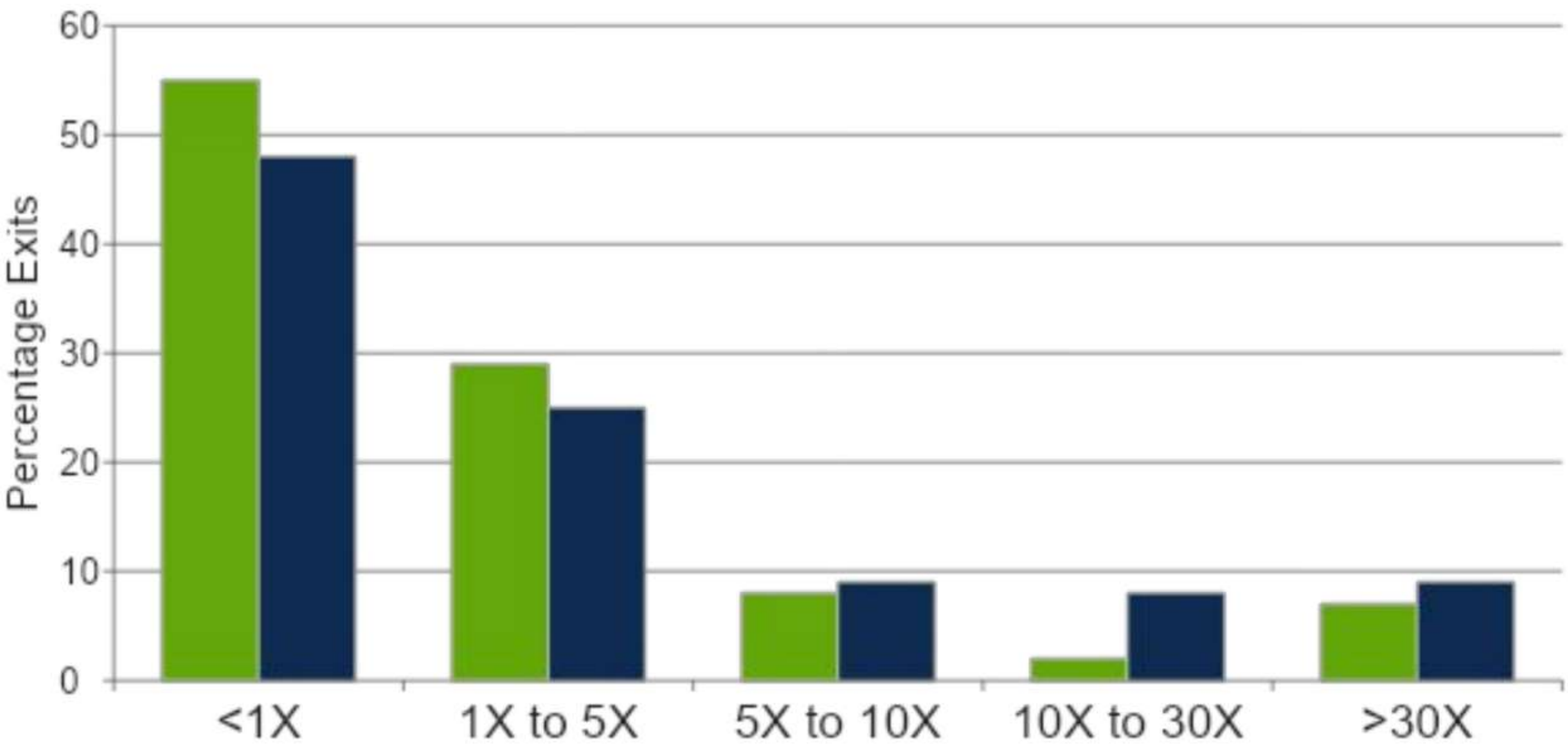
What Happens After the Investment?

Why Engage with Portfolio Companies?

2 interactions per year = **1.3**X

2 interactions per month = **3.7**X



Returns to Angels in Groups Study (2007)
(Kauffman Foundation/Wiltbank/Angel Resource Institute)

Mentoring

- A key to successful returns
- Can you actually help?
- Commitment from both sides
- Mentors don’t operate, they inspire
- Listen first!

“Sometimes a founder just needs you to be there when no one else is…” @HarryStebbings

Startup Boards

- Board make-up
- Follow-on funding
- Management transitions
- Exits

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Make-up of Startup Boards

- Sweet spot is 3 - 5 directors at time of angel round
- At least one angel director (or observer)
- Consider an independent director for balance
- Chemistry is important – toxic boards can kill companies
- Make sure active D&O insurance in force

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Independent Directors

- Usually elected by Board after the funding round closes
- Special skill sets
  - Business sector expertise
  - Startup board experience
  - Small private company M&A exits
- Must be willing to be engaged
- May expect compensation
  - Stock options
  - Cash as company matures
- Is a TCA angel an independent director?

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Multiple Employees on Board?

Just say “no”…if you can

- CEO performance is judged by the Board
- Board assists CEO in evaluating mgt team
- Board helps CEO build and train the team
- None of these are best accomplished with other employees in the room
- Invite employees into meeting as needed

Board Observers

- Non-voting board attendees
  - May or may not actively participate
- Increasingly popular for angels and micro-VC
- Avoids personal liabilities
  of serving on Board
- Increasing Board size can impact agility
- Consider interpersonal “chemistry” with observers as well (not just directors)

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Board Committees

- Consider forming a Compensation Committee immediately
- Compensation chair works with CEO on cash and equity compensation of management team
- Audit Committee chair (if applicable) works with CFO on finance and accounting issues.
  - Board selects auditor
  - Compensation chair meets independently with auditor
- Chairs chosen from among non-operating directors

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Directors' Duties

It's simple if a Director follows these duties –

- Never, never, never run out of cash!
- Mentor/Remove/Replace the CEO
- Sell the company
- Insist on regular communications with shareholders
- Do the right thing…for ALL shareholders

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Shareholder Communications

- Most common complaint by investors
- Set communications expectations prior to closing of funding (we have leverage then!)
- (At least) quarterly summary reports
  - What is working?
  - What’s not going so well?
  - What can investors help with?
- CEO and Chair share responsibility
  - Investors should direct inquiries to CEO or chairperson

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Managing CEO Transitions

Plan For The Future From The Beginning

- Board structure
  - Shared and balanced governance
- Redemption clause or founder vesting
  - For all founders
  - Especially the CEO
  - Will need shares for successor CEO

Frank Discussions with CEO

- Part of due diligence before funding
  - When will company size exceed skill sets of CEO?
  - Do not want growth limited by CEO
- Regular performance discussion
- How/when to make a change?

Recognize Symptoms

- The CEO is not performing
  - Dysfunctional team
  - Sales have plateaued
  - Milestones unmet
  - Poor communications with board
- Board decides to make change
  (usually 6 months late)

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Lessons Learned

- The good, the bad, and the ugly happen
- Written/legal documents are a must
- Ignorance is not bliss
- …Or avoid all of the pain by picking founders wisely

Follow-on Funding

Director's Mandate: Don't Run Out of Cash!

- Helping CEO with cash management discipline
- Early recognition of the need for more cash
- Start fundraising early
- Identify follow-on investors

Capital Sources for Follow-on Funding

- Existing Investors
  - If milestones met, planned round and higher valuation
  - If progress/cash insufficient, "down round" … or worse
- New Angels (Seed+)
  - Existing board and investors should participate
  - Who sets valuation?
- VCs
  - Critical decision for timing of exit
  - Engage before need
- Strategics

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Syndicating Angel Rounds

- Usually with trusted groups
  - Angel groups, family offices, seed VCs, Super Angels
- Rolodexes are key
- Shared due diligence

Sharing Due Diligence

- Necessary for syndication
- Expedites speed of closing
- Less entrepreneur’s duplication of effort
- Building mutual respect for future co-investing among investors
- May want/need indemnification

Board Funding Issues

- How will the Board change?
- Will investors demand board participation?
- BOD seat:
  - Who gets a seat?
  - Impact of VCs on board
  - New power dynamics?
- Will D&O insurance needs change?

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Planning Your Exit

“Until we enjoy an exit, we angel investors are just donors!”

– John Huston, OTAF

Why Plan Your Exit

Entrepreneurs, investors and the Board have to agree upon the answers to these questions:

- Are we building to keep or to sell?
- Are we building a 4X in four years or a 25X in eight years? Both have a 60% IRR

    (More time to exit = more risk)

- Exits take months to negotiate
    - Start the process early, if not day one
- All stakeholders need to be on same page

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Consider Exit Options

SCENARIO ONE

- 1-3 rounds from angels
- Prove the business model with key customers and partners
- Tee up the company for \$20M - \$40M exit with a proven business model
- Exit timing: 2-5 years from first round of angel funding

SCENARIO TWO

- Initial funding angels
- Move into growth/ expansion phase by raising \$5M - \$25M in venture capital
- Understand that VCs will be looking for exit above \$100M or more
- How much longer will this scenario take?

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Exit Planning is Important

- Wait until an offer comes over transom?
- What is the value of an Investment Banker?
- Auctions optimize returns
  - …but cost time and money

Alignment is Critical

- Stakeholders must agree on exit timing:
  - Misaligned directors can kill any deal
  - Exits require significant time and effort
  - Engaging professionals thoughtfully
  - Avoiding partnership contracts that could foul an exit opportunity

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Traditional Steps to an Exit

1. Build alignment on exit strategy
2. Engage the best professionals
3. Clean up the corporate structure
4. Prepare for buyer (M&A) due diligence
5. Build the buyers funnel (list)
6. Manage the auction (multiple bidders)
7. Negotiate and close

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Exits Summary

- Investors need to be proactive on exits
- All stakeholders must be driven to harvest
- Run a disciplined process, if possible
- Are you batting for a double or home run?
- It can take a long time – start early!

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Final Thoughts, Q&A On Anything We Covered So Far…

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