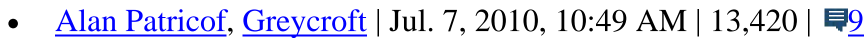
Confessions Of A VC Who Raised Money During Financial Armageddon



- Alan Patricof, Greycroft | Jul. 7, 2010, 10:49 AM | 13,420 | 9

Willy Loman

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We started to plan for our fundraising for Greycroft II, our second fund, around Christmas 2008. This was a few months after Lehman Brothers collapsed.

Our team of four partners agreed among ourselves that we wanted to raise a fund of $125 million. Because we were not yet 60% invested in Greycroft I, we knew we had plenty of lead time to complete our fund raising and commence investing in the 4th quarter of 2009 or at the latest, 1st quarter 2010.

The general partner allocation in the new fund was set in advance, so as to avoid greed or dissension which often times sets in when you get close to the goal. The management company and its structure were also set. Since everyone had been working for below norm compensation in the first fund (a $75 million fund raised entirely from high net worth investors, operating in 2 cities with 4 partners, a senior associate and 2 administrative assistants), the second fund would be an opportunity to be more competitive, especially as we planned to bring new people on board. We were a team and everyone was bought in to our long range plans including our assistants.

By late February 2009 we had put together our track record up to that point in Fund I and

prepared a 20-page Powerpoint deck. We had to update the presentation 3 times during the process as we saw what was working and what wasn't and to adjust for time passed. Most important of all, we had and have a clear strategy of what we invest in, how we invest, and our overall disciplined approach to the venture capital business. We communicated our determination to be a small fund and stay a small fund and make small investments in certain types of companies with low pre-money valuations.

We invest in a way that is designed to make every other venture capital firm our friend and our partner as we have flexibility on the size of our investment and our role in the deal. As such we virtually never do a deal without a partner whether another venture firm or a strategic investor. It's our approach – you don't have to mimic it, but it sets the stage for multiple compatible relationships. Moreover, we committed to our potential investors that Fund III, when it happens, will be no more than 10-15% greater in size. We intend to remain small. Our focus has to be totally on the carry.

In late February 2009, we hit the road and began talking to potential investors.

Here's what happened >

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It took a lot of time to communicate the strategy and get the message across.

We had 515 contacts, of this, roughly 250 passed for various reasons and 100 were non-responsive. We had 154 visits, 97 due diligence requests, 33 second visits, and 12 reference requests, to ultimately produce 9 institutional investors.

That's less than a 2% yield of all contacts and 6% of first meetings.

After expending a significant amount of time and effort explaining our approach, which met with a mostly positive reception, we still faced all of the usual comments: we love your team, we like your concept, your record is great especially your distributions (the reality is the big funds have not made distributions in some time, or have they made limited distributions), BUT

1 – We are stuck with the denominator effect where our main marketable investments (stocks and bonds) have gone down so much our alternative investments (venture capital, private equity) have become too large a percentage of our overall portfolio

2 – We are over-committed to alternative investments and we have to wait to see how much they will actually draw down from our outstanding commitments

3 – This is a great time to buy distressed assets (i.e., prior investments by other folks that have since plummeted in value)

4 – This is a great time to buy existing VC funds and private equity funds at a discount

5 – This is a great time to buy top quartile funds that wouldn't take our money before (these guys have no egos)

6 – We need to make big commitments to big funds to move the needle

7 – We're out of money and out raising our own Fund of Funds

8 – I like your idea but I can't get to it until the 4th quarter or next year.

We probably have detailed lists of a dozen or two funds that fall into each of these classifications.

Fortunately, we would not be writing this story today if we didn't have a happy ending. During the process, however, we learned a lot about various institutions and how they treat supplicants like us. Some of the highlights that immediately come to mind: courtesy on call backs in a time frame they set but don't observe, due diligence processes which promise a month or two and take almost a year, people who invite you to full committee presentations and only one person shows up after you take two days and travel over 1,000 miles to get there in a rainstorm. And these are just a few of the examples.

Fortunately, we hired an outside assistant to help us in this process (not a placement agent). Since we were a small fund, it would have been overwhelming to us and our small administrative staff to set up the meetings and follow ups, fill out questionnaires (which for the most part fall into a dark hole), and respond to the myriad of questions which occur during the due diligence process. Although not a placement agent charged with raising the money, this person was an important and critical member of the team and was a key factor in helping us to keep track of where we had been and where we were going - "If it's Tuesday, it must be Belgium." She also

kept up our spirits.

Our original fund was raised solely from high net worth investors. For Fund II, we decided that we wanted an institutional investor base to solidify the foundation of the fund going forward. Since we knew it would take institutions longer, we focused first on institutions, before going back to our existing investors, and seeing where the market led us. Two groups in particular went through extensive due diligence including: independent credit checks on each of us, negotiating the LP agreement, requesting a seat on our advisory board, and finally getting us through their investment committees. After all of that, they confessed that they were out of funds and were in the market raising their own fund of funds; this after countless meetings at their offices, calls to every one of our CEO's, co-investors and personal references. Needless to say this was a great disappointment, but in both cases they offered, based on all their work, to serve as references. We wished them luck in their own fund raising and suggested that perhaps they would invest with us in Fund III. No bridges were burned.

And then, at last, after four months of marketing, success...

We found our lead investor >

You'll Be Our Lead Investor!?

Finally, around June or July 2009, we found our keystone investor who, when they committed, said they would stick with us until the end even if it took until 2010 (which it did!) They are and have been a stalwart supporter. While tough in negotiating terms, they have always been reasonable and without them – and their willingness to serve as a reference at all times – we could not have made it to the finish line. We will remember their steadfastness!

They were followed by one other institution shortly thereafter who also allowed us to use their name as a reference and, at that point, with the confidence that we had the foundation of a strong

institutional base, we decided it was time to approach our initial individual investors for consideration to re-invest in GC II. We sent only a letter and did not make a single phone call to solicit anyone. We did not want them to feel pressured to re-up as they had been so supportive in forming Fund I and we didn't want to put them on the spot. Fortunately (and not unexpectedly), this process was much faster. In less than 10 days, we had almost a 75% renewal rate and those that didn't respond were never approached a second time. We also took in a few new individuals who we felt would be helpful to our investment strategy.

In late December 2009 we received another few institutional commitments and called for a first closing on February 1st as we had reached our minimum target. At this point we had commitments for over $100 million. I might add that all of the institutional investors that actually made commitments to us did so within a time line and process that was articulated clearly by them, less than 2-3 months from start-to-finish. They met their own objectives which for us was most refreshing.

Once we decided to call for a first close, we wanted to notify the 7 other firms who were at various stages of the due diligence process. Since each of these firms were of varying size participation levels, they needed to know that we had room for 2 or possibly 3 more groups and that we had made a firm commitment to our lead that we had a hard stop of $130 million (only because we wanted to say we were oversubscribed). We knew that the only way to move the stragglers along, some of whom we had been talking to for a month and some longer, was to push the button as we truly would not be able to accommodate everyone if we were so lucky as to receive commitments from all of them. We were careful not to be arrogant or overconfident and had already provided for a second closing within four months of the first if we needed more time. We were determined not to be in a permanent fundraising mode in order that we can get back to investing full time. We also finalized our GP and management agreement as we approached the date of the first close.

On February 5th, a few days past our deadline, we had reached our first and only closing (with a few organizations who had come in late submitting their paperwork a bit later).

So what lessons can be learned from this journey of the past year?

Read on >

Lessons Learned

So what lessons can be learned from our journey of the past year?

1 – Never assume you know who will get over the finish line and make a commitment they will fulfill. At the end of the day the most unlikely group may come through for you and the most likely investor will disappoint.

2 – Never assume you are done and that you have identified your group of investors. You have to keep pursuing new prospects up until the day you close as inevitably someone will get a hiccup and back away. Leave no stone unturned.

3 – Never give up on an institution who says no. Keep providing them with up-to-date data and items of progress to keep them involved as you never know what will persuade them or perhaps why they said no in the first place.

4 – Always, but always, ask the following questions before you leave the first meeting:

- A – Do you actually have money to commit? If not, when?
- B – What is the due diligence process and how long will it take?
- C – How is the decision finally made?
- D – If you were to commit, what would be the range of commitment?
- E – Understand who the point person is in their group for follow up and decide who is most appropriate in your group to follow up. Make someone responsible.

5 – Listen to what is said and keep extensive and accurate notes from every meeting even to the point of using a CRM system of some kind to record who was at the meeting and any identifying features (e.g. beard, color of hair, tall or short, or anything they told you about themselves) which might later assist you when going back to them for a later meeting. I guarantee you by the time you finish, all of the names will blend together and by the end if you see someone who you

met early on, you will have forgotten everything about them including what they look like. Perhaps most importantly, remember the last thing they say as they or you walk out the door.

6 – Have a very organized follow up process, and don't wait for anyone who says they will call you back in 2 weeks or a month to call you back. Most times, because they will have had 50 meetings like yours in the interim, they will probably have forgotten what you look like and what they said they would do next.

7 – Prepare in advance the list of all your company CEO's, co-investors and personal references with e-mail and telephone numbers and collect all of the data on each company in your portfolio. Anything you can do to make it easier for potential investors will accelerate the process or maybe even get them started on due diligence sooner.

8 – Don't believe or be discouraged by stories you hear about other groups raising money who have done it faster. Most times it isn't true, as it may have been just for a first closing. There may be special circumstances of which you are not aware or it may just be rumor. In today's environment you should assume it takes a minimum of a year to complete the process and you better be prepared in managing your investment strategy of your existing fund so you don't run out of money.

9 – Focus early on to get a lead name investor that others will respect and follow.

So, having just gone through this year-long ordeal, what would we do differently if we could do it all over again?

Not what you'd think >

The Bottom Line

If we had the chance to start all over from the beginning of the fund raising process, what could we have done differently? **We have thought long and hard about this question in particular and the answer is nothing.**

There is nothing we could have done at the outset to guide us better as to who would eventually be in our final group of investors. There is nothing we could have done to shorten the time required. There is nothing we could have done to reduce the number of visits or time spent pursuing leads we developed that went no place. There is nothing we could have done to avoid spending a lot of time, effort and money. In today's post Bernie Madoff financial melt-down world, institutions, while some times over the top, for the most part are appropriately cautious and increasing their already strict due diligence process. Most importantly, there is nothing we would have done to modify our strategy. We are who we say we are. Investors look for consistency and we sold, above all else, our consistency of team, investment strategy, and record that if anything reinforced our positioning in the market.

Has it been a fun process: honestly, no! It has had so many frustrating moments with people who don't return phone calls or emails, people who don't read the documents, people who can't and don't take it as seriously as you do, people who bring you halfway across country for a "full committee meeting" and don't show up. The list goes on and on. What it does do is increase the bond of your team, provide some very big highs when someone commits and lows when they turn you down, particularly when it is for illogical reasons. Most of all, it is a humbling experience that should make you more aware of your own treatment of and response to entrepreneurs who approach you daily in their own pursuit of capital. This experience should absolutely influence the style and dignity with which you say yes or no and the speed of response for both.

The names, dates, and places that produced these observations shall forever be sealed in our private book of remembrances and will not be shown to anyone. You will have to make your own guesses – but then again you may have your own list of names to fill in the blanks.

Postscript: Since we closed Greycroft II, we understand the market has opened up considerably for new funds and follow-on funds, but most of the above mentioned principles still apply. Importantly, however, is the concept of early-stage focused funds (those under $200 million and even $150 million) has been more widely accepted and is in fact a trend.

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