Chasing unicorns or following the herd?

Understanding investor psychology – advice for first-time fundraisers

By Roch Ogier and Saskia Karg
With the participation of Karim Maizar (Startup Desk, Kellerhals Carrard) and Pascal Koenig (fundraisingally.com)

Before you start preparing for your spin-off's first funding round, take some time to reflect on how investors think and how this knowledge should influence your preparation. Understanding your investors' perspective is just as important as knowing how your customers tick. Read on to walk a few steps in investors' shoes.

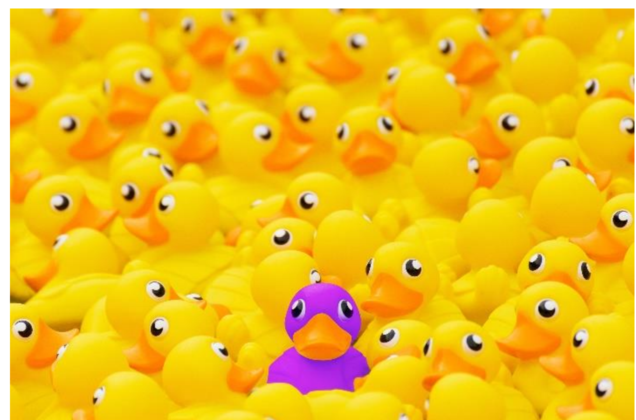
It's business, not charity

That investors are looking for business opportunities may appear obvious. As a scientist, however, you have generally been applying for non-dilutive money (e.g. grants, fellowships, donations). You have received those funds based on your project's scientific or social appeal, not necessarily the potential return on investment. Now, investors may turn you down if your projected sales are low, even if the unmet need is vast and your science is stellar. In this case, you may need to think of alternative funding strategies. Lack of accessible market potential may be a showstopper even for more socially-oriented investors.

In this context, remember that venture capitalists (VCs) are institutional investors. The money they invest primarily comes from their own investors. Most VCs are continuously in the process of raising cash themselves. Their primary goal is to show the financial performance needed to attract more investors and raise their next fund. They have to prove that they conduct the right amount of due diligence, focus on promising areas, have a well-established position in the start-up ecosystem, and, most importantly, make the "right" investments leading to good returns. Usually, a VC fund is expected to generate at least a three-fold return. Many VCs are also under time pressure, as they have to give back the cash with a return on investment within a certain period (usually ten to twelve years). Most funds are required to make initial investments within the first five years of the fund's term. Understanding the strain investors are under is helpful.

If you have high potential, you are a scarce product for the financing industry. There are fewer promising new start-ups than there are good investors. It may appear difficult for you to find investors. Remember that it is even more challenging for investors to find start-ups that will lead to the returns for their fund to be a success. You may be able to build your company with mediocre investors but you cannot run a fund with just modest start-ups. It may sound trite, but your goal is to become one of the high-potential start-ups that investors may scramble to support.

Investors appear to be chasing unicorns, but the reason for this is firmly based in reality. As many spin-offs will fail, the ones that succeed need to make up for those losses. Your project, therefore, needs to promise a high return, even if it is very risky. A project with a limited market and no further development potential will not be exciting because it will not significantly affect investors' financial results, whether it succeeds or not. While a potential exit of 50M may sound like a lot for you, investors will not think the same. Think big(ger).



MBA not required, trustworthiness is

You will meet investors before you officially launch your funding round. Many scientists think they need a "business person" in the team before talking to an investor. While some business sense is helpful, even a "crazy scientist" can make an excellent first impression as long as they come across as honest and trustworthy and are mindful of the investor's perspective. This is particularly true in life sciences, where many investors look for an unpolished gem and might even be put off by too much business-speak before launching your funding round. Early-stage life science investors know that projects will have weaknesses, so be transparent about your project gaps and disclose your plan to address them.

To state the obvious, investors need to gauge the risks that their investments will carry. Show that you understand their mindset and make it easy for them to put the current stage of your project into context. To achieve this, clearly point out your limiting steps

© Therapy Development Accelerator, University of Zurich. Do not reproduce without authors' permission.

and map out your milestones and decision points for them. An investor will want to see that you inspire trust, are scientifically credible, honest, motivated, humble, self-aware, and able to inspire people.

Investors are usually not that specialized in your field. Account for this and never allege that the investor is not bright enough to understand your fantastic opportunity. There are no investors who "do not understand anything". Each one will focus on different dimensions of the project, some more on science, some more on business or finance. It is your task to adapt your pitch to the investor. And remember, even if your project is the breakthrough of the century indeed, investors have already seen many spectacular cancer cures in mice and may therefore show some skepticism.

The "fear of looking stupid" drives long timelines

Investments usually do not happen in an instant like in Dragon's Den (Höhle der Löwen). Most investors will want to see how the company is progressing. Seeing how the team, project, and field evolve allows risk mitigation. Triage, however, may happen quickly. Many investors receive hundreds if not thousands of offers per year, take a closer look at a hundred or so, and will finally invest in a few (around 1%). Without looking into any details, investors may reject projects for reasons such as not being in line with their strategy (not their therapeutic area of focus), portfolio (have already invested in a similar project), or timing (depending on their fund cycle). Your market may be too small or your team unconvincing on paper. Large VCs, global investors, or Swiss-based VCs with an international scope may make such fast triage decisions.

However, many investors will delay their decision, especially investors with a local scope. They are the ones who typically invest in early funding of local spin-offs. As there are fewer than a hundred spin-offs per year, it is feasible to take a closer look at them if they are in the investors' scope. Switzerland is a growing – albeit small – ecosystem. Therefore, local investors need to maintain good relationships within the network and show interest and engagement in order to maintain a good reputation among entrepreneurs.

As mentioned above, being able to observe the company for a while has benefits for the investor. The absence of a "no" is therefore definitely not a "yes"… Unless there are glaring red flags, such as lack of market or IP, local investors will usually not close the door on you after a first encounter. They are keeping their options open, as your start-up could evolve unexpectedly well, or your area could become very promising. However, time does not work in your favor; while investors may warm to your project over time, they may as well hear negative or contradictory feedback about your field or see an investment case for a competitor or another hot start-up they prefer in the meantime.

Never underestimate the "fear of looking stupid". No one wants to be the only one investing in a project that fails, particularly if there were "I told you so"-type of reasons for it to fail. Such reasons could be a weighty competitor on the market backed by a potent VC or a field with past notorious failures. As said before, investors have to answer to their own investors as well. "Fear of looking stupid" can create an almost insurmountable hurdle to getting early traction on either niche or extraordinarily innovative projects. The smaller the ecosystem (as in Switzerland) and the size of the investors, the bigger the risk of conservative decisions to preserve the investor's reputation.

The "fear of missing out" (FOMO) drives quick decision-making

A "following the herd" mentality is prevalent in the ecosystem. Many angel investors, family offices, or institutions cannot conduct a full due diligence, particularly on your science. They may be uncomfortable making an investment decision on their own and may rely on a strong signal from another investor with a strong track record in the field. So, one commitment may create a domino effect. The local investors you are bound to interact with at an early stage tend to know each other well and to interact frequently. They will often share their opinions and views; therefore, your storyline's transparency and consistency are essential.

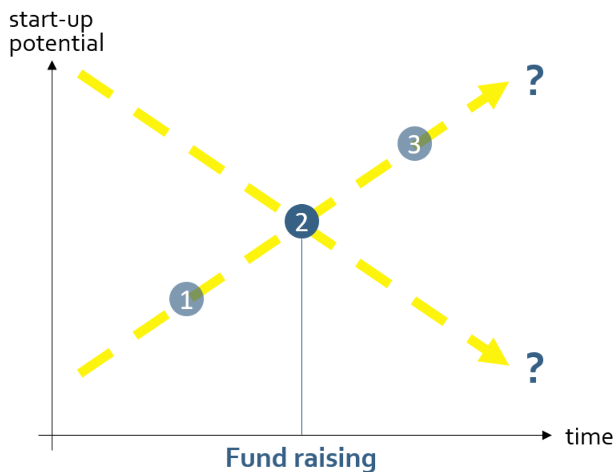
Nobody wants to be the only fool investing in a company, but nobody wants to be the only one missing the next unicorn. Often investors may appear to be stalling by asking you more questions, requesting further documents, or time for discussions with experts until you have enough signed term sheets to be confident that you will close the round. Potentially without them. Then, they can suddenly make a quick decision without any additional information. The fear of missing out has replaced the fear of being the only fool, and you are now the one with decision power. Your planning and execution will focus on creating FOMO.

Hacking first-time fundraising

1. Get yourself on investors' radars

It is never too early to ask to briefly introduce yourself and your project, as long as you appear motivated, credible, modest, and realistic. Being on the investor's radar enables them to follow your progress. When the time comes for you to raise money, you have a history with them, which can catalyze commitment. Be transparent about your intentions. If you want advice, ask for advice. If you want money, ask for money. The adage "if you want money, ask for advice; if you want advice, ask for money" does not make much sense. If you are lucky enough to have high visibility in an exciting field, investors may reach out to you. If, on the other hand, you are afraid of the limelight, think twice whether you will be ready to raise funds soon. We will discuss the different ways to get yourself on investors' radars and how to leverage your network in an upcoming article.

© Therapy Development Accelerator, University of Zurich. Do not reproduce without authors' permission.



The – obvious – need for at least two points to see a trajectory: if investors saw you at point one, they may invest at point two. If they have not seen you before, they may want to wait until point three to make sure you are on a rising trend.

2. Prepare like an Olympic athlete

Meticulous preparation will be unavoidable. You will prepare for months to perform exceptionally during a few weeks, like a world-class athlete. We will describe later how you can prepare your spin-off, your story, your round and your targeted investor list. Therefore, it is not totally accurate when people say that you should constantly be fundraising: you will be continuously preparing for it.

3. Keep it simple

As mentioned, early-stage investors receive hundreds or even thousands of presentations a year from start-ups and many of them are not specialists in your field. One of the hidden secrets to getting the attention of investors is to keep things very simple. An average investor looks at your pitch deck for three minutes. If the message is vague, too long, or too convoluted and scientific, the chances are high that you will not raise interest. Ensure that your "elevator pitch" and pitch deck are straight to the point. We will expand on this in an upcoming article.

4. Launch the round when the time is right

To state the obvious, you need to think about raising funds when you expect to require them. Some start-ups sustain themselves on non-dilutive funding or bootstrapping for quite a while. Raise funds when you can no longer obtain non-dilutive funding or when you need more money more quickly to accelerate development (costly but important next milestones to reach, catch up with competitors, etc.). Both dilutive and non-dilutive funding is possible in parallel. Non-dilutive funds are attractive to investors (money for the project, no dilution for them, and recognition of the project's value). Some non-dilutive sources appreciate having investors supporting the project, as this shows that further translation is imminent. Note that needing a salary because you just left academia will be an unconvincing reason to raise money.

Make sure you have convincing data at hand. You do not want to have to go back to the lab to satisfy investors' questions. Try to anticipate what mandatory data they will want to see. If possible, have a pipeline of good news coming up (scientific results, articles, etc.) that will keep investors excited. If your data set does not fully convince you, consider staying in academia a bit longer to improve your data and raising funds later. Do not forget that you need to show that you will reach a meaningful milestone with the funds raised.

Your financial runway must be long enough. The runway is the time you can survive with the current money in the bank and your current spending. Therefore, do not start your round only when you urgently need the money: you will have your back against the wall, which is not a good situation to negotiate with investors. As discussed, they do not have the same time constraints as you do. Have a runway of at least nine months when you start a financing round – ideally twelve months. If you do not, consider raising more non-dilutive funding, bring in some FFF (friends, family, and fools) money or, as a last resort, cut costs immediately.

5. Create FOMO by moving quickly and consistently

All your efforts will be geared towards achieving this result. The main factors that will contribute to creating FOMO are:

- contacting a large pool of investors
- creating a high level of excitement
- managing all of this in a short period of time

We will describe these steps in upcoming articles.

The importance of momentum: You want to be seen as someone who raised their round quickly, maybe even oversubscribed, not as someone who has been out there fundraising for years.

Disclaimer

Views expressed in this paper are the authors' opinions and may not be considered as an official position of the University of Zurich. As the prevailing wisdom around bioentrepreneurship remains subject to change, we regard these guidelines as a living document. As such, we are keen to hear feedback from readers and will incorporate this as much as possible into further editions. If you would like to comment on these guidelines, please contact us at: roch.ogier@uzh.ch

© Therapy Development Accelerator, University of Zurich. Do not reproduce without authors' permission.