When Should a European Startup Seek US VC Funding?

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We regularly meet with UK and other European startups who are interested in raising funding from US-based VC investors. As we've previously written, it's difficult for non-US startups to raise early-stage funding from most US VC investors without (1) existing traction from US customers and/or business partners, and (2) US operations in proximity to the US VC investor, led by one or more founders or other decision-makers.

US VC investors often will question why a non-US startup isn't looking to raise in its home market; demonstrating significant US traction backed by US operations is a great answer.

Given these dynamics, we've seen four common transatlantic startup models emerge that are most likely to lead to success in raising US VC funding:

(1)

- European founders have a business idea
- Relocate to the US to start and build a company
- Raise seed and subsequent rounds from US investors

(2)

- European founders start and build a company in Europe
- Raise a European seed / superseed / small A round
- Establish US operations (usually a sales/marketing lead to start) to capitalize on US traction
- Raise a US Series A round to support continued US growth and expansion

(3)

- European founders start and build a company in Europe
- Raise European seed and A rounds
- Use the proceeds of the A round to scale up US operations to capitalize on US traction
- Raise a US Series B round having established full transatlantic capabilities

(4)

- European founders start and build a company in Europe
- Raise European seed and larger rounds

- Demonstrate global traction (typically including US operations)
- Raise growth capital rounds from later-stage US VC investors

Each of these models implicates different considerations. Spending time up front to consider relevant factors such as those described below can help avoid costly mistakes and maximize company value and the likelihood of VC investment.

A. Commercial Focus and Regulation – What kind of business is this? Where are its key customers and markets? Where are its key competitors? Where is the best product/market fit? Is specialized knowledge or experience required for an investor to understand the business and, if so, where is that to be found?

Is the business regulated and, if so, might it be easier to develop the business model, and achieve initial scale, outside the United States (such as London, for example) where the regulation is less complex?

Is competition likely to be less fierce outside of the US, such that it may make sense to achieve some scale outside the US before entering the US market? Alternatively, does the business need to be in the US at an early stage to get the level of investment required to compete, or risk losing out to a US-financed competitor with more firepower?

B. Development – how much software and other development work is required, and where is it going to be most cost-effective to do it? Does it make sense to do the development work outside of the United States first, and then establish a US subsidiary (perhaps including a founder) to build the US market? High-quality development teams are available in a variety of places outside the United States, frequently at substantially lower cost than for the same work in the US.

C. Immigration and Location – founders cannot found a business in the US unless they already have the right to live and work there. Some of the visa categories that work well when setting up a US subsidiary of a European company (e.g., the E treaty investor visa and L intracorporate transferee visa) work less well or not at all where the business is being started in the US.

More basically, where do the founders want to live? Are they all prepared to move to the US? While it may make sense at some point for the founders to split geographies, it is difficult to do so at the very beginning.

D. Investor and Investment Considerations – most early-stage investment, other than perhaps "friends and family" investment, is local to the location of the founders. Early stage VC's, and most (but not all) angels, want to be geographically proximate to the business so that they can meet regularly with founders, provide business business and access to networks. Additionally, investors invest in what they think they know – it is very difficult, for example, to persuade an early-stage VC to invest based on a business plan in a market that they don't know.

In particular, US early-stage investors are unlikely to invest in a business that is not already on the ground in the US, although in some cases we have seen investment where the business already has US traction and the investment is used to set up a subsidiary in the US.

Similarly, certain US investors will only invest in US companies. For example, while the larger US VC's are increasingly comfortable with investing in, e.g., UK and Irish parent companies, some smaller US VC's, particularly on the West Coast, will not invest in non-US companies.

Conversely, certain kinds of European governmental tax and grant incentives, such as those provided by the UK and Irish governments, require a permanent establishment in the host country and, in some cases, a European parent company.

Furthermore, we have seen a number of cases where entrepreneurs have started with US parent companies (or been forced to "flip" into one), and then found that their most likely sources of investment are non-US and the non-US investors did not want to invest in a US parent company. For the tax reasons discussed below, moving from a US parent company to a non-US parent company is problematic.

E. Tax – the US is a high corporate tax jurisdiction (federal and state corporate tax at roughly 40%, compared with 20% in the UK and 12.5% in Ireland), and tax compliance is more expensive in the US than in many other places. Starting a business with a US parent company, or "flipping" into a US parent company, subjects the global business to the US tax regimes; subsequently moving the parent company outside the US without triggering tax is extremely difficult. Additionally, at the time of exit, particularly if the exit is a trade sale and the likely buyer is a US multinational, a non-US parent company may secure a higher price because the multinational can use "trapped cash" earned offshore that would be subject to a tax charge if remitted to the US.

These tax points may seem like far-away problems to start-up entrepreneurs. However, early-stage companies with US parent companies who conclude that they need to be non-US to secure investment will find that the process of moving out of the US comes at a high tax price.

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US investors historically have had success deploying capital close to home, and a European startup approaching US VC investors must demonstrate why it represents a particularly attractive opportunity. Few US investors have a "quota" of European companies in which they need to invest; US VCs typically just look for the best chances of achieving their desired returns. Knowing the right times in the European startup lifecycle to seek US capital reduces friction, permits clearer focus on the company's competitive advantages relative to US alternatives, and maximizes the eventual likelihood of closing a US funding round.

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