VentureBest

September 26, 2019

When Good Deals Don't Get Funded

It's the rare entrepreneur, no matter how successful, who has not been turned away by more than a few venture capital investors. What do iconic companies like FedEx, Google, Airbnb, and PayPal have in common? They are all deals that got turned down by venture investors. In fact, all four of those deals were shown the door by one of the industry's bluest of blue bloods, Bessemer Ventures. They turned down FedEx *seven* times. (Bessemer has done so many great deals that (to their credit) they are not afraid to tell about many of the great deals they turned down. See here for some fun reading.)

Still, getting turned down by investors is a drag for entrepreneurs. It doesn't take many VC brushoffs to give most entrepreneurs, even those with the requisite iron constitution, some concerns (doubts, never!) about their presentation, if not their startup.

One good way to brush away those concerns is to remind yourself that, as Bessemer's Anti-Portfolio demonstrates, really good deals get turned down all the time, even by really good investors. (The fact that most deals get turned down because they are not good deals is true as well – but not relevant, of course, to any discussion of *your* deal.) So why do venture investors, even good ones, turn down good deals like yours?

We'll start with an assumption: your deal (we'll call it "Good Deal") is in the right space, at the right stage, and in a good location for the fund you pitched (we'll call it "Good Fund"). The team/market/technology boxes are all checked. We'll even assume that Good Deal will eventually appear on Good Fund's own list of deals they wish they had done.

And now, we will get to the task at hand. What are some of the more likely reasons Good Fund will send Good Deal off without a check?

Vision-Driven Turndowns

Among the most frequent explanations for a Good Fund turning down a Good Deal is very basic: Good Fund just isn't

Related Practices

Fund
Grow
Sell
Start
Venture Capital & Private Equity

buying what Good Deal is selling. That can take the form of not buying the “upside” (the reality and metrics of the business opportunity) and/or not believing Good Deal’s assessment of the risks of capturing that upside, and its strategy for overcoming those risks. Entrepreneurs must remember that the best investors, like the best home run hitters, strike out more often than they hit it out of the park. Babe Ruth was caught looking at a lot third strikes.

The threshold vision turndown is exasperating. It shouldn’t be. Disruptive startups were only “hiding in plain sight” after they are successful. They are by their nature non-obvious. So don’t sulk when yours is turned down. Just go bang on the next door.

Other Common Turndowns

The collection of turndown reasons beyond not buying the vision is large and diverse. Still, a handful that account for most of those turndowns. We’ll start with a lack of personal chemistry.

The venture investor/portfolio company dynamic is complex across a number of legal, business and cultural dimensions. These complexities permeate the relationship, but are most problematic at the lead investor/entrepreneur interface. It is like a marriage: a marriage based mostly on financial alignments that tend to drift apart over time as the startup, the markets and the investor’s own business realities evolve. For most venture investors, any serious doubts about whether they can work in harness with the entrepreneur as their “marriage” evolves– including in the almost certain-to-be bad times they will share– is a deal killer. And it should be.

Next on the hit list is probably the “we all like it but nobody loves it” turndown. It is not enough that Good Fund thinks Good Deal is a good deal. Someone on Good Fund’s senior investment team has to step up as Good Deal’s champion. A Good Fund VIP must buy in to Good Deal at a gut level, and be willing to put their reputation and time on the table to get the deal done. Most VCs don’t do deals just because they like them at a gut level; they almost never do deals that they don’t like at that level.

A close cousin of the “no champion” turndown is the “no bandwidth” turndown. Someone appropriately senior at Good Fund – usually the deal champion – must have the bandwidth to execute and manage the deal. For most venture investors doing deals is as much about available time as it is available capital. If Good Deal’s champion is already working a half-dozen deals (that’s a lot), two of which are in the midst of down rounds and one of which is coming up on a possible exit, the chances he/she will sign up for another deal, no matter how excited he/she might be about it, are slim. And even if he/she does, their partners might nix it.

Next up is the “too many good deals, not enough money and time” turndown. Every entrepreneur thinks their deal is tops, of course, but the fact is that most venture investors, particularly the good ones, generally see more doable deals than they have the time and money to do. Even in a seller’s market, as we have now, it’s a competition to get the attention of the best investors. When a venture investor tells you they like what you are doing, but not quite as much as what some other entrepreneur is doing, they might be telling the truth. They might have even flipped a coin to break a tie (been there).

Now for a common if sometimes less than completely honorable reason Good Fund might turn down Good Deal. They never had any intention of doing the deal, but were very interested in the space. Perhaps, they are just fishing for general intelligence and insights. Perhaps, more cynically, they have a portfolio company in the space, or are actively considering an investment in another deal in the space, and are looking for competitive intelligence. (I haven’t, in thirty-five years in and around the space, seen any more villains in the VC business than you might see in any other noble profession. But, I've seen a few.)

Turndowns on deal terms (pricing and beyond) are the last of the "usual suspects" when Good Fund turns down Good Deal. The simplest terms turndown is based on price, and is usually pretty straightforward. Smart entrepreneurs try to avoid talking about price until they've set the hook with an investor. But, if there is an obvious mismatch (almost always a situation where a naïve entrepreneur is an order of magnitude or more north of reality) you can expect a quick turndown regardless of the other attributes of the deal.

More modest deal-killer price differences usually come up later in the game and, in my experience, as often as note mask more complex concerns about the deal. Price itself is not as objective as it seems: differences in other terms of a deal, for example control-related provisions, liquidation preference distinctions, etc., can put very different "real" prices on term sheets that otherwise have the same "list" price. Shifting the conversation to those other terms – particularly control-related terms (Board seats, voting, protective provisions) – often reveals those masked concerns. Those kinds of concerns often come up later in the process for the simple reason that the stress of the process itself is what can bring them to the fore.

Concluding Thoughts

Getting turned down by VCs is a way of life for most entrepreneurs, even those that end up on investor lists of "deals we should have done." And that, finally, is the point. Most deals made by most investors don't work. Why assume that false negatives are any less common than false positives?

Pitching to VCs is, for most entrepreneurs, most of the time, a game of numbers. Keep that in mind as the brush offs pile up: each "no" is a step toward the first "yes." At least for entrepreneurs pitching good deals. And you, of all people, wouldn't pitch any other kind, right?

Related People

Paul Jones
Of Counsel
pajones@michaelbest.com
T 608.283.0125

Paul Jones
Of Counsel
pajones@michaelbest.com
T 608.283.0125