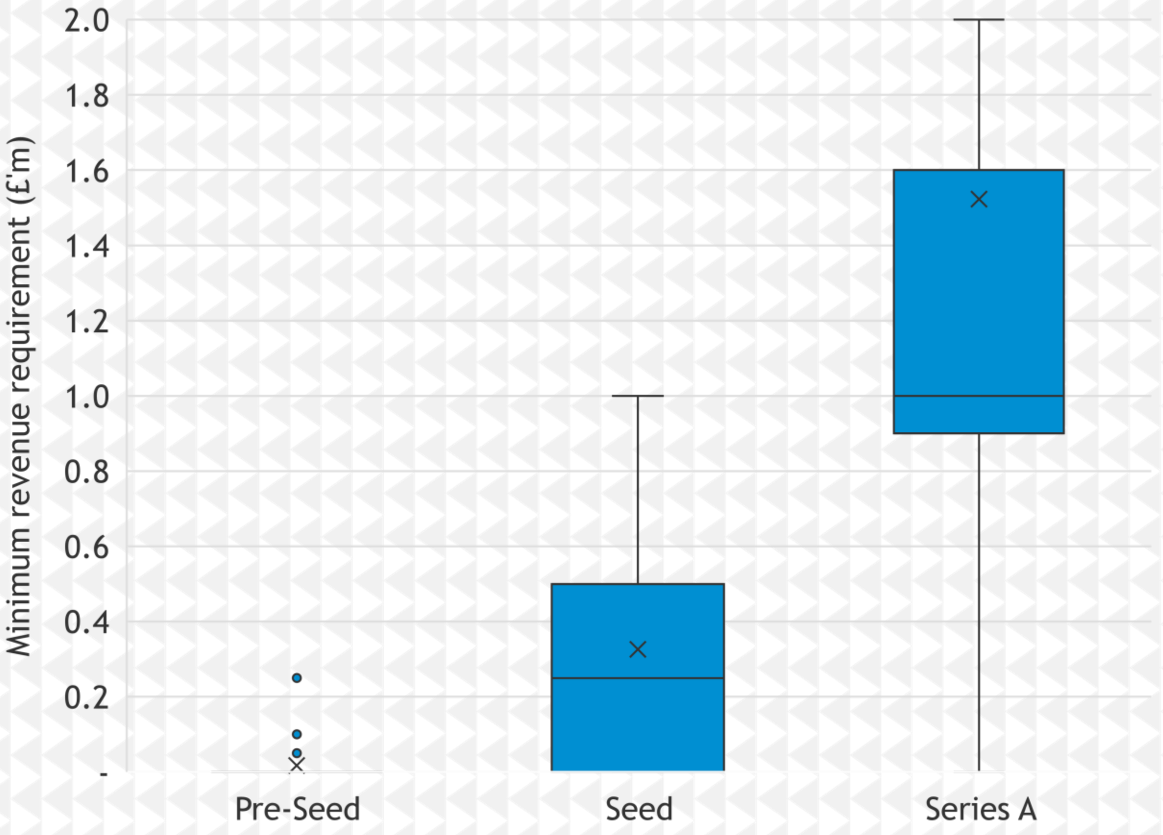
Minimum revenue requirements

When we asked investors what their minimum revenue criteria are:

- **87% of Pre-seed investors responded saying that they do not have a minimum revenue requirement;**
- **Most seed investors answers ranged from £0 to £500k (with an average of £250k);**
- **Most Series A investors' answers ranged from £900k to £1.6m (with an average of £1.0m).**

We noted that the funds requiring greater revenues (e.g. £5m+ for a Series A round) largely invested in consumer brands.

We also noted an apparent funding gap between Seed and Series A with respect to minimum revenue requirements. A Company currently earning between £500k and £1m in ARR may be too mature for a Seed investor but may not meet the minimum revenue requirements for most Series A funds. This highlights the importance of raising enough money at Seed to be able to grow past the £1m ARR threshold before requiring further investment.



Note: the above graph excludes statistical outlier points of £5m and £8m at Series A

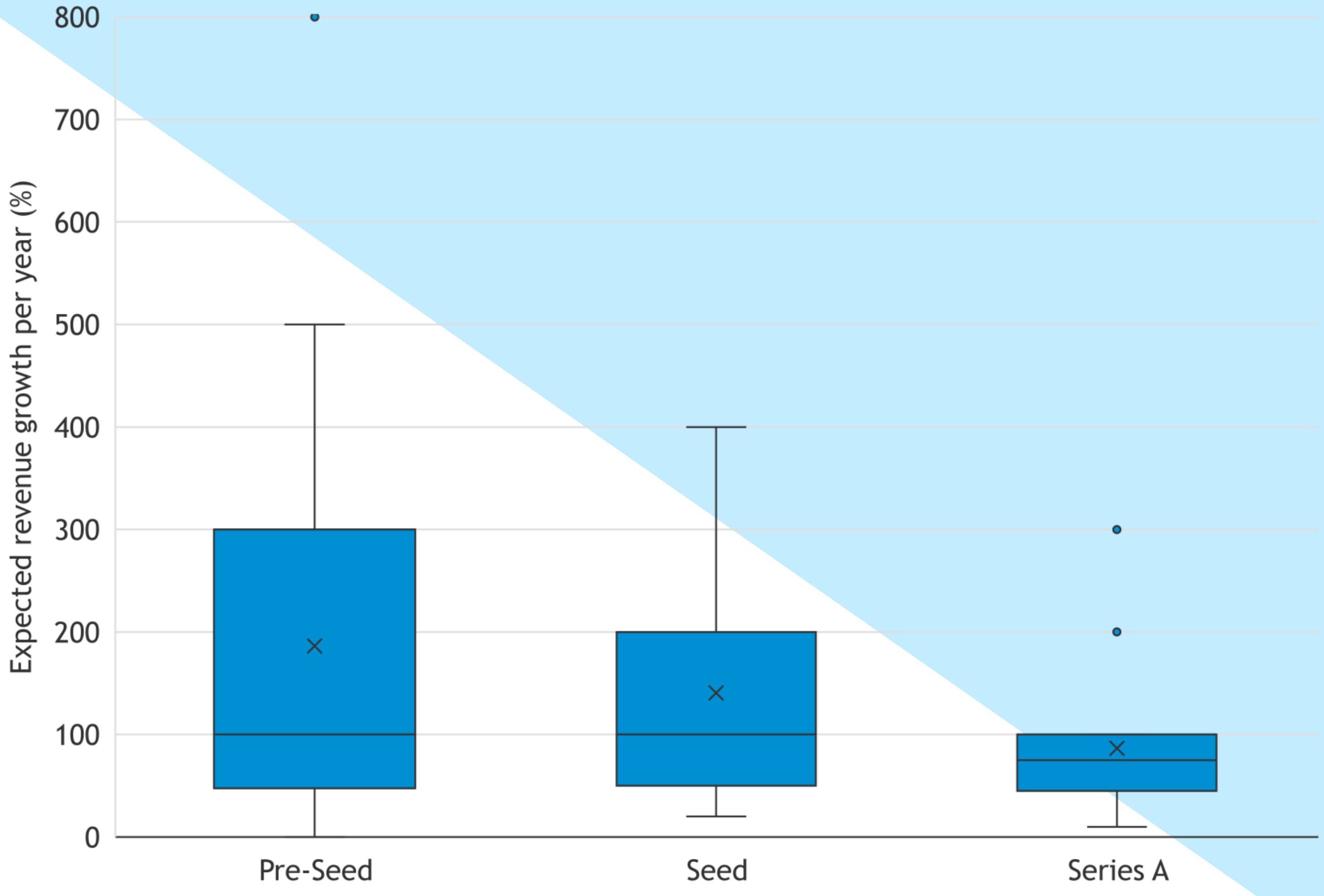
Investment Criteria

Investors need to observe 'product market fit'. One way to determine this is by assessing revenue growth.

Revenue growth expectations

While revenue growth is heavily dependent on sector and other investment-specific variables, when asked what level of YOY revenue growth they would typically expect post investment:

- Most Pre-seed investors' answers ranged from 48% to 300% (with an average of 100%)
- Most Seed investors' answers ranged from 50% to 200% (with an average of 100%)
- Most Series A investors' answers ranged from 45% to 100% (with an average of 75%)



Investment Criteria

For early and growth-stage investors, the quality of the founder and management team is key.

We asked investors 'what are the three most important qualities they seek in a prospective investment?'

1. **Strong founder/management team (95%)**
2. **Large and growing market (55%)**
3. **Strong unit economics* (53%).**

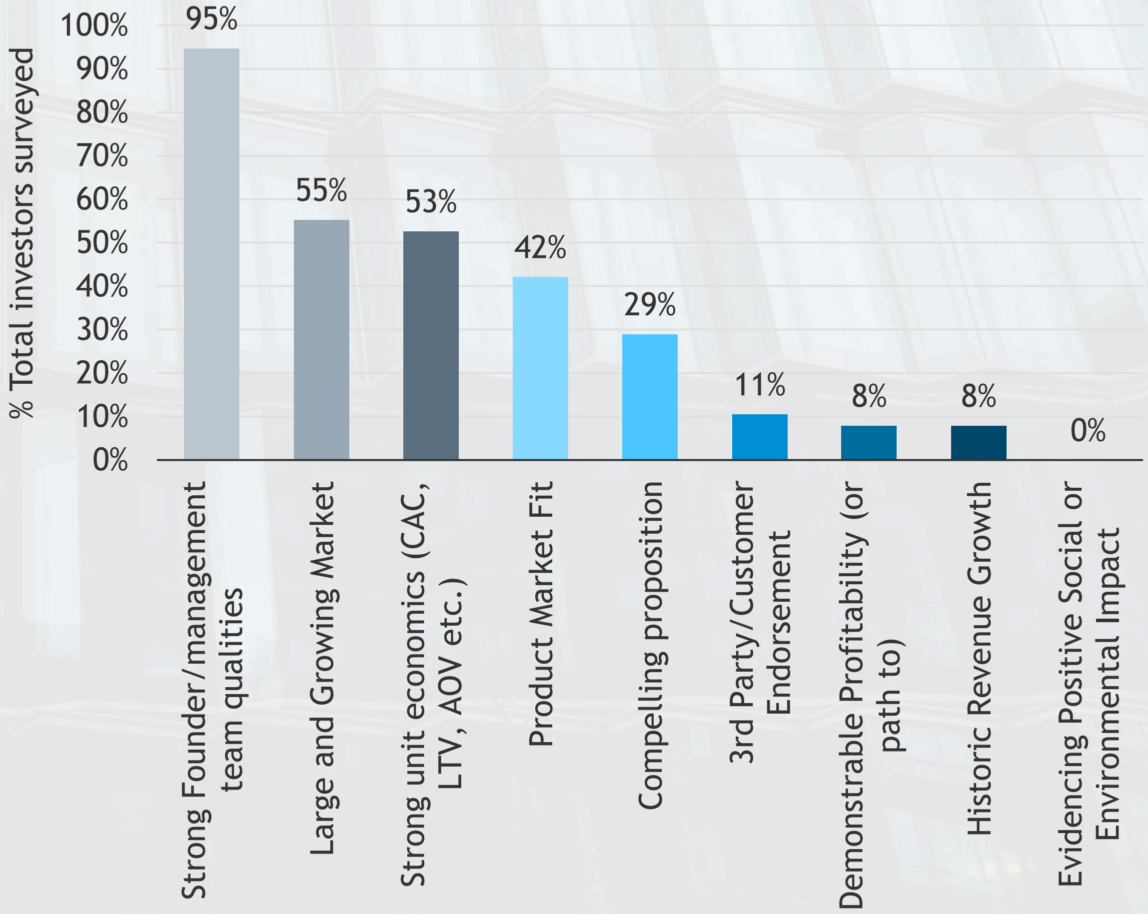
From here, we can conclude that whilst other qualities are important, the fundamentals of an 'investable company' is one that is led by a strong management team, in a market with a large opportunity, that can evidence a scalable and capital efficient business model.

**See appendix for examples of strong unit economics.*

BDO can ensure key qualities are brought out in your deck. For support please contact - growthadvisory@bdo.co.uk

"Evidencing social or environmental impact isn't sufficient to win you a deal, but if you put it in dollar terms, it might get you through the door. Ultimately, if you're an exceptional team with a stepwise solution to a billion-dollar problem, you're half the way there"

Ed Phillips
Partner at Future Planet Capital



Investment Criteria

What characteristics are most important in a founder?

VISIONARY | PERSPECTIVE | ADAPTABLE

HONESTY | ENTERPRISING

COMMERCIAL ACUMEN | HUMILITY

GRIT | RESILIENCE

STORYTELLING | GRAVITAS

PASSION | OPEN TO FEEDBACK

AMBITION

SECTOR KNOWLEDGE

PEOPLE MANAGER | TENACITY

ETHICS | HARD-WORKING

ENERGY | INTELLIGENCE | MARKET FIT

INTEGRITY | EXPERIENCED

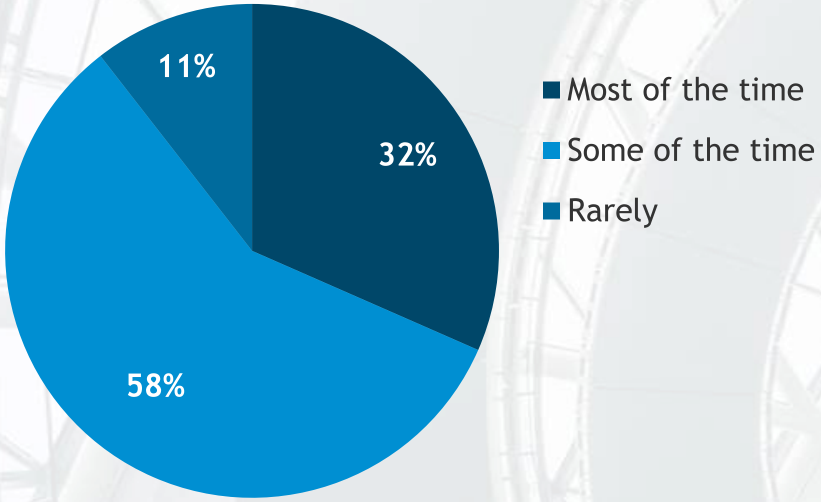
DRIVE | ENTHUSIASM

COACHABLE | LEADERSHIP

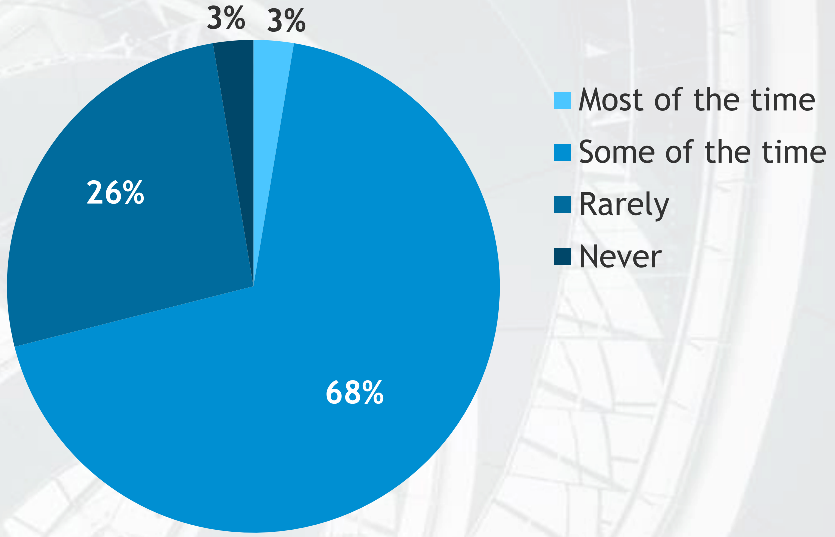
Potential Reasons for Investment Failure

Valuation is key for both founders and investors. It's important that both are aligned before progressing further.

How often are founder expectations are aligned with investors on valuation.



How often does misalignment on valuation obstructs investment.



90% of investors surveyed reported that founder expectations are misaligned on the topic of valuation at least some of the time and 32% of investors found this to be the case most of the time.

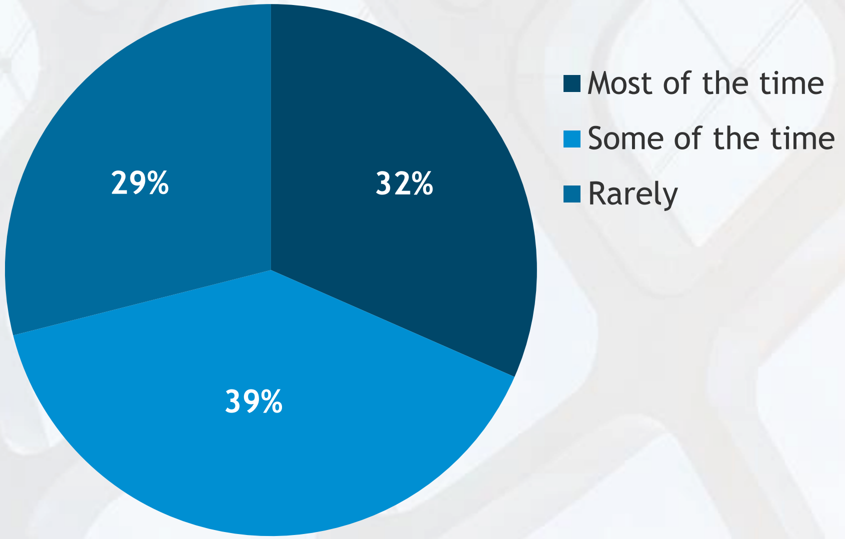
Just 3% of investors say that misalignment on valuation would make them walk away from a deal most of the time. This suggests that, whilst a founder and investor eventually need to come to an agreement, the founder should feel confident to pursue a deal process even when negotiation on valuation is still ongoing.

To determine a fair valuation before commencing negotiations, please contact BDO Growth Advisory – growthadvisory@bdo.co.uk

Potential Reasons for Investment Failure

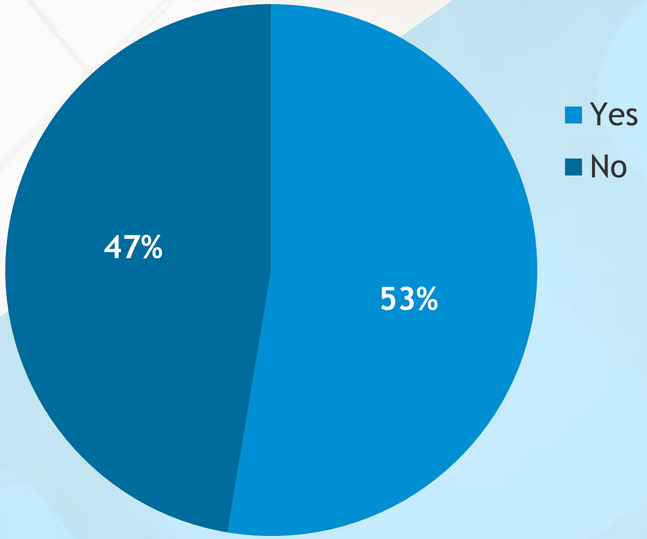
As a founder looking to raise VC investment, diligent preparation before going to market will enhance your chances of success.

How often are the companies 'deal ready' when they contact investors.



Investor sentiment was inconclusive when asked how often companies are 'deal ready'. To be 'deal ready' a business should have a complete data room (including deck, model and pipeline) and be able to provide additional information in a timely manner.

Does a lack of readiness result in investors walking away?



53% of investors would regard lack of readiness as a deal breaker so the consequences of failing to be sufficiently prepared are high.

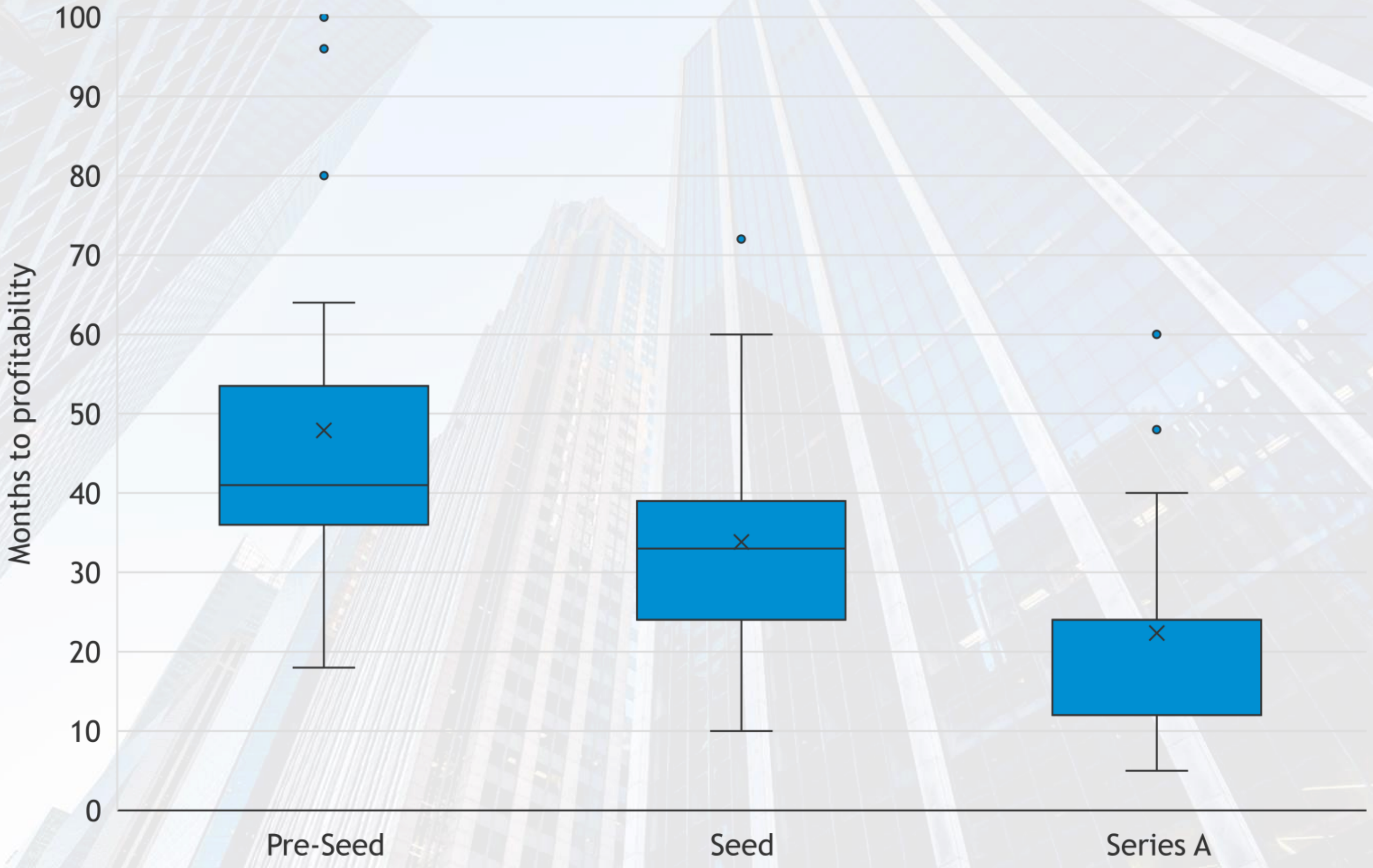
If you are unsure whether your data room (including model) is 'deal ready', please contact BDO - growthadvisory@bdo.co.uk

Path to Profitability

Investors no longer tolerate indefinite losses. An understanding of when and how a company will begin to be profitable is important.

Given the current economic climate, a demonstrable path to profitability is at the forefront of investors' minds. This is increasingly relevant as a company progresses through the various investment stages. When asked how long after an initial investment they would expect a portfolio company to become profitable:

- Most Pre-seed investors' answers ranged from 36 months to 54 months (with an average of 41 months);
- Most Seed investors' answers ranged from 21 months to 39 months (with an average of 33 months);
- Most Series A investors' answers ranged from 12 months to 24 months (with an average of 24 months).



To discuss how you can demonstrate a robust path to profitability through your model , please contact BDO Growth Advisory - growthadvisory@bdo.co.uk

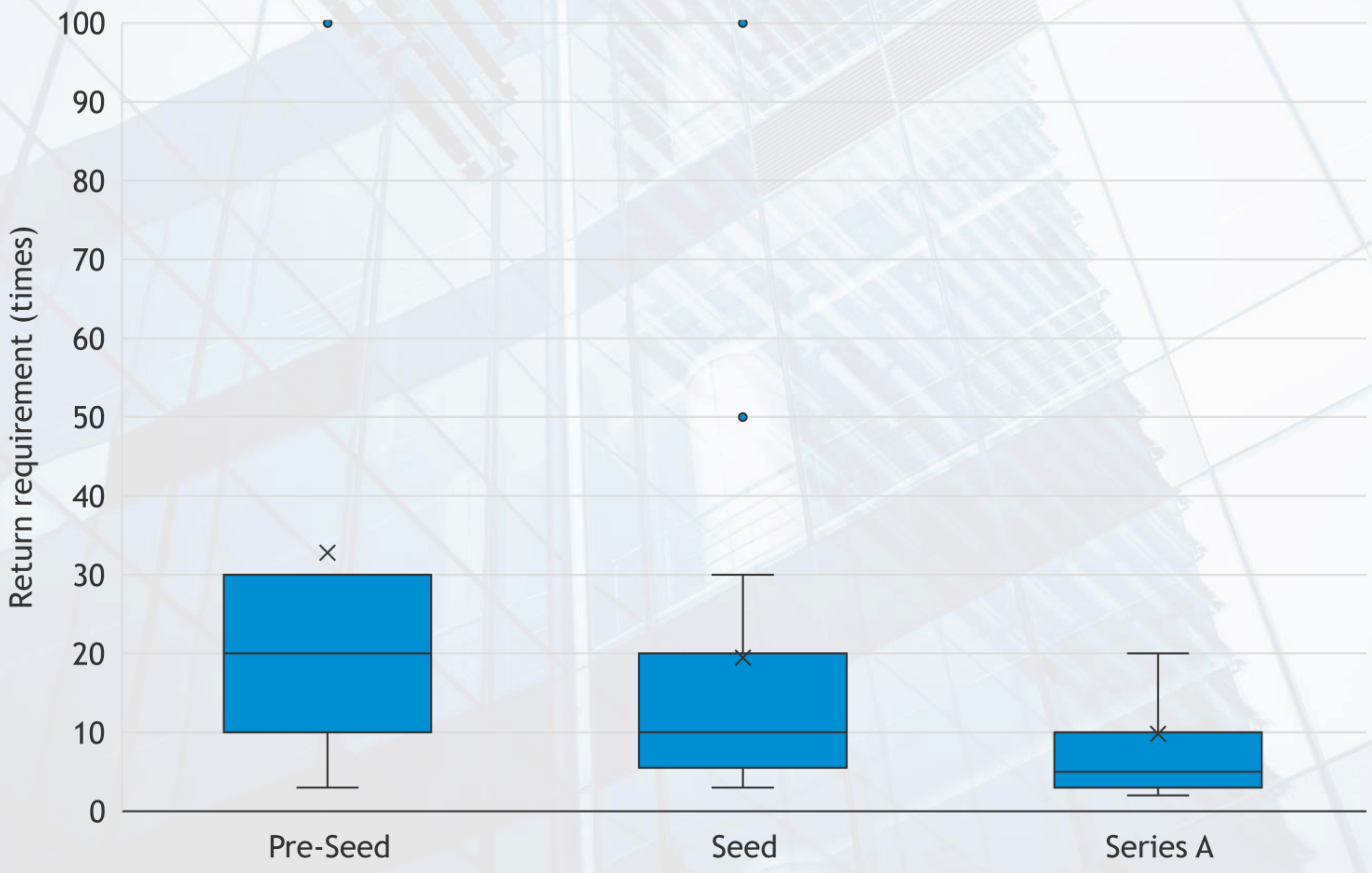
Investor Returns

When founders are thinking about a valuation and the dilution that follows VC investment, it's important to consider what an investor is looking to achieve on exit.

When asked what minimum returns investors seek on initial investment:

- Most Pre-seed investors' answers ranged from 10x to 30x (with an average of 20x)
- Most Seed investors' answers ranged from 5.5x to 20x (with an average of 10x);
- Most Series A investors' answers ranged from 3x to 10x (with an average of 5x).

Here we see the correlation between the risk profile of each investment stage and the required return. Pre-seed businesses are less established and so there is more inherent risk than with established businesses. Therefore, the potential returns for investors will need to be higher (and thus the valuations lower) in early-stage investments vs. later stages.



VC Advice for Founders Looking to Fundraise

Don’t just take our word for it!

“Be crystal clear on the value proposition for your realistic addressable customer segments. In lieu of revenue, demonstrate that you have engaged closely with potential buyers and are solving an urgent problem.”

“When looking for investors, focus on finding the people you want to work with for the next 7-10 years. It takes a long time to build a big business and you want people around you for the journey that you can trust and build an enjoyable working relationship with.”

“Be clear on what you do, why you do it, who your customers are, what your value proposition is and why you will win. Pre-empt investor Q&A by preparing a FAQ before going to market, it will save you significant time.”

“Make sure you do your research on who you are hoping to go into partnership with. Never expect it to happen quickly and be flattered if it does.”

“Get your documents ready and explain the tech in a written format that your grandma can understand (no matter how difficult your tech is).”

“Make sure you have sufficient cash runway to last you the duration of a funding round. Bring in specialist advice to help get you deal ready eg fractional support”

“Be prepared, be realistic and show evidence of execution, strong team and vision.”

“Know your potential investors and who you want to raise money from and why, keep a tight process.”

“Try and find investors who genuinely know the sector / market you operate in, who will add more than just capital”

Appendix

Relevant definitions

- **Liquidation preference:** a right given to a class of preferred shares allowing those shares to receive proceeds in a liquidation event in advance of other classes of shares.
- **Non-Participating Preference Shares:** In a liquidation event, the investor will typically receive the higher of:
  - their initial investment, multiplied by an agreed-upon liquidation multiple, or;
  - their pro-rata distribution of proceeds alongside the ordinary shareholders.
- **Participating Preference Shares:** In a liquidation event, the investor will:
  - First receive their investment back, multiplied by an agreed-upon liquidation multiple, before any money is distributed to other shareholders and;
  - Receive their pro-rata distribution of the remaining proceeds alongside the ordinary shareholders.
- **Advanced subscription agreement (ASA):** an equity investment where the investor pays in advance for shares that will be allocated at a later date. The price at which the ASA converts will typically be determined by the valuation achieved at the time of the next funding round.
- **Convertible instrument:** A loan or instrument that an investor gives to a company with the intent that it will convert into equity at a later stage as opposed to how a standard/ traditional bank loan would be repaid.
- **Strong unit economics:** These are demonstrated by performance metrics such as (but not limited to): Gross Margin, Customer Churn, Customer Acquisition Costs and Customer Lifetime Value.

BDO Growth Advisory Contact Details

If you'd like to discuss how we can help you on your funding journey, please get in touch!

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