<u>Angel Director Vetting Questions for Angel Insights Exchange</u>
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Angels can help entrepreneurs by discussing the profile of effective directors, and then making introductions to outstanding candidates. Too frequently CEOs and angels think that writing the largest check plus possessing deep domain expertise in the venture's space makes for an ideal director candidate. Or, sometimes it is presumed that "independent directors" cannot remain "independent" if they make a cash investment in the venture. This is a ludicrous argument if they receive options (as all outside directors should).

My view is that all outside directors should make a cash investment in the venture. Clearly Exit Goal Congruence (EGC) with the CEO increases with the size of a director's investment, but, as mentioned below, the ability to invest in future rounds is more important than the size of one's first check. Furthermore, I think that any venture planning to rely on an angel director's specific technical knowledge (versus her/his network and business acumen) is woefully under-staffed. Therefore, I tell angels they might need to coach some entrepreneurs on the director selection factors. Listed below are five director vetting questions I have learned from savvy entrepreneurs who built highly effective Boards.

1) Do they understand the Business Judgement Rule and directors' dual duties of care and loyalty?

<u>Why?</u> Entrepreneurs are far too busy to teach directors the basic legal aspects of their fiduciary duty to all shareholders, including the Zone of Insolvency, if applicable.

2) Have they ever served as a director of a start-up that had a lucrative exit.........or as importantly, one that expired?

<u>Why?</u> Merely serving as a director of another enterprise is inadequate experience to help lead a start-up to an exit. This is doubly true if the enterprise was either a Not-For-Profit or a public company. Dangerous are those directors who have served on boards of publicly traded companies if they assume start-ups are just smaller versions of large companies. Do they think babies are just small adults? If so, they will swiftly become fatigued upon realizing the amount of care and feeding start-ups demand. Many board meetings of baby ventures start with the amount of cash in the bank today (to the dollar) and the current burn rate. Is this a routine agenda item at large companies' board meetings? Most ventures that have achieved lucrative exits missed payroll and struggled to stay standing at some point. Most public company board meetings lack the drama and tension that is routine for start-ups.

3) Will they make it easier for me to raise my next round due to their "star power" + network + ability & willingness to write follow-on checks?

<u>Why?</u> If the venture has neither achieved Survival Cash Flow Break Even (SCFBE) nor has enough cash from the last round to reach it, then its survival hinges on the kindness of investors. This is because the venture cannot "sell its way to survival" without more funding. Without sufficient cash to win enough customers to reach positive cash flow makes investors more indispensable than customers. Even when raising more capital is not essential for survival, "star power" directors who refuse to invest further can scare off other investors.

4) If I must add VCs to my cap table to achieve an exit, what experience/relationships does the candidate have with VCs?

Why? Savvy entrepreneurs have heard tales of woe about negative deal drift that occurred after the VC term sheet was signed. This is often caused by the CEO's all-consuming immersion in the VC due diligence process at the expense of keeping the business on plan (which was assumed in the negotiated valuation). Having a director lead the VC vetting process and then assist with some of the due diligence lowers the odds of more onerous terms at a deflated valuation being demanded prior to closing.

5) Has the candidate ever asked me a question that I had not previously considered?
Why? Many entrepreneurs suffer self-inflicted problems caused believing things about their business that are not true, and disregarding others that inconveniently are. Experienced start-up directors can help avoid these blunders, but ideally will also ask entrepreneurs many "first time questions" they had never heard before. Ventures often burn through all their resources and close their doors not due to their wrong answers to obvious questions, but due to overlooking the questions that determine their survival. And, savvy entrepreneurs take the long view, knowing this is not their last venture. Extracting as much learning from this outing, whether it succeeds or shutters, can make their next one even more rewarding.

Summary: Angels can encourage entrepreneurs to "take the long view" when assessing whether director interactions will likely be illuminating and not merely agreeable. The more an entrepreneur's start-up will require future capital, the more she/he should vet director candidates on their ability to help attract it. This is doubly true if the plan is to exit without seeking VC funding. Prior to discussing compensation with the winning candidate, savvy entrepreneurs have developed a crisp answer to this question: "*What factors convince me that this director will increase the odds that my venture will be successful?"* Angels can prompt this question by providing the five questions above.

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