4 Crucial Indicators To Know Before Seeking Venture Capital Funding

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In this day and age of shrinking VC funding for startups, you might think your business is the exception. You might think your business model is so ripe for growth with a little cash infusion that VCs should compete to see who can be your primary investor.

Besides the fact that startup founders are rarely objective about their business prospects, it’s always good to get outside perspectives before heading down the potentially long, winding and soul-bruising road of VC pitches.

Do you know who you might want to check with as a first step before you sink a bunch of time and energy into your pitch deck? Your marketing agency. (If you don’t have an agency, make a friend with an agency exec pronto.)

If an agency isn’t your first choice as a sounding board — hear me out. I’ve worked with dozens and dozens of intelligent, ambitious startups since founding Playbook Media. Throughout those relationships, I’ve recognized a few significant indicators of whether your business is positioned to sprout unicorn wings with some extra resources — or whether you have some fundamental issues to address before you take your pitch to your version of Sand Hill Road.

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1. Burn threshold

Also known as “burn multiple,” this metric takes a broad view of your business to calculate how much revenue you bring in for every dollar you spend. Divide your net burn by net new revenue for a given period, and you’ve got your number. (Anything over 2 these days, and you’ll have difficulty getting funding because your operational efficiency needs work.)

Your agency partners won’t have all that data on hand to calculate your burn threshold, but there are plenty of ways they can help you improve it. They can reduce costs by lowering your average CAC (the cost of acquiring a customer). They can improve your customers’ average LTV (lifetime value) using lifecycle marketing, referral programs, upsell campaigns, etc. They can also run frequent forecasting models to ensure your strategic decisions are informed by current data and market conditions – which have been evolving rapidly.

An agency can be beneficial in understanding your entire marketing picture and assessing where you can cut spending and suffer minimal revenue effects. Agencies proficient at MMM (media mix modeling, which I’ll touch on more in a bit) will be great partners in that endeavor.

2. K Factor

Your K Factor is your natural growth rate if you aren’t doing any marketing. It usually boils down to product-led growth and virality stemming from your existing customer base, site users, media outlets picking up on your momentum, etc. This isn’t specific to products, by the way; if you have a software service or platform, you can build tons of product-driven growth.

Agencies can help you determine your K Factor if they’re

proficient at understanding the impact of each of your advertising channels. Ideally, your agency is using media mix modeling to determine the incremental impact of each channel; when they analyze all of your channels and touchpoints and compare it to your overall growth, they'll be able to isolate a baseline level of growth that isn't explained by those channels. That's your K Factor.

The key to optimizing your K Factor is growth loops. Reforge defines growth loops as "closed systems where the inputs through some process generates more of an output that can be reinvested in the input." This can go beyond organic loops, too — although K Factors are defined in the absence of ads, you can apply a little advertising budget to great effect if you're working with growth loops. An example is taking a popular TikTok post from either your company's or a relevant creator's page and doing a Spark ad, which boosts the post and prompts more engagement that feeds the post's organic momentum.

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3. Channel reliance

Despite recent setbacks (check out the last couple of quarterly earnings reports), Google and Facebook still dominate their competitors in gobbling advertising budgets, as we see time and time again with new clients coming to us to jump-start their growth.

I think brands should almost never spend more than 50% of their budget on Google and Facebook (combined), which is easier said than done. There are several reasons for this, but the two most important are that Google and Facebook are getting increasingly expensive and that all companies should protect themselves against over-reliance on one channel that could get hit by, say, algorithm updates or outside influences like the iOS14 release.

Beyond those reasons, there are clear warning signs that you should diversify your marketing channels ASAP:

- Diminishing returns (CPAs keep climbing no matter what you try)
- A lack of new users
- Demographic trends shifting away from your core platforms (e.g., younger generations are now using TikTok instead of Google for their search engine of choice)
- Business goals evolving out of alignment with your core channels

If any of these sounds familiar, start carving out ideas and resources to reallocate the budget into new channels.

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4. Market penetration

There are a few market-penetration scenarios that potential investors will hone in on right away (for better or for worse):

- The market is small, and you're dominating but might have a hard growth ceiling (example: Wild Earth)
- The market is large but ripe for disruption, and you have one or more differentiators that will help you carve out market share (example: Dollar Shave Club)
- The market is new, and you have the plan to build awareness for the market's need and your solution (example: Fitbit, back in the early 2010s)

Agencies can analyze and tell you what segment you might be in. For Wild Earth, an agency would help define the target market by segmenting data into silos (e.g., vegans, dog owners, owners who only feed their dogs dry food, owners who order online, and owners who will pay a premium for food and

shipping). Cross-reference that relatively small audience that lives in the intersection of those segments with data like rising CACs and relatively high impression share. That company looks like a poor choice for investor funds *unless* you can leverage what you're already doing well into other product categories.

If things like search volume and available impression volume are curiously low, you may have a tremendous opportunity to build awareness for your product or service as the leader of a new market (or market segment). "Video rentals" probably had a ton of search volume when Netflix was in its early stages, but "online video rentals" or "video rentals by mail" were exponentially less popular queries that, when combined with the rising trends of online shopping and engagement, evidenced a market ripe for introduction. Brands like Peleton (spinning classes at home vs. spinning classes) and Rent the Runway (luxury fashion for rent vs. luxury fashion) represent similar scenarios that, when the story is told well, represent catnip for intelligent investors.

The takeaway

With startup funding relatively hard to come by, you should recognize that poor indicators in any of these areas put you out of position to leave a VC pitch with millions of dollars. But there's hope yet. First, most issues in these areas are fixable. Second, fixing them now will mean you'll be extraordinarily well-positioned to take full advantage of future VC investments when you have a better story.

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