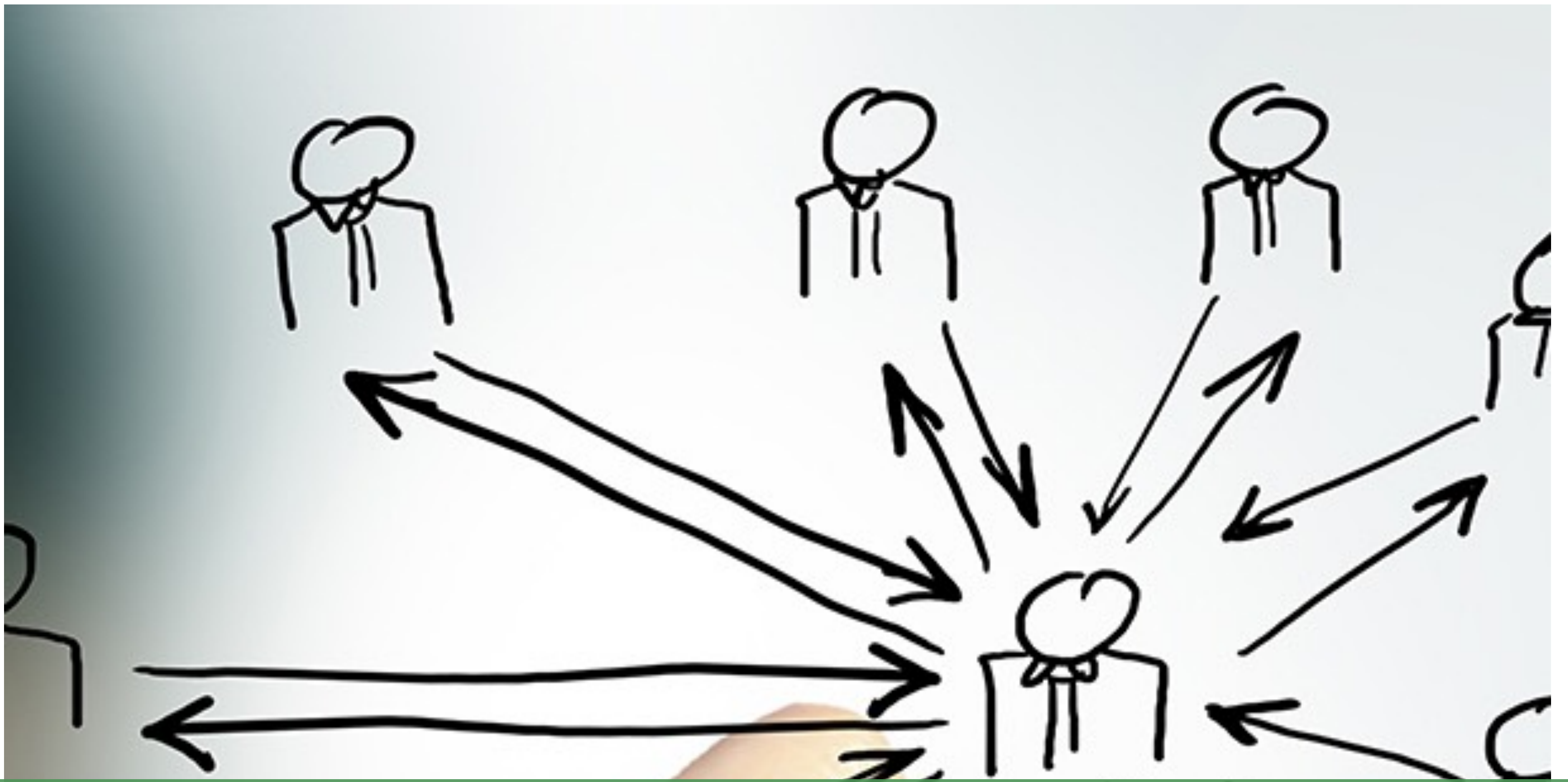

Lead, Follow or Get Out of the Way

The Art and Science of Deal Leadership

Written by two of the Boston's most active and experienced angel investors, the following eBooks are great reference books for both new and experienced angel investors. Easy to read with a fast-moving conversational Q&A format, these comprehensive guides will help any early stage investor gain the skills and insights needed to make smarter investments.

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Understanding Early-Stage Deal Terms

Angel Exits: Perspectives and Techniques for Maximizing Investment Returns

Director's Guidebook: How to be an Effective Board Director in Early Stage Companies

About the Authors

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Seraf Co-Founder **Christopher Mirabile** is the Chair of the Angel Capital Association and also Co-Managing Director of Launchpad Venture Group. He has personally invested in over 50 start-up companies and is a limited partner in four specialized angel funds. Christopher is a frequent panelist and speaker on entrepreneurship and angel-related topics and serves as an adjunct lecturer in Entrepreneurship in the MBA program at Babson. Due to their combination of roles as investors, advisors and angel group leaders, Ham and Christopher were named among Xconomy's "Top Angel Investors in New England."

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Preface

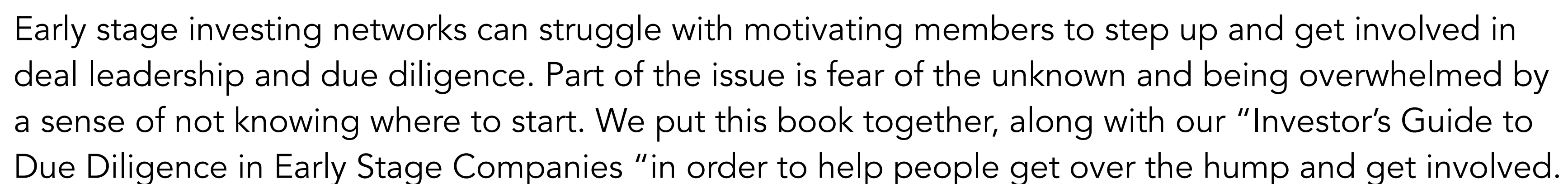
Hambleton Lord &
Christopher Mirabile

Active deal leadership is one of the essential elements of success in early stage investing. As legendary investor Fred Wilson observed, every round needs a lead investor:

"A lead investor sets the price and terms of the investment, takes a large part of the round, and usually agrees to represent the entire round on the board. Then everyone else gets to pile in behind them and piggyback on all of that work. And the entrepreneur and lead investor allow the followers to do that because either they are likely to help the company in some way or because the company needs more capital than the lead is prepared to invest at this time."

Deal leadership is hard, and Fred Wilson doesn't even mention the diligence aspects of deal leadership. Being a great deal lead takes experience, or the guidance of a great process.

That is the purpose of this book - to provide the guidance of a great process so that more people can step up to serve as much-needed deal leads. As you work your way through this book, and the tools and checklists included as appendices, you will benefit from the learnings of very experienced investors who have honed their process over many years, and over many hundreds of deal lead efforts culminating in investments in nearly 100 companies.



Early stage investing networks can struggle with motivating members to step up and get involved in deal leadership and due diligence. Part of the issue is fear of the unknown and being overwhelmed by a sense of not knowing where to start. We put this book together, along with our "Investor's Guide to Due Diligence in Early Stage Companies "in order to help people get over the hump and get involved.

Not every investor needs to be a deal lead, but every successful early stage investment has a deal lead. You cannot make money in this space without leads on deals. Do you have what it takes? Read along to find out.

Leaders Wanted: The Importance of Deal Leadership

The first time I served as a deal lead was unintentional. I happened upon a team I really liked, going after a market I thought was really attractive, with a solution I thought was really smart. So I started telling other investors about it. Many perked up and took an interest, but nothing was really happening because there was no bandwagon to jump onto.

The entrepreneurs had no idea how to raise money or structure a round, so they were hesitant to jump in and set terms, and the other investors, while interested, had plenty of other priorities to attend to. So if this was going to go anywhere, someone was going to need to define the round and establish an acceptable set of terms for people to invest.

> Sometimes being a deal lead is about being a cheerleader and manufacturing enthusiasm, but more often than not it is about managing that enthusiasm and defining a process.

In thinking about terms, I had a sense of where the market was at, but just the same, I spoke to the interested investors to calibrate against what they thought might be acceptable. And I spoke to the company as my thoughts came together. From there it was very natural for me to recommend a way to go about communicating those terms. They agreed. We set out a simple termsheet. We showed it to some other investors. They agreed to come on board. And looking back, I realize that in that moment, I became a deal lead for the first time.

A lot has changed over many years and many investments, but that essential core interaction has not. Every deal needs a lead, a focal point, a way to prime the pump. When I told Ham the story of that first deal leadership experience, he asked me to expand on the role a bit more. Here are his questions and my answers.

Q

Christopher, you and I have led many, many deals over the years. At a high level, what does it mean to be a deal lead?

The deal lead is the investor who steps up to take responsibility for driving the process and sets the terms on which the investment will happen. The deal lead is like the catalyst in a chemical reaction. It is the ingredient that makes the chain reaction start to happen.

Sometimes being a deal lead is about being a cheerleader and manufacturing enthusiasm, but more often than not it is about managing that enthusiasm and defining a process. From a leadership perspective, deals really have three main phases:

- Discovery
- Diligence
- Syndication

Discovery is really the "pitching" phase. It is about testing the waters and finding interest and support for the concept. The deal lead can be a very valuable shepherd during the discovery process, introducing the company around to investors who might be interested.

The diligence phase is the phase where investors try to test assumptions and gauge risks and build a pressure-tested investment hypothesis. The deal lead plays an essential role of traffic cop and coordinator in group diligence efforts.

The syndication phase comes after the initial investors have committed to the termsheet and are looking for others to fill out the round. Human nature is to procrastinate, so syndication is really about staying on people and getting them to commit. The CEO should play an important role here, too, but the deal lead is invaluable as a lead investor who can talk investor-to-investor to the people contemplating the deal.

Q

What makes a good deal lead?

I guess at a very high level it is people skills and experience with the process. To break that down into specifics, it is:

- Knowing how to run a really good diligence process that finds the efficient balance between speed and thoroughness,
- Having an eye on the market and knowing what deal terms will be attractive to other investors,
- Having connections to investors behind you who can invest along side you,
- Knowing the right things to say so you are effective at cheerleading and coaching folks along,
- Educating and mentoring the CEO through the process,
- Staying on top of things and moving the process quickly,
- Having connections to find a value-added director who can take a board seat and oversee the investment, and
- Having a group of smart investors who can help with the due diligence.

Q

Does a deal really need a lead? What about company-led rounds where the CEO puts together a termsheet?

A round absolutely can be led by the company, and it happens quite regularly, particularly in cases of necessity. But the company-led round really presents two main sets of issues:

The first set of issues occurs at the stage of building and filling the round. Every decently-sized round needs a market-attractive termsheet and a good diligence report. If a company does not have an investor to negotiate with them and hash out a set of terms that are "at market," they will end up with something based on the termsheet of their friend's company or their lawyer's suggestions for terms. These termsheets can be spotted a mile away and often have inappropriate or off-market terms buried in them. Once a few inexperienced people have committed to those terms, they become a hassle to change and act like a big roadblock to bringing other investors in.

Company-led rounds also don't have diligence materials to offer prospective investors. Without a diligence report, the company will burn themselves out trying to "re-pitch" the company

and re-answer the same sets of questions over and over, with time-consuming and not entirely convincing results. A third party diligence report is not gospel, but, like a third party termsheet negotiated at arm's-length, it does add a big measure of credibility to the round. Without this credibility, it can feel like the entrepreneur must have some kind of a flaw if they have not been able to find any investors.

The second set of issues presents itself after the round is complete. It can be summarized as a "diffusion of responsibility" issue. Company-led rounds are sometimes referred to as "party rounds," meaning all that name implies.

- Nobody is in charge,
- There is no investor representation on the board,
- No meaningful governance or oversight,
- No plan for staging capital into the company and defining milestones for the next round,
- No single investor with real skin in the game,
- No one to organize and rally investors in the face of management team issues,
- Creeping valuation issues from things like stacking convertible notes, and
- A general lack of accountability and rudderlessness.

Of course some of these party round companies get lucky, gain some traction and attract the attention and oversight of key investors later. But many do not. You can imagine what happens to those which do not.

> The syndication phase comes after the initial investors have committed to the termsheet and are looking for others to fill out the round. Human nature is to procrastinate, so syndication is really about staying on people and getting them to commit.

Q

Why put in the work to be a deal lead? Why not just join rounds led by other people?

Since a round only needs one lead for its many investors, that can be a perfectly viable way to go for many investors. In fact, some investors, particularly those in well-organized networks, go their entire career without stepping up as a lead. Even if you do occasionally lead, you cannot lead

everything, so it is fine to invest where a trusted co-investor leads.

The advantages to doing it yourself, however, are that you can:

- Make sure it gets done right,
- Get to know, observe and work better with the CEO,
- Make sure the deal terms work and the round fills quickly so the CEO can get back to developing the company,
- Make sure there is a good overall capital strategy for the company, and
- Put someone you trust and whom you know is good on the board.

With company "projects" you really care about, sometimes the desire to lead becomes overwhelming.

Q

Does everyone rely on the deal lead's due diligence? Is that a safe practice?

As noted above, a third party diligence report can lend tremendous credibility to a round. It is typically shared subject to a diligence sharing "treaty" or one-off disclaimer. Sharing a report can save a ton of work for both the investors and the company, but it is not a cure-all. Unless it comes from a source you know and trust, with a process you know is consistently thorough and professional, the cautious investor is going to want to double-check some things firsthand. It is very common for investors to rely on third party diligence lock, stock and barrel, but experience has taught us that it is very smart to double check key issues like the team (with a few blind reference checks of your own) and the market (with a few calls to customers or experts more knowledgeable than yourself).

Q

So if the lead sets the terms, does that mean no one else has any input or ability to renegotiate the terms?

It is possible to tweak the terms or even change them wholesale, especially if you are bringing a lot of money to the round. This is a major hassle for all involved, and a significant risk to the company due to the possibility of lost investors or lost momentum or both. So most experienced investors try as hard as they can to look at the the terms on kind of a take-it-or-leave-it basis. Either the deal is attractive on the terms being offered, or it is not. This is an example of why the deal lead role is so important. For things to work smoothly, it is essential to get in place at the beginning an acceptable set of terms around which investors can rally. That is what a great deal lead does.

If you have to change the terms mid-process, tremendous friction, wasted time and uncertainty ensues. In some cases it is a "tempest in a teapot" because the new terms being introduced later in the process are investor-friendly and end up being viewed as a bonus to previously committed investors. But, sometimes the existing investors think the change is a bad long-term idea, even if it is technically in their short-term interest, and so they push back on the change. When that happens, you end up with a

bunch of investors negotiating and fighting amongst themselves. It quickly turns into chaos. Most investors have little patience for that and will wander off and let the loudest voice win; the theory being that there are plenty of fish in the sea and it is better to look elsewhere than to try and clean up a deal that has gotten wrapped around the axle on terms.

Best case scenario, these rounds are bumpy, unprofessional time-wasters that highlight a lack of leadership and a lack of professionalism. Worst case, they careen toward entropy and simply fall apart with everyone concluding they don't need the brain-damage.

Chapter 2

Short & Savvy: Hallmarks of A Good Deal Process

During my many years working for a large enterprise software company, I participated on dozens of due diligence teams. I had the valuable experience of sitting on both sides of the table during these projects. I ran diligence teams where my company was looking to buy other companies. And, I handled the brunt of responding to a diligence effort when my company was dealing with potential acquirers. Needless to say, it's a real challenge for both sides, and not everyone understands what it takes to run a good due diligence process.

No big surprise here, but everybody seems to want good diligence to be performed, but few seem to want to do it. Partly that's because it is work, and it requires a tolerance for ambiguity and uncertainty. Also, the many diligence processes that are not well run end up being a poor experience for the participants. So what can you do to make things run smoother?

At Launchpad we run due diligence processes on early stage companies dozens of times each year. And, we've been going at it for over 15 years! We've had ample time to think about and refine the process and to assimilate great suggestions from the smart investors who have been on our teams. We believe that the goals of a good diligence process are: efficiency, insight and informed decision-making. We think the hallmarks of a good process are:

- Speed
- Efficiency
- Conciseness
- Respect

Ham has experienced diligence from both sides of the table, as well. He raised funds for several of his software startups, and he led more diligence processes at Launchpad than he probably wants to admit. So let's put Ham on the spot for a little more perspective.

Q

Ham, what does it mean to have a process with goals of efficiency, insight and informed decision-making?

First off, we find it's critical to have a standard due diligence process that everyone on our team adheres to. If everyone on a diligence team understands up front what expectations they need to meet, it makes each person's job a bit easier.

> We believe that the goals of a good diligence process are: efficiency, insight and informed decision-making.

Let me give you an example from the Launchpad playbook. Let's say your assignment is to perform reference checks for the company CEO. First off, the company provides you with a list of individuals to contact. Second, you should reach out to members on your diligence team and/or your personal contacts to see if there are any other individuals who can provide a back channel reference for the CEO. You will then contact these references and ask a series of questions based on a management assessment questionnaire (see Appendix). Having performed 3 to 5 reference calls, your job is complete after

you write a very short (one or two paragraph) summary of your calls. Not bad… you finished your assignment in a few hours!

So take the above example and apply it across all of the areas that you need to cover during due diligence. Each area needs a well-defined process to make it efficient and easy to accomplish in a limited number of hours. Once you define a consistent process, you will be amazed at how efficiently it runs. And, when every member of the team has a well-defined job, the overall experience improves for all participants.

That leads us to the second part of your question relating to insight and informed decision-making. Having invested in 100+ companies over the past 15 years, we've seen lots of companies succeed and lots of companies fail. Using our post-mortem reviews on these companies, we've been able to go back and refine our due diligence checklist to make sure we are covering critical issues that can lead to either success or failure with our investments.

Let's make this concept a bit more concrete. A few years ago, after doing a review of some of our failed investments, we realized we weren't asking enough probing questions related to customer demand. When we performed customer reference checks, we usually received positive feedback from the early customers. Where we fell short in our diligence was with our understanding of customer demand beyond those early customers. This insight forced us to revise our customer reference check questionnaire (see Appendix.) Now we ask a couple of new questions during the reference check that are intended to better understand demand through the lens of buying priorities:

- On your list of the top problems in your organization, where does solving this problem fall on your priority list?
- Is your company generally an early or late adopter of new solutions?

By running a consistent, efficient diligence process that is informed by our prior investment outcomes, we believe we are making more thoughtful investment decisions. In turn, this helps to set a standard for excellence within the early stage investment community.

Each area needs a well-defined process to make it efficient and easy to accomplish in a limited number of hours. Once you define a consistent process, you will be amazed at how efficiently it runs.

Q

When you talk about the hallmarks of a good process you cite "speed" as the first thing. What does that mean, and how do you do it?

At Launchpad, we have a bit of an advantage when it comes to the speed of our diligence efforts. A typical diligence team at Launchpad will have 8 to 15 people. We divide the diligence tasks across the group. We always break it up into very focused assignments. Sometimes we will assign one person to a focused task and sometimes two people.

Our goal is to have the diligence process complete and at least a first draft report written within a month of starting the process. With a volunteer group of investors, this timeframe is only possible if we have different teams work in parallel on their separate tasks. We don't always achieve our one month completion goal, but we are usually close. Sometimes we are delayed by holidays and travel. Other times, we are delayed when the company is not able to get us materials in a timely manner.

Q

How about "efficiency?" How do you run a meandering, discovery-oriented process efficiently?

We discussed the answer to this question during the initial question. Ultimately, it comes down to not allowing the process to meander too far. You do this by putting in standard procedures for almost every task, and a clear focus around the expected deliverables. If you arm your diligence team with the tools they need to get the job done and you show them exactly what they are expected to produce, the resulting process can be both professional and efficient.

Q

Why do you say "conciseness," rather than "thorough?" At first blush, wouldn't you be aiming for thorough?

Thorough is a very slippery slope. Some investors want to dot every "i" and cross every "t". If we did that at Launchpad, we would end up making fewer investments. This would badly undermine the diversification so necessary to generate good angel returns, and we would burn out the folks doing the diligence. It just doesn't make sense with an early stage company to look under every rock for a problem.

Instead, you should focus on identifying the key risks that are actually likely to affect outcomes and limit your diligence to the critical areas that need further examination. So, for example, if a company has been in business for a year or so and has only a few customers, you won't spend much time looking at their prior year financials. Conversely, if the company has licensed core technology from a university, you want to make sure that the IP agreements are in order.

The resulting due diligence report should also be concise. At Launchpad, we use a Due Diligence Report Template (see Appendix.) The template is focused on 11 major topics that should be researched and understood when performing due diligence on an early stage technology company. Experience conducting hundreds of

diligence projects and leading dozens and dozens of syndications has taught us that it's important to be succinct in your diligence summary. Otherwise, you will end up with a long report that investors won't read through, thus defeating the purpose of the report.

> You should focus on identifying the key risks that are actually likely to affect outcomes and limit your diligence to the critical areas that need further examination.

Q

And where did you come up with "respect" of all things? Isn't the point to turn a skeptical and jaded eye on the claims of management and see if they are what they are cracked up to be? What does respect have to do with it?

In my view, respect is one of the core principles that guide how I conduct myself in business and in life. Therefore we insist that it be an unwavering hallmark of our organization - in all situations, and without exception. Not only is it the right thing to do, it is good business. Great teams have choice in picking investors, and they want to work with investors who respect them.

That does not mean you need to tip-toe around. It's okay to be demanding during the diligence process. A CEO should expect to answer tough questions. At that same time, the CEO should expect to be treated in a respectful manner.

And, this goes both ways. Members of the due diligence team should be treated with respect, as well. Although the startup community seems to be a large and rapidly expanding world, in reality, it's quite small. CEOs talk to other CEOs. Investors talk to other investors. It doesn't take long for a disrespectful individual to lose credibility in the community. And deservedly so, in our view.

Q

How unique is this process? How did you arrive at it?

I don't believe that our process is entirely unique. Perhaps at the detail level, but in terms of broad themes, we are probably typical of a well-run process. VCs and angels have been investing for decades. Well-run organizations have put in place processes that work well for their particular ecosystem. What we've built at Launchpad works for us because it is based on lots of:

- Deals,
- Experience,
- Observations about what works and what doesn't, and
- Great suggestions from many smart people on many smart teams.

And finally, we ask the entrepreneurs for feedback on how things went for them. It's amazing what you can learn when you ask questions!

Q

How do entrepreneurs react to it?

Many assume that it is like root canal surgery for entrepreneurs. In fact, the opposite is true. Good entrepreneurs will get a lot out of a well-designed diligence process.

- They learn a lot about the weaknesses in their plan,
- They learn a lot about themselves and their team, and
- They learn a lot about their market and how to go after it.

Finally, they really appreciate the respect shown to them for their time and the value they get.

One Step At a Time: Overview of Deal Stages

Since I am part of a team that runs a very active angel network, most of the time, I am juggling a bunch of deals in different stages of completion. It can be hard to keep track of where everything stands. Obviously, regularly updated lists and status reviews are helpful, but even more helpful is an overall sense of each of the stages in the process. In particular it helps to know which stages are critical junctures and key turning points in the life of a deal. That way as deals make progress and are approaching those points, you can jump in proactively and help guide them along.

So what are these stages and how should a deal lead think about the overall process? As we have pointed out in our articles on diligence, we like to progress diligence in logical, sequential stages in order to conserve time and effort - that of the entrepreneur as well as the investors. It doesn't make sense to put a ton of work into an effort if you have no likelihood of investing. So a process designed with checkpoints along the way is the best approach.

A good basic process will include the following stages:

- Initial Pitch Meeting
- Deep Dive Meeting
- Due Diligence Phase & Goal Alignment
- Negotiation of Terms
- Solicitation of Soft-Circles
- Syndication
- First Closing

Let's have Christopher take us through a closer look at each of these stages at an overview level.

Christopher, how do initial meetings work? Are you talking about screening, or a formal pitch?

Pitching companies typically are introduced to the investors by a trusted source and then selected and invited to pitch as a result of making it through some form of screening process. Active early stage investors will look at anywhere from 50-100 companies for each company they actually invest in. Angels invest in a lot of companies, but say no to the significant majority of companies they speak with.

Screening is typically done by a committee or subset of the investors in a network. The companies which make it through screening will typically progress to a pitch in front of the full group or network. These pitches are almost always relatively short in duration - somewhere between 10 and 30 minutes, with a 15-20 slide deck as a guide, and some time for questions and answers after the presentation.

> We like to progress diligence in logical, sequential stages in order to conserve time and effort - that of the entrepreneur as well as the investors.

Well-crafted pitches will typically cover a pretty wide gamut of topics, including:

- Description of the Customer Problem
- Overview of the Product/Solution
- Team/Key Players
- Market Opportunity
- Competitive Landscape

- Go To Market Strategy
- Stage of Development & Key Milestones
- Critical Risks and Challenges
- Financial Model & Projections
- Funding Requirements & Use of Funds
- Exit/Liquidity Options

If the pitch and Q&A goes well, a presenting company will typically progress to a more lengthy session. Many groups including Launchpad refer to this next lengthy meeting as a "deep dive meeting."

Q

What do you mean by a "Deep Dive?" How do those meetings work? Who attends? Is there a formal agenda?

The deep dive meeting (see Appendix for example deep dive meeting notes) is pretty much exactly what it sounds like. A longer format meeting, typically two or more hours, to unpack the story in a little bit greater detail than can be done in a pitch. If a pitch is a quick check of investor interest, a deep dive is a chance to qualify that interest and see if there is enough substance to merit forming a due diligence team. Deep dive meetings typically involve the investors most interested in the company based on the initial pitch meeting. And, not surprisingly, the diligence team is recruited from these deep dive volunteers.

In most cases, there will be 2-5 themes or clusters of key questions that arise during the pitch. The deep dive is focused on these questions; the questions should be organized into an informal agenda with time allocations. To make the meeting most effective, the company should receive in advance an overview of the key topics to be covered and the key questions which were brought up at their presentation. And the meeting should be actively monitored to keep it on schedule and ensure that all the key topics are touched on.

As noted in an earlier question, a good diligence process progresses through a series of checkpoints.

- Screening is one,
- A successful pitch is another,
- And a deep dive is a big one.

Forming a team and undertaking a diligence process is a lot of work for investors, and a lot of time and distraction for founders. It should not be undertaken on a whim. Therefore many companies progress no further.

At Launchpad, slightly over 50% of the time, interest in the company diminishes after the deep dive and we halt discussions with the company. The decision need not be unanimous, but it must be crisp and clear. If the majority lacks interest, it is important to be definitive and not waste investor or company time.

Diligence causes some attrition and fatigue; it is a disaster to go in with too few volunteers and too little conviction. It is better for all involved to make a clean break and step out of the lead role. If the company finds another lead and gets the round going, investors can always peel off and circle back and join the round under another group's leadership. But a group with insufficient enthusiasm should not undertake the deal lead role. It is bad for everybody involved.

If interest remains after the deep dive meeting, we select a deal lead and launch into the next phase of due diligence.

> Goal alignment is about making sure everyone wants and expects the same things out of the company. Goal alignment is typically used to establish common ground around the long range plans of the company.

Q

When noting the section of diligence, you called the main phase "due diligence & goal alignment." Why do you give "goal alignment" the same billing as due diligence?

They get equal billing because diligence is really a combination of micro and macro. You need the team to delve into the details of the business and build and test an investment hypothesis. But the deal lead's job is to simultaneously keep an eye on the big picture:

- Are the investors and founders on the same page?
- Is this a deal that is going to work?

Goal alignment is about making sure everyone wants and expects the same things out of the company. Goal alignment is typically used to establish common ground around the long range plans of the company. It's crucial to make sure the investors and the founders are in sync and want and expect the same things. Goal alignment needs to cover a variety of areas, including:

- Long term company objectives
- Use of funds and aggressiveness of investment levels
- Long range financing plans and assumptions
- Exit strategies and expectations on size and timing

One of the key conversations the deal lead should have with the CEO revolves around where and how fast the company is planning to spend the cash investors are supplying. This "Use of Funds" discussion presents an interesting test for the early working relationship because it involves some tricky questions. Key hot button topics that frequently come up include compensation for the management team, key initial hires and marketing spend.

It is also important to figure out if there is agreement on what we need to learn about product / market fit before we pour on the gas. Is there a consensus about how many new markets we will enter simultaneously?

Another set of alignment-oriented questions might be along the lines of:

- What are the growth milestones that allow the company to raise a future round of financing at a favorable valuation to the early investors?
- Will there be enough funding from this early round to allow the company to achieve these important growth milestones?

As the diligence team is unearthing key details of the plan, the deal lead's role is to fit that information into the overall big picture puzzle and make sure there is alignment on goals.

Another very important by-product of the goal alignment process is laying a foundation for the long term relationship between the deal lead and the CEO. It is fairly typical for a deal lead to end up being a board member or at least a close advisor to the company or liaison to investors. Over a period of 6 to 8 weeks, the deal lead will spend a fair amount of time interacting with the CEO. This is an important time to establish the basis for a longer term working relationship. If possible, it helps to spend time getting to know the CEO on a more personal basis. The goal is to make sure you are comfortable working together for the next several years.

Q

Goal alignment sounds awfully close to a negotiation. When does the negotiation stage formally start? How do you know it is time? Who is in charge of it? How do the issues from diligence play into it?

It has been observed that everything is a negotiation, and that is probably true in this context. Every interaction tells you something about the management team and informs your approach to deal formation. Many of the issues uncovered by the diligence team will have implications for terms like valuation and size of round. And, you often discuss with the CEO, at least preliminarily, big issues like valuation range, size of round and board representation as a sanity check and condition of inviting a company in to pitch.

But all that said, the formal negotiation really should not start in earnest until it is virtually certain that the diligence team will reach a positive recommendation. It is true that you could shave a little time off if you started a bit earlier, but that can prove to be a disastrous mistake for a couple of reasons:

- If the team suddenly uncovers a "deal breaker" issue and decides the deal is uninvestable, you will have a mess on your hands trying to explain that to founders with whom you already started negotiating deal terms.
- If the team finds an issue, that is not important enough to kill the deal, but has big implications in terms of valuation, you are going to find it extremely hard to re-trade the price of the deal if you have already floated a higher number. It does not matter that you found a new issue - the entrepreneurs will always experience it like you are reneging on the deal.

So it is generally best to wait until the team has reached a positive consensus and begun drafting their diligence report. At that point you can begin to flesh out a termsheet.

There are two ways to go about forming a termsheet: you can walk the CEO through the concepts and your thoughts before showing it to them, or you can just send them a proposed draft termsheet. I generally base my approach on the sophistication level of the founding team. If they are very experienced and familiar with early

stage investing terms, I will generally just prepare a draft termsheet and send it to them.

But, if they are new to the whole investment process and some context and education and perspective might help them better understand the termsheet and react to it more constructively, then I will generally have a conversation and explain the various issues and where I am coming from on each point before sending it over. That way they know roughly what to expect and are not surprised by the harsh black and white of the terms on paper.

> Formal deal term negotiations really should not start in earnest until it is virtually certain that the diligence team will reach a positive recommendation.

Q

What do you mean by soft-circle? What is going on and how does that process work? What is the role of the deal lead? Are there better and worse ways to do it?

A soft-circle is an indication of interest by an investor in a deal. It typically involves the investor specifying an actual dollar amount they are willing to invest in this round with this company. It is called "soft" because it is conditioned on the final terms being acceptable and as described in the termsheet.

Soft-circles are an essential tool for two reasons. First they allow a deal lead and entrepreneur to run around and line everyone up and rally support for the deal. The mounting cumulative total of the soft-circles is really the yardstick of the deal's progress and momentum. If they accumulate quickly, or at least steadily, it is an indication that the terms of the deal are going to be acceptable to the market.

Secondly, soft-circles are a way of holding investors and money in suspension while you line up one or two orchestrated closings. People are mentally committed to the deal, but they have not yet written a check. So they are on-board but held in suspension while you get the minimum money needed for the first close.

This ability to hold committed investors in suspension is invaluable because closings are a fair amount of work and involve coordination and transactional expense working with outside counsel. This is because the key terms of the deal are effectuated by means of a new class of preferred shares and these are memorialized by the filing of a revised certificate of incorporation

in Delaware or another state of incorporation. (For more on deal terms, see *A Guide To Angel Investing Documents: Preferred Stock Deals and Fine Print: Understanding Key Deal Terms and How They Can Affect Your Returns*). Closings also involve the collection of a lot of signatures on a lot of documents as well as the transmission of a lot of checks. It is much more efficient to do all that work at once in one big organized orchestrated way than to have money trickling in over weeks and months.

Soft-circles can be solicited any number of ways; via email, telephone or a webform. At Launchpad we use a simple webform which results in a cloud spreadsheet (for example, Google Forms and Google Docs). This way, all the information is in one organized place and the resulting cloud spreadsheet can be shared with the entrepreneur and their attorney. In fact, we often let the entrepreneur use the webform for other investors who are not in our group. And, they can embellish the cloud spreadsheet with other notes and annotations that everyone involved in the deal administration can see. Since we are consistent in using Google Forms, the investors in Launchpad are familiar and comfortable with the process. We can easily post and circulate new investments to our investors. Very effective, yet fast, light and efficient.

Q

You've referred to a "first close." Are there others? Is this syndication? What is a syndication and how does it work? For that matter, why is it called syndication?

Yes, yes, it is all related. In finance, the term syndication refers to bringing groups or entities together into a transaction. In early stage investing it is about showing the deal to different investors, groups, networks, or funds to have them join the collection of investors funding the deal.

Often this kind of collaboration is necessary to fill the deal since each individual investor is only contributing a small amount relative to the overall round size. But regardless of whether it is necessary, it is often desirable since it builds a stronger, broader and more diversified financial base for the company to rely on in future rounds. And it gives the company a broader network of investors who can advise, help and make introductions.

The way syndication typically works is the lead investor and their network or closest associates will be in the first close. Once the closing minimum is met, the company has a close and can start putting the money to work. Then, the deal lead will accelerate the process of presenting the deal to other investors. Not only will they have a termsheet and diligence report, they will have two other key advantages:

- They now have some momentum to show - they can show that a good chunk of money has already closed, and additional soft circles are piling up.
- They have scarcity - the round is starting to fill up - a consensus is emerging and it is time to move or you will be left behind.

Momentum and scarcity are absolutely key ingredients for deal leads looking to get investors to move.

Q

What is a closing? Why are they necessary? How should a deal lead be involved with a closing?

As noted above, a closing is an orchestrated transaction involving the company and all the investors signing and exchanging deal documents, sending in money and making filings with the state and federal regulators. Because closings are a fair amount of work and involve coordination and transactional expense working with outside lawyers, you want to have as few closings as possible and have each one be as big as possible. This is because the key terms of the deal are effectuated by means of a new class of preferred shares and these are memorialized by the filing of a revised certificate of incorporation in Delaware or another state of incorporation.

Closings, in conjunction with closing minimums, allow for a very important protection for investors, who fear being the first person to invest and having their money stuck in an under-funded company. A closing with a defined minimum needed to close gives investors the certainty that their money will not be released to the company until a certain minimum viable dollar threshold has been met.

A deal lead's role in a closing is to keep the lines of communication open with investors on timing and expectations, and to advise the company on how not to screw it up. The way most companies screw it up is by sending the closing package from hell – the biggest "unforced error" in all of early stage investing.

Every investor has experienced it. A giant mess of documents arrives via email late on a Friday night from some person you never heard of. Some documents are in PDF, some Excel, the rest in MS Word. They are all dumped into the bottom of an unclear email demanding immediate attention and response. The documents are inscrutably named, with long strings of digits from internal file system numbers.

When investors start to wade in, nowhere is it made clear what documents they are supposed to sign and what documents are for information only. Nowhere does it indicate where in the document they are supposed to sign. Nor is it ever made clear that several documents need to be signed in two places and one in three. And of course some documents are only for existing investors whereas others need to be signed by everyone.

A deal lead can and should make sure everyone is clear on the closing process and it gets done on time as expected. They should keep on top of the company to communicate with investors to make sure the follow-ups happen:

- Counter-signed documents go out,
- Stock certificates (or receipts or electronic certificates) go out,
- A summary of the final close and company financing status goes out.

Many Hands, Light Work: The Team Approach to Processing Deals

Do you remember the first time you became excited about investing in an early stage technology company? You were impressed by the CEO and you loved the market opportunity. But, you knew you had to dig deep to find out whether there was a real winner in the making. So, you took a step back and started putting together a list of all the questions you had and the research you needed to do before making an investment. It felt a bit like being back in college and working on a major research paper. You were excited by the project, but daunted by the amount of work!

Even when you right-size the process and try to focus on the major issues, diligence can be a lot of work. It can be fun, and if you are trying to build a diversified portfolio of 10 or more investments and do all your own diligence, you are going to burn out long before you are diversified. Plus, you probably won't do as good a job working on your own as you could if you had some help.

A team approach brings more hands, more eyes, more perspective and more expertise in areas where you may be less knowledgeable. Angel investors working together in groups address the biggest tension in early stage investing. This is the tension between the need to be diversified in this asset class to win, and the fact that, done right, each deal represents a lot of work. Properly constructed diligence teams are a perfect way to address this tension.

Q

Ham, you formed and led a lot of diligence teams in your 15+ year angel career. What resources are you working with when forming a team? What is the deal lead's role in putting the team together and making it work?

The very nature of a team means you are not working alone. Everyone on the team should have a well-defined job. As the deal lead, it is your responsibility to divide up and delegate tasks based on the diligence checklist you put together. Your team should have people with applicable skills and knowledge in the areas that you need to research. If you don't have the right skills internally, you might need to reach out into your group's external network to find appropriate skills. For example, at Launchpad, we work with our attorney to help us on the occasional Intellectual Property review.

Angel investors working together in groups address the biggest tension in early stage investing. This is the tension between the need to be diversified in this asset class to win, and the fact that, done right, each deal represents a lot of work.

Once you have each of the key risk areas covered by one of your team members, the deal lead's role evolves. Now, you own the ultimate responsibility for making sure things move forward in a smooth, timely fashion. This includes:

- Gathering documents and important materials from the company,
- Making sure your team members are completing their assignments,
- Assembling the content and editing the final due diligence report,

- Keeping things on track and hitting your deadline for a final investment decision.

Needless to say, a great deal lead tends to be an individual who likes to manage teams and projects. If that doesn't fit your personal/work profile, you should probably reconsider whether you should be a deal lead.

What does it mean to be on a diligence team? What is a typical time commitment and set of expectations?

As a diligence team member, you will volunteer to take on a specific diligence assignment, such as customer reference checks or a competitive review. With a well defined task, your job is to assemble the appropriate information in a timely fashion.

During the diligence effort, the deal lead manages activities and requests with the entrepreneur to ensure professionalism and coordination. Each team member is expected to be responsive to other team members and timely with their deliverables.

Most diligence assignments are relatively specific and should be completed within a reasonable amount of time. Depending on the task, your work effort should fall within a range of 2 to 8 hours. For the entire diligence team, with everyone working in parallel, the typical diligence process can be completed in 20 to 40+ person hours of work. By working in parallel, a diligence team should be able to wrap up their assessment of the company and publish a report within a month.

How do you approach the question of tools? Is there special due diligence software you are supposed to use? Is there one proper way to produce the work product?

There are many ways to approach the question of tools to support the due diligence process. At Launchpad, we apply tools to all of our processes with the philosophy that you want to be pretty heavy on the tools in the beginning at the deal flow stage with a deal flow management system, and pretty heavy at the post-investment stage with a good portfolio management system, but you want to keep it pretty light and loose in the middle during diligence. We therefore apply tools in the following manner:

- **Deal Flow** - We use a sophisticated content management system that helps us track our interactions with the hundreds of companies that apply to Launchpad every year. This system is well organized, supports a lot of different views into the data, and allows us to closely follow a company as it progresses from their initial application to our group all the way up to the due diligence stage.
- **Due Diligence** - We deliberately allow our deal leads and diligence participants to use a collection of comfortable off-the-shelf, simple products to help manage diligence. All of the products (see below), are tools that most business people are familiar with, having used many of them for work or personal activities.

- **Portfolio Management** - Once we invest in a company, we want to track that company as part of our overall portfolio. At Launchpad, and for our personal early stage portfolios, we use Seraf to stay on top of our investments, gain visibility, track performance, and report on our portfolio.

For the entire diligence team, with everyone working in parallel, the typical diligence process can be completed in 20 to 40+ person hours of work. By working in parallel, a diligence team should be able to wrap up their assessment of the company and publish a report within a month.

There are four types of tools that we make frequent use of during the due diligence process. All of these tools are free, web-based platforms. Some of these products have more full featured, paid subscriptions. So here's what we recommend you put in place:

- **Deal Room** - The Deal Lead should set up a shared folder in the cloud (e.g. DropBox but other cloud folders will work) and invite team members to the folder. Materials can be collected there for everyone's reference.

- **Meeting Scheduler** - Coordinating calendars for a group of individuals is never easy. You will need a meeting scheduler (e.g. Doodle, TimeBridge, NeedToMeet) to conduct scheduling polls to arrange meetings.

- **Conference Calls** - Most meetings during the diligence process will be handled by conference call. You will need a conference calling service for this reason (e.g. UberConference, FreeConferenceCall).

- **Diligence Report** - As we noted in our eBook on due diligence, the Deal Lead should consider assembling the report in Google Docs so that everyone can see each others' work as it comes together. See the Appendix for a diligence report template.

Chapter 5

Every Team Needs A Coach: Managing the Deal Process

Not everyone is cut out to lead a deal. In our experience, it takes a certain temperament and set of people skills to lead a bunch of peer volunteers. There are many successful investors who cringe at the phrase, "managing the process." Managing is the last thing they see themselves doing. The good news is that early stage investing seems to attract a lot of people who are motivated, take-charge people who are looking to help out and give back. So there are many early stage investors who love to "manage." Maybe they were product managers or some form of group leader in their career. Or, maybe they just love being organized and leading group efforts.

Ham spent a good part of his early career as a product manager for a software company. So he's one of those folks who is skilled at and enjoys managing a team process. In the early days at Launchpad, he pulled together the guidelines that evolved into the processes we use today in every one of our due diligence efforts.

> The first time you lead a deal, it can be a bit overwhelming. This is where strong organizational skills and an ability to work toward a goal come into play. Having a well-thought-out checklist and a well-coordinated team will make your job easier.

Q

Ham, assuming an individual is the type of person who enjoys managing a process, what does it actually take to "manage the process?"

It all comes down to the checklist. The first time you lead a deal, it can be a bit overwhelming. This is where strong organizational skills and an ability to work toward a goal come into play. Having a well-thought-out checklist and a well-coordinated team will make your job easier. A willingness and ability to delegate tasks across a good sized group of 6 to 12 individuals is crucial. Taking on many of the tasks by yourself is defeating the purpose… remember, diligence is a team sport!

Q

What are the main tasks the deal lead is really doing in their leadership role?

There are a handful of major responsibilities that a deal lead must be willing to buy into to ensure a successful diligence process. They include:

- **Keeping the process moving** - If diligence drags on, the likelihood of a successful deal diminishes rapidly. You don't want speed for speed's sake, but you do need to push the team to complete all the assigned tasks.
- **Communicating with the team on a regular basis** - Without regular communications, it's very common for diligence team members to slack off on their assignments. By communicating with the team on a weekly basis, you are applying subtle pressure to get all assignments completed.
- **Coordinating interactions with the company** - Just as diligence team members need to be in the loop, so does the company CEO. You want to make sure they know what's going on with your team. And, you will help coordinate

any meetings your team might need with members of company management.

- **Maintaining a positive and supportive (but objective) tone** - It's easy to find all the "warts" with an early stage company. Helping your team members (especially the less optimistic ones) maintain a reasonable perspective on what an early stage company should and shouldn't be able to achieve in its first years is critical. That said, you are not a cheerleader for the company. So make sure you maintain a proper balance when working with your team.
- **Creating a succinct but thorough and professional diligence report** - Are you going to read a 40 page diligence report filled with lots and lots of details? I doubt it! So why would you want to write a 40 page report? Through lots of trial and error, and after reading a few 40 page reports produced by other investors, we came up with a succinct format for diligence reports. So, keep it short, thorough and professional, even if that means editing one of your team member's 5 page "summary" on their assignment down to 2 or 3 paragraphs.

Q

What are some traps for the unwary?

I can think of dozens of ways that the diligence process runs into real problems. Over the years, we've run into many situations that made us rethink how to best run our diligence teams. And, we've heard war stories from other early stage investors that helped to shape our approach to diligence. I won't write an exhaustive list of traps, but here's a list of some of the most common problems:

- **Too much 1:1 communication** - As a deal lead, there will be times when you need to have a quick conversation with a team member. That's okay as long as it's not your standard operating procedure. You are better off having a weekly conference call to make sure that your entire team is in sync. And, it's a more efficient use of your time, as well.
- **Too many long conference calls** - This trap is pretty obvious. Your team members will become bored and burned out. Stick with, at most, a weekly call and make sure it lasts less than 1 hour… and shorter than that is even better.
- **Trying to force a consensus too early** - Just because you are 100% positive on the company and are ready to write a check doesn't mean that other team members are too. It's best to let individual team members pull together their summaries and then move towards a consensus.
- **Arguing with findings and having a bias** - It's very rare for all findings during diligence to trend positive. And, there is nothing wrong with discovering some negative issues. In my personal view, any diligence report that doesn't have any negatives is a bit suspect. Accept what your team uncovers, so that your final report is fair and balanced.
- **Allowing team members to let the team down** - You have to stay on top of each team member and make sure they complete their assignments in a timely fashion. Hopefully, you won't end up with any foot draggers, but there are times when life gets in the way. Whether it be vacation, work or personal issues, there will be team members who can't complete their assignment. It's your job to replace that team

member so the overall process completes on time.

- **Not resolving personality conflicts** - Sometimes people will get lumped together on a sub-team and they just don't gel and cannot seem to work together. You need to be alert to these kinds of frictions and fix them before they impact deliverable quality or timeliness, or undermine team morale. You also don't want to have the entrepreneur see investors fighting. Your job is to get in there and swap someone out for a replacement before frictions escalate.

> No matter the context, every leader has to motivate his/her team, has to be clear about expectations, has to be organized, and has to be diligent. So keep that in mind as you develop your style of team leadership.

Q

Should you be looking for one particular style of leadership? Does a deal lead have to be a type A drill sergeant barking orders to be effective?

Over the years at Launchpad, we've worked with more than two dozen different deal leads. As you would expect, deal leadership styles differ. So, feel free to adapt our recommendations on process so it works for you. That said, some of the basic guidelines related to communications and coordination are critical. No matter the context, every leader has to motivate his/her team, has to be clear about expectations, has to be organized, and has to be diligent. So keep that in mind as you develop your style of team leadership.

Q

How about a situation where diligence leadership can go off the rails?

One of the biggest challenges in doing diligence reviews is knowing when to stop and when to press ahead. As we noted in our eBook on Due Diligence, the diligence process is a fickle beast - there are times when it takes discipline to keep going in the face of mounting issues, and there are times when it takes discipline to call a time-out despite accelerating deal momentum.

It can be very discouraging to get into a diligence project and begin finding issues and

realizing the story is not as complete and attractive as you first thought it was. The desire to quit the effort can be very seductive. Equally seductive is the desire to minimize or ignore late-breaking issues once you've already put a ton of time and work into a deal. In both cases, allowing yourself to be seduced in the moment can lead to big mistakes.

You need a framework that builds in natural evaluation points or circuit breakers to give you the opportunity to reestablish your perspective and honestly review where you are relative to where you think you should be.

The deal lead's role is crucial in this regard. Diligence is not only about identifying risks, it is about putting those risks in perspective and figuring out which ones matter and which ones don't. You need a framework that builds in natural evaluation points or circuit breakers to give you the opportunity to reestablish your perspective and honestly review where you are relative to where you think you should be. And you need a deal lead who's not mired in all the detail work but can step back and see the big picture.

Chapter 6

"Places, Please!" Organizing A Deal Team

Even with a right-sized approach, every time I get into a project, I am always reminded that diligence is still a fair amount of work. At Launchpad we estimate that we spend around 40 person hours on a typical diligence process by the time the project is completed. If you are dealing with busy investors who are volunteering to do this work, burnout is a real risk.

6 Ways to Manage a Deal Team

Given the number of deals we do in a year and the pace at which we move, we cannot afford burnout. So we work to manage it in six ways:

- We utilize a larger overall team size consisting of a dozen or more people organized in small sub-teams working in parallel;
- We base involvement on an opt-in approach where people self-select and volunteer as their passions dictate;
- We don't move forward unless there is spontaneous enthusiasm and interest from enough volunteers;
- We let people choose their area of focus so they can be in their area of expertise and comfort zone;
- We augment teams by tapping uninvolved investors for discrete questions and input on specialty topics; and
- We are clear about the process and the deliverables so that people don't waste effort and do more work than is absolutely necessary.

Still, it is a lot of work. We begin the pre-diligence process (i.e. deep dive meeting) on 20-25 companies a year, and push through to final due diligence reports on 8-12 companies a year. So it helps in our case that we have a large pool of 150 investors to recruit from. We can arrange it so our investors do not have to participate in diligence more than once every 12-18 months unless they want to.

Christopher organizes most of our diligence teams, so let's ask him how this works and what advice he has on the process.

> If you cannot get your experts to engage with a deal, that is a big red flag. It is tantamount to having the people who know most about the subject like the deal the least. That is pretty telling. In those situations, it is best to set the opportunity aside and move on to something else.

Q

Christopher, where do you start when forming a team?

The team forms in a couple stages. Overall, our process is to start wide, and end wide, but be more narrow in the middle. By that I mean:

- All our investors see the company pitch,
- All see the final diligence report and get a chance to soft-circle invest,
- But, a smaller number are involved in the diligence sausage-making in the middle.

Here is how we do it:

During a pitch we ask all investors to indicate their interest level. Indicated levels can range from "not interested" to "would consider investing" to the highest level of interest, "willing to help with diligence." We also ask people to let us know if they have particular resources or connections that might be helpful to a company.

Once we have those investor indications of interest, we do some number crunching. We look at:

- Total absolute interest levels
- Relative interest levels on a percentage-of-attendees basis
- Skill level of those interested (because if all our experts on the subject hate it, but the uninformed love it, that can be a problem)

Based on these three indicators, we figure out which companies have enough critical mass to merit a deep dive meeting. At one of our monthly group meetings, it can range from none to all three of the presenting companies making the cut, but typically two out of the three presenting companies will earn a deep dive.

From there we get some possible deep dive dates from the company and then put it out to all the investors expressing interest in the form of a deep dive scheduling poll. And then we do some number crunching again to find the deep dive date that is going to have the largest and strongest team we can field. Typically, that results in a deep dive meeting of anywhere from 10 to 25 investors, with 15 to 20 being the normal attendance range.

Before the deep dive meeting ends, we ask the CEO and her team to give us the room and we take the temperature of the investors.

- If no one really likes the company, we are done.
- If a few people like it, but not enough to form a team and no one wants to step up as a deal lead, then we are done.
- If a plurality like it and want to form a team, and we can find someone to volunteer as a deal lead, then we take down all the names and the deal lead is off to the races on forming the team, assigning the roles and laying out the project plan.

Q

How do you document the assignments?

Regardless of outcome, we always send out deep dive notes which capture the deep dive discussion in a Q&A format, and also capture the next steps. If the next steps are that we are not moving forward, we note that. If we are moving forward, we note who the lead will be and sketch out the volunteers, sometimes even noting who is going to cover which topic areas. We email that information out with a note that volunteers should stand by for further communication from the deal lead. Then, off-line, we coordinate with the deal lead on getting a team organized,

building a project plan and getting a "next steps" email out to everyone.

What if you don't have enough expertise in the room? What do you do? Do you ever hire experts?

Venture capitalists will sometimes hire outside experts to help with their diligence, but angels and smaller funds generally cannot afford to do that. They must rely on their own expertise and connections to evaluate deals. Fortunately, investors tend to like and be drawn toward companies in their area of expertise, so your best experts for any given company tend to show up and volunteer. And, we pay a lot of attention to the topography of skills in our group and try to focus our deal flow and pitching companies exclusively in areas where we have competence.

Sometimes, for one reason or another, you won't have all your experts in the room at a deep dive. So you need to go out and manually recruit your experts to help fill out the gaps with the team. If you cannot get your experts to engage with a deal, that is a big red flag. It is tantamount to having the people who know most about the subject like the deal the least. That is pretty telling. In those situations, it is best to set the opportunity aside and move on to something else. Investing in areas where you have no expertise on the diligence team is a fool's errand. It is initially a waste of valuable human capital, and then later, invariably proves to be a waste of valuable financial capital.

If your team's inherent expertise is not sufficient, you may not need to give up or hire experts. If you can get the word out to people that you are looking for subject matter expertise in a certain area, you will be surprised at what you can find with a little networking. Angel investors are often very connected people who are good at bridging to other connected people. Be sure to tap into the power of that network. And don't forget significant others - we once found much needed expertise in the spouse of an investor.

> Angel investors are often very connected people who are good at bridging to other connected people. Be sure to tap into the power of that network.

Once you have a deal lead and team, what do you do next?

Our group manager works with the deal lead to:

- Familiarize him/her with all the tools and checklists available,
- Look at the calendar to put an overall plan together,

- Set dates for key items like interim status calls and first draft of report,
- Help get workspaces like shared folders set up, and
- Work on the next steps/call to action email to the team.

How involved that collaboration is depends a lot on the experience level of the deal lead. If they have done it many times before, it is pretty hands off. Either way we are looking to respect their own personal style of working and make sure they have the tools and info they need to be successful, as well as offer a good experience to their fellow investors.

> It all gets easier with a little practice. Most new deal leads tell me they enjoyed leading a deal much more the second time through.

Q

Sounds basic, what's so hard about this?

The basics are easy. Doing it well takes a little practice. The goal is to use both investor and entrepreneur time efficiently. You want to avoid confusion, duplication of effort, and diffusion of responsibility. You want everybody to own something and everything to be owned by someone.

There are lots of little tricky spots to trip you up; for example, you need to make sure you:

- Confirm team members and topic leaders so that you don't find out two weeks into the project that no one is working on competition or the financial plan,
- Have collected all the sub-teams' information requests so that you can hit the company with one consolidated request rather than have every sub-team chasing them separately,
- Know about vacations of key players on your team and at the company,
- Don't accidentally invite the company to the investors' data room,
- Don't copy the company on key investor communications, and
- Keep calm and keep your perspective throughout the process.

It all gets easier with a little practice. Most new deal leads tell me they enjoyed leading a deal much more the second time through. And the most fun of all is when an experienced deal lead ends up on a deal with a great team, where everything comes together well and ends up in an enthusiastically positive outcome.

Grist For The Mill: Gathering Data for Diligence

Do you know what the magic moment is when an entrepreneur can say to her team that she is in diligence with a potential investor? It's certainly not at the first meeting with the investor. And, most likely it's not at the second meeting. At Launchpad, we take care to be clear about when a company is in diligence and when they are not. The reason for this is twofold.

First, there is the signaling risk - we take a good number of companies to the deep dive stage, but only about half of them into diligence. If a company in the deep dive stage is running around town saying they are in diligence with us, they run about a 50% chance of giving themselves a black eye and having to explain why our "diligence" came out negative.

Second, we don't want frustrated expectations or surprises that can leave a company pissed off and feeling misled. If they are in a situation where they have about a 50% chance of moving forward, we want them to understand that so that they have the right perspective.

So we go out of our way to make the probabilities as clear as we can by sharing historical averages and making our process as transparent as possible. Overall our ratios look something like this:

- less than 50% of the companies reaching out will be scouted,
- less than 50% of the companies scouted will come out positively,
- about 1/3 of the companies with positive scouting reports are invited to pitch,
- about 2 out of 3 pitching companies earn a deep dive,
- about 50% of the companies earning a deep dive make it into and through diligence to investment.

In practice, this translates into something in the neighborhood of a 3-5% hit rate. So it pays to be clear with the company about where they stand. Only if all goes well at the deep dive, can the entrepreneur report back to her team that she is in diligence with Launchpad. Most early stage investment organizations have a slight variation on this process, but it is pretty typical that it will take 2 to 4 meetings with the entrepreneur before investors are ready to do the heavy-lifting involved with diligence.

> The trick to doing diligence well, and to keeping the process speedy and efficient, is coordination. By that, I mean coordination of requests and coordination in storage. If your goal is a professional and efficient experience for both CEOs and investors, you don't want a chaotic process where everyone is playing off a different sheet of music.

Diligence focuses on discovering and understanding the key risks in a company. This is

achieved by asking lots of questions and reviewing many documents. If diligence is fundamentally the review and evaluation of information, it stands to reason that the information needs to be collected first. Some bits of information will always be trickling in throughout the process, but most projects start with an initial information request for a big batch of the basics.

The trick to doing that well, and to keeping the process speedy and efficient, is coordination. By that, I mean coordination of requests and coordination in storage. If your goal is a professional and efficient experience for both CEOs and investors, you don't want a chaotic process where everyone is playing off a different sheet of music.

Let's get Ham's insights on how to orchestrate this.

Q

Ham, you've said that it all begins with the initial information request. What do you mean by that?

When pulling together an initial information request, you want to ask each member of the due diligence team to provide you with his/her list of required information before you do anything. That way you can engage the team members in the process and make sure they are thinking through their project. And, you want to avoid having each member hassle the CEO individually for this information. That's not a good experience for the CEO, nor is it calculated to get everything you need. So one consolidated initial information request is key. For a list of the types of information we typically ask for, the column titled "Information Request" in this due diligence checklist provides a great starting point.

Q

What do you do with all that information?

Everyone needs access to it. First, start by setting up two shared folders using Dropbox, Google Drive or some other tool that allows you to create a shared cloud folder to serve as a data room. The first shared folder will provide access to both the company and to all members of the diligence team. This allows the company to deposit documents, and all of the diligence team members to review the documents. Remember, some information is useful to more than one individual. The company should deposit all documents requested by your team in this folder.

A second shared folder should be set up for investor notes, draft reports, interview notes, etc. This allows all the investors on the team to see each other's progress. This folder is visible only to the diligence team. The company does not have access. It pays to be careful about permissions and carefully labeling links when you share these folders - a pro tip is to name them descriptively, for example "Investor Only NewCo DD Folder."

Q

Why is it so important to have a private investor-only folder? Wouldn't it be helpful to get the company's feedback on key issues?

Well, you definitely want, and should get, the company's take on major issues that crop up, but if you let the company read your report and notes and involve them in your report creation process, three things happen:

1. You are not writing the investor's story, you are rehashing the company's take on things. Diligence reports are supposed to be of investors, by investors and for investors.

2. You are going to chill the honesty of the team members, and that is not a good thing. You want candor and straight talk. If they know the company is going to read what they write, they are going to worry about ruffled feathers and their reputation, etc.

3. The CEO is going to get distracted and bent out of shape over all sorts of little things. Early stage diligence does not turn on little things. With early stage diligence, the point is to get the overall big picture right. The exact assumptions going into each model are not critical, it is the overall conclusion that matters, and it is usually right, even if one small detail is off.

Q

Once the information requests are out, what comes next?

The team members are going to need to speak to the company, so the deal lead's role is to facilitate those meetings in an orderly fashion or at least provide some oversight to see that they are set up in an orderly fashion. For new entrepreneurs, it can be very overwhelming and nerve-wracking to have a bunch of investors swarm all over them about a bunch of different topics, so there is a role for the deal lead to coach them through the process. Sometimes with larger, more built-out company teams, it works best to let individual diligence sub-teams meet with different people in the company separately. For example, the team building the financial model can meet with the person at the company who created this model. Or, the customer/go-to-market team can meet with the founders most responsible for sales.

Other times, when the company is just a small team of 2 to 4 individuals and all the diligence sub-teams want to speak to the same couple of folks, it can make sense to build a stack of meetings where the founders meet with different sub-teams sequentially across a day or half day. That way it is efficient and different sub-teams can sit in on each other's meetings if they want to.

Q

What about subsequent follow up meetings?

Once a little bit of relationship and rapport is built up, it's ok for sub-teams to coordinate directly with the company to set up follow-on meetings or calls. The deal lead's job is to make sure one of those teams is not spinning its wheels and taking up tons of founder time obsessing about an issue for which there is not a good answer. Some investors, particularly new and inexperienced ones, get confused and think it is the company's job to explain all the risk away, and they can get frustrated or even combative and badger the company about why they don't know something. The deal lead's role is to keep an eye out for such inappropriate behavior and remind the investor that this is early stage investing and some things are best guesses. That's why valuations are low and the potential for return is high!

Even where there is no frustration, professionalism and respect matter. They should be a hallmark of all interactions. Don't be too skeptical, scornful, or disrespectful. It's important to been seen by the entrepreneur and her team as adding value in all exchanges. Diligence team members are effectively brand ambassadors for your organization. Remember, reasonable people can differ on many aspects of building an early stage company and there often is not one single right answer. Helping a CEO discover key risks and giving guidance on ways to address those risks go a long way to building your value in the eyes of the entrepreneurial community.

Professionalism and respect matter. They should be a hallmark of all interactions. Don't be too skeptical, scornful, or disrespectful. It's important to been seen by the entrepreneur and her team as adding value in all exchanges.

There is nothing worse than trying to run a good process and then finding out that the CEO is really upset because one bad apple on your team misbehaved and made everyone in your organization look bad. As deal lead, you have to stay on top of what's going on. Make sure you are cc'ed on all the emails (no matter how painful an impact on our inbox - remember it is temporary!) to make sure nothing is getting out of hand. You have to manage the quality of the entire process end-to-end, especially with diligence teams containing new investors who have not done it before or whom you don't yet know and trust.

Chapter 8

Forks In The Road: The Importance of Interim Checkpoints

If the business precept is true, that you "manage what you measure", checking in on your team with regular checkpoints is key to a successful process. Over the years we have run into a series of surprises with diligence teams. Sometimes we discover diligence teams that turned out to be off drilling dozens of dry wells. Other times we have CEOs call on a Sunday afternoon very distressed about an interaction with a member of the diligence team. From these surprises we learned that you really need to stay on top of things since they can go haywire fast. Similarly, diligence can go nowhere fast. It is all too frequent a situation where you think a sub-team is working on something and on schedule with it only to find out they have not done anything yet. You manage what you measure...

One of the biggest challenges in doing diligence reviews is knowing when to stop and when to press ahead. There are times when it takes discipline to keep going in the face of mounting issues, and there are times when it takes discipline to call a time-out despite accelerating deal momentum.

It can be very discouraging to get into a diligence project and begin finding issues and realizing the story is not as complete and attractive as you first thought it was. The desire to quit the effort can be very seductive. Equally seductive is the desire to minimize late-breaking issues once you have put a ton of time and work into a deal. In both cases, allowing yourself to be seduced in the moment can lead to big mistakes. So you need a framework that builds in natural evaluation points or circuit breakers to give you the opportunity to reestablish your perspective and honestly review where you are relative to where you think you should be.

The interim status call is just such a circuit-breaker. It forces people to collect their thoughts and assess where they are in a boiled-down fashion. It also keeps people moving. There is nothing like an approaching deadline for a public accounting of your progress to focus someone on a volunteer side project.

One of the biggest challenges in doing diligence reviews is knowing when to stop and when to press ahead. There are times when it takes discipline to keep going in the face of mounting issues, and there are times when it takes discipline to call a time-out despite accelerating deal momentum.

Christopher has been overseeing dozens of these calls each year for many years, so let's get some insights into how to make them work.

Q

Christopher, when is the best time to have the first interim status call?

Diligence is all about momentum and getting things done before fatigue, boredom and other distractions overtake the project, so you want to have the first call as soon as you reasonably can. But there is little point in doing a call until people have had some time to do some work. So, assuming the company is responsive with information requests, I tend to aim for the end of the second week, or early in the third week. Regardless of when you actually place it, you need to publicize it ahead of time. The key is to put the call in the schedule early so people know it is coming and can self-manage to the deadline.

Q

How is the call facilitated?

You've nominated a deal lead for a reason, so it is best to let him/her lead the call. If the diligence team and deal lead are part of an angel network with professional management, there is plenty of time for the group manager to speak up during the discussion, but the manager shouldn't undermine its deal lead by monopolizing the call. A good manager will empower its deal lead by prepping together ahead of time and discussing goals and likely outcomes. But let the deal lead lead the call.

Q

How long should the call be, and what are you trying to cover?

No one likes long conference calls, so every effort should be made to keep it to an hour. You have a lot of sub-teams to hear from, and they have to cover a lot of factual findings, and then you need time for some synthesis. So it takes active facilitating to keep the call to an hour. That is an important part of the prep.

A format that works well is to start by having the different sub-teams summarize their findings so far. Note they should be summarizing their findings, **not** their activities. Everybody knows they worked hard and did a lot. What people need to hear about is if they found anything of note.

Once all the sub-teams have a chance to summarize their findings, if there are things that are just not baked yet, they become priorities for further work. This will result in follow up calls for the relevant sub-teams, and the deal lead should make sure those teams have an action plan and a due date.

Q

What do you do if you find a major yellow flag or diligence concern?

First of all, the deal lead should take the temperature of the group and see how people feel about the issue. Some items like entrepreneur integrity are going to be an absolute "game over" issue. Other items, like a serious competitor or a much less robust product than anticipated, are going to be a judgement call. So it is valuable for the deal lead to gather other people's reactions and not jump to their own conclusion. If it is not a show-stopper, then the focus should be on what additional work needs to be done in order to gauge the impact of this and put it into the proper perspective in the diligence report. If it is something that would likely stop the average investor from investing, then it is probably time to blow the whistle.

Q

If everything is going well, what is the next step?

Invariably one of the sub-teams is behind schedule or not done with their work or not available. Even in positive situations, there is more work to do before starting to draft the diligence report sections. Some sub-teams may be close to ready, so you can get the process started for them.

With the other teams it is more about agreeing on what steps they will take, what information they will gather, and what questions they will answer. The important part is to keep the team focused on the looming deliverable - their report section. This is not only key to getting reports done on time, it is key to making the process feel concrete and manageable to the participants. You can have the sub-teams that are in good shape take a first cut at their report section and invite them to share a draft with you for comment. With the sub-teams still contending with information gaps, you can talk to them about what specific information or analysis they think they will need before they can begin tackling their section.

The important part is to keep the team focused on the looming deliverable - their report section. This is not only key to getting reports done on time, it is key to making the process feel concrete and manageable to the participants.

Q

So it sounds like you may be starting the report drafting process at this point? How do you kick this off?

We are big believers in a very structured report template and all of our investors are familiar with it. So the teams mostly know what they are trying to accomplish with their section. There are three ways a deal lead can tackle report-building:

- Email everyone a copy of the template and say "fill out your section." Then the deal lead manually assembles it him or herself.
- Put the template on Google Docs, share the link and tell people to log in and fill in their section.
- Ask people to write unstructured memos on their findings and conclusions in their area. Then the deal lead assembles the final report.

There are pros and cons with each approach. Emailing a word document of the template is familiar and easy for everyone, but it can lead to a version control mess and a lot of email searching to find the right draft ("no, you used the one I sent at 10:10am on Tuesday, but I sent a later one in the same thread at 2:15pm. You should have used that one!").

Allowing everyone to create their own free form mini-memo shares the same familiarity and also the same version control issues. It also introduces the new problem of verbosity. The deal lead is going to have a ton of work editing a five page memo down to three paragraphs without changing the meaning or emphasis. The only good thing I can say about that approach is that sometimes the longer memo is nice to have in the supplemental files for investors who want to go deeper into a subject than the summary diligence report. The reality is that many "authors" have trouble going straight from a mass of unstructured notes and facts right to a tight couple of paragraphs, and will need the interim memo stage to help them organize their thoughts. So I don't discourage the practice, I just insist that they are not "done" when they give me a three page memo. **They also have to give me the three paragraph version.**

In my experience, sharing a Google Docs version of the template that can serve as a shared workspace and canonical version of the report is really the most efficient way to go about it. People can see each other's work and be guided and spurred on by the progress others are making, and they can be guided by the template. The deal lead can see exactly where each sub-team is at all times. And, the deal lead never has to be the version control manager or editor or file wrangler. They can say, "I've looked at your draft section, and I made some edits in redline" or "I like what you have but I need you to make it much shorter."

The only disadvantage with Google Docs is that some people are not as familiar with the tool and may have issues with losing their password, not finding a menu or command, or pasting their text into the document in gigantic purple letters (grin). And there is also the possibility that someone could put their elbow on their keyboard, select a lot of text and then delete a chunk of someone else's work. Google Docs does have version control so it is possible to roll-back in case that happens. Work will likely be lost if more than one person happens to be working right at the same time and you need to roll back to an earlier version. It's a rare issue, and worth the risk in my view. Plus, it can be mitigated by the proactive downloading and saving of copies by the deal lead or individual authors during the

most active report writing times. We advise our deal leads to leave the document open in a browser tab and and download archival copies pretty regularly just for peace of mind.

You need to be careful not to get ahead of the final conclusion of the team. You need to be really sure you are done and coming out with a "go forward" recommendation. In a surprising number of cases, even when things start out looking positive, late-breaking issues can crop up and derail a diligence effort.

Q

If it is trending positive, do you communicate that to the company at this point?

The deal lead and the group manager should talk about that and approach it with caution. As we outlined in the Chapter 7, you need to be careful not to get ahead of the final conclusion of the team. You need to be really sure you are done and coming out with a "go forward" recommendation. In a surprising number of cases, even when things start out looking positive, late-breaking issues can crop up and derail a diligence effort. This is especially true of blind reference checks and customer calls which tend to happen later in the process.

So it is important to be very careful in talking to the company and to potential members of the syndicate too early. The company in particular will be listening for what they want to hear and it is very easy to get into a sticky situation where you have to surprise a team with new information that contradicts previous information.

That said, at some point, usually after a second check-in call or when most of the due diligence sections exist in draft form and things look good enough, it makes sense to start talking to the company about the termsheet negotiation and setting a deadline for completion of the project.

Chapter 9

Trust But Verify: The Importance of Reference Checking

There is an old Russian proverb that was adopted by Ronald Reagan during the later part of the Cold War and which became a signature phrase of Reagan's in the mid-1980s. When talking about the Russians, Reagan always liked to say we should "Trust, but Verify." It came to summarize the approach the US would use after the signing of a landmark nuclear disarmament treaty with the Russians.

At Launchpad, we like to follow this advice when it becomes clear that we like what we are hearing, and we believe there is solid investment opportunity with the company. That is the turning point where we start making reference calls on the management team and check in with customers. These conversations are critically important, but they tend to occur during the second half of the diligence process and for good reason.

Ham has gotten pretty good at these reference checks over the years, so let's figure out his tricks.

Q

Ham, first of all, if these reference checks are so important, why aren't you doing them sooner?

There are many reasons for delaying the start of "Trust, but Verify". An obvious reason is that it takes a fair amount of time, but that's much less important than the following reasons:

1. You don't want to bother your network and invade someone's privacy until you are reasonably sure you are going forward.

2. You do not want to disturb delicate existing customer relationships with intrusive investor questions unless you are pretty sure you are going forward. Interviews that remind customers of the shaky finances of their vendor are not ideal. That said, interviews with prospective customers with whom the company has no relationship are much less problematic.

3. All companies will provide you with a set of references that you should assume will have a positive bias. Other contacts should be "blind" reference checks with people in your network that know the CEO or other members of the management team. It takes time to work your network, so you often don't have good leads on blind references right away.

You do not want to disturb delicate existing customer relationships with intrusive investor questions unless you are pretty sure you are going forward.

Q

How do you go about these management and customer reference checks?

During a typical due diligence process we run four different types of reference checks:

- Company-provided personal references
- Company-provided customer references
- Blind personal references
- Blind potential customer references

To keep the effort at a manageable level, we suggest you make two or three calls for each of these reference types. So, you are talking about eight to twelve calls that should last around 15-30 minutes each.

The deal lead should divide call assignments amongst the diligence team members. Personally, I like to give all the CEO reference checks to one person, all the management team checks to another, and then split the customer reference checks across one or two individuals. How you divide things up will be based on the size of your due diligence team.

At Launchpad, we have a well-defined set of questions we use to guide the management assessment interviews (see the appendix for our questionnaire.) It helps us uncover red flag issues that we need to keep an eye out for, and it helps us apply resources to help the CEO be successful. In addition, we have another set of questions that we use to guide our customer reference checks (see the appendix for our questionnaire.) And, if you use these two guides, you will have a consistent style of call notes that will help you when writing the summary diligence report.

You should initiate scheduling as soon as feasible, since these calls take time to set up. However, it is best to defer customer calls, in particular, until late in the process when positive outcome seems likely. That way, you don't disturb customers unless necessary. And, remember, back channel corroboration and blind reference checks via your organization's network are always VERY helpful.

Q

Besides reference checks, what else is going on at this stage in the process? Some groups are starting to draft their sections, but are others are still working?

Yes, there are always areas that require additional research. It takes time to recognize that need and time to find the resources and do the digging. In many cases, the company is still doing research to help you verify where the key risks lie, or responding to some of the documents you asked for based on your diligence checklist. For example, they might be working on verifying the size of the market opportunity. And, you are also likely getting down into the details of the financial model at this point.

Your status calls will continue during this stage. It's always helpful for the team to hear how the references are trending. The deal lead should continue to update the CEO, as well (using some caution and circumspection, as noted above). Finally, based on how you are doing in completing the diligence checklist for this investment, the deal lead might need to assign one or two small research projects and enlist help, if needed, to fill information gaps and resolve important issues.

Chapter 10

Short and To the Point: Producing a Tight Report

We've all experienced pedantic people try to make their points by browbeating the listener. And we've all been frustrated by repetitive or long-winded people who just cannot get to the point. We just tune them out. They are not effective, whether in person or in writing. Diligence reports are the same - they won't help anyone if they go unread. And they will not be read if they are long and cumbersome. The extra length not only takes more time to wade through, it obscures key take-aways and impedes understanding. Producing a shorter report requires a bit more work and a bit more discipline, but it really makes for a better result. A short report can be supplemented with appendices, if needed, for that small subset of people who want more detail on a particular subject.

Experience has taught us that there are a few keys to getting a good short report done on time:

- Using a structured report template
- Making expectations clear
- Repeatedly stressing brevity
- Starting early and leaving time for revision
- Having a deal lead understand their role as an editor
- Seeking rewrites and revisions

As an English major with a law degree and experience with corporate communications, Christopher brings just the right skill set to help deal leads whip these reports into shape. Let's see what insights we can glean.

Q

Christopher, a lot of people really don't enjoy writing and tend to procrastinate when faced with a writing task. How do you get a group of investors to produce a tight report on time?

Focus on the deliverable. From the very beginning, before a Launchpad investor has even joined the network, we describe an individual's involvement in diligence as "doing a bit of research and producing a couple of paragraphs." Stress the deliverable throughout the process.

Q

But people are still going to procrastinate, aren't they?

Yes, with volunteer efforts, some slippage and procrastination is inevitable. No one is going to be pulling all-nighters to get their diligence report section done. But, it can be minimized with the careful application of a little peer pressure. If an organization has a culture of not letting colleagues down, as ours does, people will generally step up and be professional. Especially if you set clear expectations that it will get done. As noted in Chapter 8, that can be part of the value of creating the report in a shared workspace like Google Docs. People can see who is producing and who isn't. End of day, the report will be as late as its latest section, so calling each co-author and asking them if they have everything they need will make a big difference.

If an organization has a culture of not letting colleagues down, as ours does, people will generally step up and be professional.

Q

When is the right time to get people writing? Is diligence ever done?

Diligence is never done, but it does approach a point of diminishing marginal returns pretty quickly. At some point additional work is not going to bring new insights or further de-risk the investment. These companies are early stage, so, for example, until they try their proposed go-to-market strategy and see if it works, you just cannot know. So you have to have some tolerance for ambiguity and press ahead in the face of uncertainty.

And there can be real value in just putting pen to paper. As we all know from writing difficult correspondences, sometimes you don't really know what you are thinking or feeling until you actually sit down and begin to write the letter. Diligence is like that. Get people drafting early so they can figure out where their thoughts are and whether they have gaps that will require additional research. If everyone leaves it to the last minute, you will have a patchwork quilt full of holes.

Q

How much editing is required? Does the deal lead do it all?

The deal lead is responsible for overall production of the report, but I usually work with the deal leads to help with the editing. The goal is not to substitute your judgement for that of the team member, it is to stress brevity, force clarity, ensure consistency of quality, and eliminate basic typos and formatting mistakes. You want it in the words of the team members, but a little polish and clean up usually works wonders in terms of making it professional. Ninety percent of the editing we do is to push authors to make it shorter and boil it down to the bottom line.

Q

Do you recommend online collaboration on drafts or having teams email pieces of the report in for the deal lead to assemble?

Collaboration has a lot of advantages in that it allows people to see each other's work, and it forces people directly into the constraints of the template. You can make it work with people emailing sections, but you invariably get more words than you want. Then you have to assemble and boil down and edit yourself. And, then you need to recirculate to make sure that you have not paraphrased it incorrectly. Try as hard as you can to push people to give you their deliverable in the final form you need. Transforming it yourself is a thankless task.

Q

Does every team member have a section to write?

Not necessarily. Most sub-teams will have more than one member, and a sub-team lead will do the initial drafting and circulate it for comments to other sub-team members. This is essential when a team is divided. Our report template contains an important section at the end which allows each individual member of the overall diligence effort to add their "bottom line." For example, they might write "I am really impressed with this team and I am planning to invest" or "I think there is a market here but it will cost more than the team thinks so I am not going to invest at this time." We look for as much participation in that section as we can get, and not surprisingly, it is one of the most useful and appreciated sections of our reports.

Q

What happens to the report when it is done?

We "publish" it out to the full Launchpad investor network in connection with a termsheet and a request for soft-circles. And we archive a copy of it on our organization's internal website for future reference.

Diligence is never done, but it does approach a point of diminishing marginal returns pretty quickly. At some point additional work is not going to bring new insights or further de-risk the investment.

Q

How about all the ancillary materials collected in the dropbox folder?

We circulate the formal items like appendices with the final report, but we put the remaining secondary materials and working papers in an archive and store it for 18 months. Start-ups and their markets move so quickly that there is really very little benefit to lots of old research materials and notes. We like to let the final report speak for itself, but we view the rest of the materials as very perishable and we delete it after 18 months, and usually the company has raised another round by then anyway.

Chapter 11

Good To Go: When You Have Enough to Move Forward

There are a million reasons not to invest in any given startup. Even in the best case, there will be unanswered questions, missing pieces, missing team members, projected losses and uncertainty all around. The diligence process tends to document all of the warts in one place. You would think a compilation of those warts would be the death knell - the final nail in the coffin.

So why do people invest in startups? Because of their potential, and because investors have the experience and necessary framework to put all those risks and uncertainties into the proper perspective. At the earliest stages, ALL startups have problems. The question each investor has to ask is whether those problems are insurmountable.

Through the years, Ham has evaluated hundreds of companies, and ultimately, invested in over 50 of these businesses. At Launchpad, he established a process that helps determine whether it makes sense to move forward and make an investment. So let's see what he recommends to investors as they go through this very same challenge.

At the earliest stages, ALL startups have problems. The question each investor has to ask is whether those problems are insurmountable.

Q

Ham, what do you do to place some standard procedures into your process of evaluating companies before making an investment?

First of all, there are three very important components in our diligence process. We find that it is extremely helpful in the early days of a diligence project to outline the following three items:

- **Identify Key Risks** - After listening to the entrepreneur's presentation, we caucus to discuss first impressions and immediate top of mind questions and concerns. From that we are able to distill it down and pull together a list of 3 or 4 critical areas that need further examination. The answers to the key questions help us identify the areas of solid ground as well as the key risks that will need to be addressed for the company to achieve a successful exit for the investors.

- **Develop the Investment Thesis** - Ultimately when you are forming an investment thesis, you are building a model or likely scenario in your head. An important filter that can help when assessing potential investment opportunities is sometimes defined as the Three P's: Potential, Probability and Period. For the sake of completeness, we cross-check against our due diligence checklist when forming these questions. But, to keep the process efficient and focused, our diligence team members work together to distill the list of key questions we are really trying to answer and disregard questions which will not add value in a given situation. The answers to the key questions help us identify the areas of solid ground as well.

- **Acknowledge What Needs to Be Believed** - Once we have a handle on the key risks, and we have built an investment thesis, we need to synthesize them into a workable company hypothesis. The best way to keep yourself honest when doing this is to take the trouble to acknowledge and actually list "what needs to be believed" for the investment to make sense. Thus, when we get to the final stage of our due diligence effort, and we write up our very brief report, we make sure we know and prominently document right at the beginning "What Needs to Be Believed" or WNTBB. If an investor just cannot get comfortable that something on the WNTTB list will come true, then maybe this deal is not for them.

Q

What are the key things you look for in deciding whether there is enough positives to go forward?

First off, I expect to see enthusiasm is mounting for the company, amongst the team. Each of the sub-teams should be coming back with positive results from their research. It's also important that the founders show the following key characteristics while we work with them: high integrity, a straight-forward style, passion about the opportunity, responsiveness in communications, accuracy in information supplied, transparency, cooperation, coachability, and engagement.

Furthermore, we like to see the company's business continue to progress during diligence. We aren't expecting miracles during this relatively short time period, but we do expect to see some positive movement. We know diligence takes a ton of time, but the team needs to show they can juggle, delegate and prioritize. They cannot let the business completely go on pause during fundraising.

Finally, as we evaluate demand for the company's product, we expect the customer calls to go extremely well.

> When we get to the final stage of our due diligence effort, and we write up our very brief report, we make sure we know and prominently document right at the beginning "What Needs to Be Believed."

Q

When you say "enthusiasm is mounting" does it have to be universal enthusiasm, a majority, or is a minority enough?

The answer to this question depends on your organization. Do you require that all investment decisions are made by 100% of your investors, a majority of your investors, or is a minority good enough? At Launchpad, a minority of investors is enough for us to proceed. So our view is that it does not have to be universal.

For Launchpad, the tricky situations are the divided due diligence teams. If no one intends to invest, it's an easy decision. And, the same is true if everyone likes the company. But when the team is divided it is complicated. You need to look at what your experts think about the key risks in each of their areas. Are there any show stoppers that conflict with your investment thesis and WNTBB? As long as there is no third rail issue, such as a lack of integrity, our approach is to get all the perspectives documented in the report, consider whether the issue merits being on the list of WNTBB items. And assuming it still represents a legitimate investment opportunity, we circulate the report and let individuals decide based on their own personal risk profile.

Q

Aren't the founders exhausted and annoyed at this point in the process? How responsive, engaged, and enthusiastic can you reasonably expect them to be well into a diligence effort?

There's an old joke that goes something like: "An entrepreneur will spend 100% of their time fundraising for their business and the other 100% of their time running the business." If the fundraising process drags on for months and months, it will have a serious negative impact on the CEO. So, it's important that the deal lead set realistic expectations with the entrepreneur. It's important that the entrepreneur try to be responsive and keep the process moving fast. And, it's important that the deal lead be aware of the entrepreneur's need to operate their business at the same time they are supporting the diligence effort.

With that said, the CEO and her team can feel the momentum build as you near a final decision. They are learning more about their business from a well-run diligence process. So while they are tired, they should also be "smelling the oats in the barn" and having great feedback they are eager to test with the money invested in the round.

> It's important that the deal lead be aware of the entrepreneur's need to operate their business at the same time they are supporting the diligence effort.

Q

Why is it important for outside investors to start showing interest at this point?

At Launchpad, we like to lead the deals we are involved in, and we also like to have co-investors involved as an additional source of capital, both in the present and down the road for that company. It's pretty typical that co-investors look to the deal lead to do the heavy lifting on due diligence along with negotiating the investment terms with the company. So we look for a certain level of outside interest as a good litmus test of whether others will be interested and how big an investment syndicate might be possible.

Chapter 12

Let's Make a Deal: Negotiating Terms

Imagine you've always wanted to own a second home, but weren't sure you should buy one. You hem and haw and agonize about the decision, but then one day you finally decide to go for it. There is a brief moment of joy and excitement, but it is quickly followed by a great soberness as the reality sets in. You will have to figure out what to pay for it, get the purchase and sale done, maybe arrange all the paperwork for a mortgage, and find some way to care for it and maintain it in the off-season. This mental process is a lot like what you go through when you decide the diligence on a company is positive enough. At first you are like "OK, let's do this!" and then you realize you've got to set terms, actually make the deal happen, and live with the downstream consequences.

As a deal lead, once you conclude that there is enough of an opportunity to merit potential investment, and around the time you start drafting the final report, you can push through the temporary euphoria and begin negotiating the termsheet. In some cases this will be driven entirely by the deal lead, while in investor networks with dedicated management, it might be led by a manager with the involvement of the deal lead. In either case, it is a vitally important role which is informed by the learnings of the diligence process.

Start-ups have a lot of risk, and the diligence process is really about documenting those risks so that investors can make informed decisions. As we've pointed out in our eBook on Due Diligence, you are not looking for a deal with no risk. You are looking for a situation where you know roughly what you are getting yourself into. (Kind of like the house inspection and budgeting process for that second home!) A termsheet negotiation is about acknowledging all those risks and allocating them between the two sides of a deal. So, it is natural that the negotiation would be informed by the learnings of the diligence process.

Christopher spent the majority of his career in roles where negotiation was a key part of his responsibilities. And a lot of that time has been spent in early stage investing. So let's put him on the spot to see how he thinks about it.

Q

Christopher, how do you approach the negotiation process when you are leading a deal?

My approach reflects the fact that I lead a large network of investors and tend to be working with really terrific deal leads. I will almost always set myself up to serve as the point person for the negotiation for four reasons:

- It's a huge convenience if the process is led by someone who does a lot of these and is very facile with the terms and terminology and can write a termsheet himself.
- You need someone who has a good sense of what's market and what terms will be acceptable to the investors in the deal.
- It's important to have someone in the discussion who is willing to be be the "bad cop" and hold firm on key terms, like valuation, and not be swayed by pressure or worried about the working relationship with the entrepreneur.
- You want to protect the person who is going to join the board and work closely with the CEO from having to be the heavy in the negotiation.

Q

What is your starting point for the process?

It is important to keep in mind your role in the big picture financing life-cycle of the company. Some inexperienced investors might come into this situation with a scorched earth approach, looking to drive the best possible bargain and the toughest possible terms for themselves. The problem with that approach is two-fold:

- The toughest set of terms is not necessarily the best bargain for investors.
- The working relationship with the team can affect your outcome and returns as much as the deal terms.

> Start-ups have a lot of risk, and the diligence process is really about documenting those risks so that investors can make informed decisions.

If you go in looking to ram a greedy set of terms through, not only will you potentially cause mistrust and harm the working relationship with the founders, but you may also saddle the company with terms that make it very hard to raise money in a future financing. Subsequent investors may not want to put money into a deal with ridiculous terms for prior investors, or they may insist on the same terms for themselves. Your job as the architect of the first termsheet with the company is not to drive the most aggressive bargain. It is to come up with an acceptable set of terms that is as "vanilla" as it can possibly be. Once you are an investor, you don't want any wrinkles or friction, particularly of your own making, to cause issues with bringing in subsequent financing.

So with that philosophy in mind, I always start off with a standard set of template terms that our investors, lawyers and syndicate partners are used to, and then tweak them and customize them for the specific deal situation. Usually, it is just a handful of routine terms which need tweaking, but other times special issues in the diligence or special aspects of the company's situation require heavier customization. Once I have a draft termsheet to propose, I need to get it in front of the company for reaction.

At this juncture I have a choice. There are two ways to go about forming a termsheet:

- Before sending it, you can walk the entrepreneurs through the concepts and your thoughts on each key term, or
- You can send them a proposed draft termsheet.

I generally base my approach on the sophistication level of the founding team. If they are very experienced and familiar with early stage investing terms, I will generally just prepare a draft termsheet and send it to them. But if they are newer to the whole investment process, then some context and education and perspective might help them better understand the termsheet and react to it more constructively. In this case, I will generally have a conversation

and explain the various issues and where I am coming from on each point before sending it over. That way they know roughly what to expect and are not surprised by the harsh black and white of the terms on paper.

Governance is a very important part of all our deals. In addition to financial capital, we invest a fair amount of human capital into our deals. In most cases, the deal lead will take either a board seat or board observer seat with the company.

It might sound patronizing at first blush, but the reality is that education is a huge part of the early stage negotiation process. Active investors negotiate termsheets all the time and are very comfortable with the concepts. But entrepreneurs have a lot of anxiety and uncertainty, as well as a lot of hot button issues. So it can be really helpful to take the time to explain the logic behind key terms. For more on founder and investor concerns and a good overview of early stage deal terms, see our eBook on Understanding Early Stage Deal Terms.

Q

What areas merit special attention?

There are a great number of sticky issues in termsheets, but when I am starting a negotiation, most of my thinking and effort goes into:

- Figuring out the right valuation,
- Making sure the option pool is the right size,
- Considering how to construct the board,
- Determining how to structure the founder vesting terms,
- Sizing of the round and the minimum needed to close, and
- Deciding how to structure the liquidation preference.

Vesting for founders and early employees is very important in early stage deals. There is nothing worse than a co-founder of a company owning 20% of the company's stock after working for the company for a year or two. You want all key employees to have two or three years of vesting left, even if they have been involved with the company for quite some time. This may require a restructuring of the cap table.

Governance is a very important part of all our deals. In addition to financial capital, we invest a fair amount of human capital into our deals. In most cases, the deal lead will take either a board seat or board observer seat with the company. This is a key role and requires a fair amount of the deal lead's time over the years when we are active with the portfolio company. For early stage deals, we do not expect to control the board, but we will have a strong voice.

Pre-existing investors are also an area needing attention. One goal of completing a financing is often to clean up the balance sheet, and we need to be certain that any convertible bridge debt is brought over to the equity side of the ledger. In negotiating the termsheet, we need to be mindful of the thresholds and discounts applicable to any outstanding convertible bridge debt. Often upon conversion, bridge debt will entitle holders to a discount off the purchase price in an early stage round, and will require that such round be of a specific size before conversion is mandatory. These terms can be and often are negotiated as part of a round of financing. We need to consider what leverage might exist, in any given situation, before taking the terms of existing convertible debt at face value.

Because securing an exit is important, but can sometimes be at odds with the founders of the company or other legacy stockholders, we require drag along rights. These require all stockholders to approve or otherwise agree to sell their equity in a transaction receiving the affirmative vote of a majority or two-thirds of the shareholders. This becomes an important tool to prevent minority shareholders from threatening to exercise dissenters' rights in a prospective deal or otherwise seeking to gain leverage in an exit transaction by signaling that they will not proceed.

Another important right to secure for our investors is the right to participate in future rounds of financing – sometimes called pre-emptive rights or rights of first refusal. These rights entitle investors in the angel round to participate in any future financings of the company up to their pro rata share of the financing in order to maintain their percentage interest. Sometimes a company will seek to include a pay-to-play provision that requires investors to exercise this right upon each future financing or otherwise lose pre-emptive rights altogether.

And finally, a key toggle point in any angel financing is whether we will be seeking a straight liquidation preference or a participating preferred structure. Upon a liquidation or sale of the company, a straight liquidation preference entitles the holder to receive either their investment back as a priority to the common stock (and any junior classes of preferred stock) or that which they would otherwise have received had they converted into common stock prior to the transaction. Participating preferred gives the holder the benefit of both worlds: a priority payment equal to the amount invested plus a pro rata amount of any remaining value. Weak liquidation preferences may not be attractive to investors because they feel they are not being adequately compensated for the early risk they are taking. But overly generous liquidation preferences can turn off later investors or contribute to a massive preference stack that greatly diminishes the early investors returns in weaker exits.

All in all, there are a lot of issues to consider, and getting a termsheet that is going to work for a large investor base can be a pretty tricky process!

Q

So, do you always prepare the first draft?

Yes, it is traditional for investors to prepare the first draft of the termsheet and get it over to the company. That is certainly my strong preference, because if the company does the first draft there are usually a lot of things missing and a lot of wacky off-market terms. When I am drafting and

thinking about the termsheet, I will involve the deal lead in the process, if he/she wants to be involved.

> Your job as the architect of the first termsheet with the company is not to drive the most aggressive bargain. It is to come up with an acceptable set of terms that is as "vanilla" as it can possibly be. Once you are an investor, you don't want any wrinkles or friction, particularly of your own making, to cause issues with bringing in subsequent financing.

Q

Do you deliver it in person and sit right down and negotiate?

No. As noted above, I will sometimes talk with the CEO before sending it over. But once I send it, I recognize that companies generally need time to confer with their attorney before responding. So a redline of their thoughts and issues is generally a good next step before sitting down.

Q

How long does that take and what else is going on at that point?

In the background, the deal lead is typically marshaling his or her troops to finish the diligence report, and I am simultaneously giving some thought to issues like potential board and observer appointees and what the best syndication strategy might be.

Q

What happens next?

Once I have comments back from the company we try to hash out an agreement. The goal is to get a mutually acceptable termsheet done right at the same time the final draft of the diligence report is finished. Once the termsheet is done and signed, we publish the diligence report and the termsheet to our investors and begin to syndicate the round.

Chapter 13

Cutting Bait: When To Walk Away

If one of the trickiest parts of due diligence is knowing when to press ahead in the face of mounting concerns, surely the other tricky part is knowing when to suspend your efforts. The former is a challenge of overcoming inertia and uncertainty, and the latter is a challenge of overcoming momentum.

We talked about the importance of suspending final judgement in the early stages while you gather information, and we also talked about the role of natural "circuit breakers" in the process to make sure you don't end up with a small minority of enthusiastic people leading to a bad case of deal momentum.

In a realm where every deal is imperfect, how do you tell when something is just too flawed to accept? Ham has been in this position many times before, so let's see what insights he can offer.

Q

Ham, what are some of the signs that it might be time to bail?

Give me a few hours and I can describe dozens of signs. Over the past 15 years, I've run into many different situations, but I would have to say the following five issues are the most common:

- **Entrepreneur Integrity**: If you suspect that you are running into ANY issues around the integrity of the entrepreneur, you are done.
- **Big Surprises**: Some of the surprises I have run into over the years include:
  - Finding out the company has a lot of debt they need to pay off,
  - A key founder quits during diligence,
  - The company doesn't have ownership of vital Intellectual Property.
- **Big Shortcomings**: These situations can be a bit more challenging to determine whether you are looking at something fatal or not. It takes a bit more judgement on the part of the diligence team. Examples might include:
  - The size of the market opportunity is not large enough,
  - The company requires too much capital to make this a slam-dunk win for early investors,
  - Customer reference checks come back lukewarm.
- **Loss of Enthusiasm and Interest**: This is the case where you have lost all momentum within the diligence team and you won't be able to raise any significant capital for the company. You might have one or two interested investors, but that's not enough to properly support the company with this round of financing.
- **Company Intransigence**: There are times when the CEO is just not willing to compromise. For example, you start the negotiation of a termsheet, and your position and the CEO's position are too far apart. If that happens, it can be very difficult to come up with a deal that's seen as fair for both sides.

Q

When you talk about integrity issues, what are you referring to? Is it always obvious?

When we look to make an investment in a company, the most important factor in our decision is the quality of the team. The key characteristic we look for in the CEO is integrity. That character trait might sound obvious, but I feel it's very important to be on alert for trust issues when you are interacting with an entrepreneur. From the initial meeting with the company, during the due diligence process, and finally while negotiating the deal, I want to make sure the CEO is being honest and negotiates in a fair manner. If I sense any duplicity at this early a stage, I can be sure that things will only get worse as the company progresses from the honeymoon phase through the challenges faced by all startups.

Q

Why do you cite surprises as a reason to give up? Aren't surprises an expected outcome of a fact-gathering exercise?

There are surprises and then there are SURPRISES! When you first start diligence, you should expect to learn things about a company that you didn't expect. Examples might include the product is really buggy, or the first few customers paid almost nothing for the product. These are the types of "warts" you expect to uncover in almost all early stage companies.

As you might surmise from the examples I gave in the list above (i.e. debt, loss of a key founder, lack of IP ownership), I am talking about surprises that indicate the CEO is hiding something from us or ignorant about what makes a company valuable. With debt, it could mean the CEO isn't being truthful about the company's financial position or is too financially unsophisticated to understand why that is a big problem. The loss of a key founder might speak to the CEO's ability to build a great team. And finally, with lack of IP ownership, the CEO doesn't realize the importance of IP to a future acquirer.

When we look to make an investment in a company, the most important factor in our decision is the quality of the team. The key characteristic we look for in the CEO is integrity.

You talk about fatal shortcomings. Is one section, one area of weakness, enough to tank an entire due diligence process? If not, what does it take? If most startups need work in most areas, aren't all of the sections going to be a little weak?

It's important to distinguish between areas where a bit more work or experimentation is needed by the company versus true fatal flaws that will be

very difficult, if not impossible to correct. The examples that I cite above (i.e. market size and capital requirements) are very tough to overcome.

Let me be a bit more concrete. Let's look at Market Size. If you add up all the potential customers for the product and multiply by how much they will pay for the product, and you end up with a $5M market opportunity, the company shouldn't be taking in any outside investors. It might still be a nice little business, but not one that can work with outside investors. The CEO is better off bootstrapping the business.

Here's another example. Suppose the company has a product that needs a lot of explanation before the customer will buy, and therefore, they need to build a direct sales organization. Furthermore, their average customer spends $1,000 per year for this product. Unfortunately, their go-to-market strategy has a fatal flaw. A direct sales organization is too expensive given the price of their product.

All that said, sometimes the fatal flaw is not so fatal after all. In some cases, it's the ignorance of the CEO that gives the appearance of a fatal flaw. For example, maybe the company I described above doesn't need a direct sales organization. Perhaps a member of the diligence team can show the CEO how to sell the product using a strategy that is significantly less expensive for the company. That's how a great investor adds value by applying their financial capital and human capital to help the company.

And, to answer your last question, there will be weakness in at least one section of the diligence report and probably multiple sections. That's just the nature of seed stage investing. You can't expect perfection when a company is at such an early stage!

Q

How do you interpret team interest issues if the deal lead is always called on to be a cheerleader to some extent?

In the majority of diligence projects, the deal lead does play the role of cheerleader. The deal lead wants and expects the other diligence team members to be excited about the company. But, to be fair, not everyone has an upbeat personality. And, you can't expect every member of the diligence team to remain enthusiastic during the entire diligence process. Individual risk tolerances and interest areas differ, so some will always want to get off the merry-go-round before others.

So how do you gauge whether interest in the company is high enough to justify continuing the diligence process? We use the interim call as an opportunity to do a roll call or "show of hands". We also monitor the one-on-one interactions we have with the diligence team members. We pay attention to the level of expertise of the different team members. If your experts are bailing early, that is a bigger signal than if a few generalists wander off the reservation. And finally, we do our own gut check to see if we are just "not feeling it" and whether we think the larger investor group will be interested.

Making sure that the company is properly financed is one of a CEO's top priorities, and so being busy is not an excuse for lack of responsiveness. Ultimately, you are looking to build a great partnership. If you feel that it's a one way street, you will need to either fix the problem or move on to your next investment.

Q

How do you define "company intransigence"? What is the difference between being busy and unresponsive?

At the end of the day, once you have the official closing on your investment, you expect to have established a strong partnership with the CEO. The investors and company management are now on this journey together. And, a long journey it will be. Most successful early stage companies can take 7-10 years before they reach an exit. If you run into "company intransigence" during diligence, you are setting yourself up for a very long and rocky marriage!

So, how do I define intransigence in this situation? I can think of four areas where the CEO has serious shortcomings:

- **Responsiveness**: It takes many days to get replies to our email requests,
- **Cooperation**: Not helpful in setting up customer calls, management meetings,
- **Coachability**: Not willing to take guidance from experienced business people, and
- **Flexibility**: Difficult to pin down for meetings and phone calls.

You should expect that a CEO has much work to do and that your requests are not the only things on her plate. Remember, she has a business to run in addition to putting time into fundraising. That said, making sure that the company is properly financed is one of a CEO's top priorities, and so being busy is not an excuse for lack of responsiveness. Ultimately, you are looking to build a great partnership. If you feel that it's a one way street, you will need to either fix the problem or move on to your next investment.

Appendix

At Launchpad Venture Group, we provide our investors with a series of templates to help facilitate the due diligence process. In this appendix, we include example templates that we use on a regular basis.

- **Deep Dive Meeting Notes Template**: This template records key items from the initial company presentation and from our deep dive meetings. It helps organize our due diligence efforts.
- **Due Diligence Report**: This template is designed to result in a short, readable due diligence report. Our goal at Launchpad is to provide our investors with a 2 to 4 page summary report that is readable and comprehensive. It covers all the main areas in diligence and provides the author(s) with a structured approach.
- **Due Diligence Checklist**: After reading this book, you might feel overwhelmed by all the different aspects in due diligence. The Due Diligence Checklist is designed as a quick reference guide to help steer you through the various aspects of diligence.
- **Customer Reference Check Questionnaire**: At the core of this questionnaire are a series of questions that will help you distinguish whether the company is selling aspirin, oxygen or jewelry. And, you can find out a bit more about the size of the potential market opportunity.
- **Management Assessment Questionnaire**: This questionnaire is designed to get the story behind the CEO and his/her team. If you are able to make enough reference calls, you should be able to find similarities and differences to help you paint a pretty good picture of the team you are investing in.

Key Documents and Workpapers

While the final due diligence report and termsheet are the two main deliverables produced by the diligence process, a large number of other documents, notes and work papers are produced and used throughout the process. To help give readers an alternative and more concrete view of the diligence process, we thought it would be helpful to look at it from a documents and workpapers standpoint. Below is table where we outline the key documents we use in our typical diligence process.

Stage	Key Documents & Tools	Chapter Cross Reference
Form Team, Assign Roles	Deep Dive Meeting Notes	Chapter 3 Stages of a Deal, Appendix
	Team Assignments	Chapter 2 Goals and Hallmarks of a Good Due Diligence Process; Chapter 4 Diligence is a Team Sport; Chapter 5 Managing the Process
Initial Information Gathering, Review Meetings	Due Diligence Checklist	Chapter 4 Diligence is a Team Sport; Chapter 6 Form Teams, Assign Roles & Lay out the Plan, Appendix
	Company-Investor Dropbox Folder	Chapter 4 Diligence is a Team Sport; Chapter 6 Form Teams, Assign Roles & Lay out the Plan
	Investor-Only Dropbox Folder	Chapter 4 Diligence is a Team Sport; Chapter 6 Form Teams, Assign Roles & Lay out the Plan
	Company Supplied Corporate Information	Chapter 4 Diligence is a Team Sport; Chapter 6 Form Teams, Assign Roles & Lay out the Plan
	List of References for Team	Chapter 9 Customer & Reference Checks
	List of Customer References	Chapter 9 Customer & Reference Checks
	Market Research & Reports	Chapter 9 Customer & Reference Checks
Interim Status Call	Call notes, research notes and summaries, interview notes, memos	Chapter 6 Form Teams, Assign Roles & Lay out the Plan; Chapter 8 Interim Status Calls

Stage	Key Documents & Tools	Chapter Cross Reference
Customer and Reference Calls, Additional Research	Company-Supplied Contacts	Chapter 2 Goals and Hallmarks of a Good Due Diligence Process; Chapter 9 Customer & Reference Checks
	Blind Contacts Found Through Research and Networking	Chapter 2 Goals and Hallmarks of a Good Due Diligence Process; Chapter 9 Customer & Reference Checks
	Customer Interview Guidelines	Chapter 2 Goals and Hallmarks of a Good Due Diligence Process; Chapter 9 Customer & Reference Checks, Appendix
	Management Reference Check Guidelines	Chapter 2 Goals and Hallmarks of a Good Due Diligence Process; Chapter 9 Customer & Reference Checks, Appendix
	Industry Reports, Web Research & Competitive Intelligence	Chapter 6 Form Teams, Assign Roles & Lay out the Plan
Compile Report	Section Drafts From Team Leaders	Chapter 10 Write and Compile Report
	Company Overview	Chapter 10 Write and Compile Report
	Individual Bottom Line Ratings	Chapter 10 Write and Compile Report
Negotiation and Closing	Termsheet	Chapter 1 The Importance of Deal Leadership and the Deal Lead Role; Chapter 3 Stages of a Deal; Chapter 12 Supporting Negotiation and Closing
	Final Due Diligence Report	Chapter 10 Write and Compile Report, Appendix
	Deal Documents	Supporting Negotiation and Closing

Deep Dive Meeting Notes Template

Deep Dive Meeting with {NewCo} {Date}, {Location}

Company Attendees

Name	Role	Name	Role
{Name 1}	CEO	{Name 2}	CTO
{Name 3}	??	{Name 4}	??

Investor Attendees

Name	Name	Name	Name
{Name 1}	{Name 2}		

Additional Investors Originally Expressing Interest but Not in Attendance

Name	Name	Name	Name
{Name 1}	{Name 2}		

Contents Of This Document:

1. Summary of Next Steps after the Deep Dive Meeting
2. Key Themes Raised at Original Pitch Meeting
3. Post-Pitch Investor Questions & Company's Written Answers
4. Q&A Notes from the Deep Dive Meeting
5. Materials from Deep Dive Meeting (These are provided by NewCo)

Summary of Post Deep Dive Next Steps:

{Provide a short two or three sentence summary of the outcome of the meeting. For example: "This was a well-attended and productive discussion. We covered everything we wanted to cover except the financial projections. Coming out of the meeting there was near universal enthusiasm for moving forward, so we decided to form a team and progress to due diligence." }

(Use this table to record team assignments. Subject areas can be customized or combined as needed. The "Notes" column may not be needed in each case, but it is the place to record a contact, expert, question, special task, possible additional volunteer, time constraint or other item of interest relating to the topic assignment.)

Subject	Volunteers	Notes	Subject	Volunteers	Notes
Diligence Team Lead	Name	notes	Market Size, Market Opportunity, Regulatory	Name	notes
Customers	Name	notes	Financial Model	Name	notes
Leadership Assessment	Name	notes	Valuation & Funding Strategy	Name	notes
Technology & IP/ Uniqueness & Competition	Name	notes	Investors / Deal Terms	Name	notes
Sales & Marketing	Name	notes	Exit Strategy / Payoff	Name	notes

*Assistance requested, but not yet confirmed.

Agenda & Themes Raised at the Original Pitch Meeting:

(This section is where you organize the notes and reactions from the investor pitch. Positives are optional, but they are very helpful to teams looking to understand which parts of the pitch worked. The "Key Concerns" box is where you try and condense and organize the investor concerns, questions and feedback into a more manageable number of "themes" or groupings and use that to organize the deep dive meeting. A deep dive meeting can really only cover 2-4 topics in any depth, so it is important to boil it down into themes.)

Positives Noted	Key Concerns / Themes to Organize Deep Dive
Item 1	Issue One (50 minutes of deep dive time)
Item 2	.
.	.
.	.
.	Issue Two (30 minutes of deep dive time)
	.
	.
	Issue Three (15 minutes of deep dive time)
	.
	.
	.

Discussion Notes:

[Insert summary of meeting intros and other notes relating to the meeting kick off here in this intro paragraph. For example, if the meeting started with a demo, the highlights can be summarized here.]

[The remainder of the notes just attempt to capture the flow of the meeting. Q&A format works well because it allows for fast and efficient note taking and also helps capture the quality of the give and take. It is hard to get it perfect working live in the meeting, but if you capture the gist of the question and a few notes on the answer, you can easily go back and flesh it out when editing it prior to distribution.]

Q: Example investor question?

A: Example notes on entrepreneur answer.

Q: Example investor question?

A: Example notes on entrepreneur answer.

Q: Example investor question?

A: Example notes on entrepreneur answer.

Q:

A:

Q:

A:

Deep Dive Meeting Appendix:

Factual Questions The Company Answered in Writing Prior to Deep Dive:

Typically provided as a set of slides or a document with answers to questions sent in advance of the deep dive meeting.

Due Diligence Report

Company: {Company Name}

CEO: {CEO Name}

Report Date: {Date}

Company Description:

{insert 1-2 paragraph summary description of company here}

Due Diligence Assessment:

Topic	Rating	Remarks
Investment Thesis	+	
What Needs To Be Believed (WNTBB)	+	
Failure Risk	0	
Leadership Assessment	++	
Technology, IP and Product Roadmap	+	
Customer Need and Go-To-Market Plan	0	
Uniqueness and Competition	+	
Market Size and Market Opportunity	0	
Financial Projections and Funding Strategy	-	
Exit Strategy	0	
Deal Terms and Payoff	+	

Individual Assessments:

Team Member	Rating	Summary Remarks
{Name 1}	+	
{Name 2}	0	
{Name 3}	++	

Key

(++) = Very Positive (+) = Positive (0) = Neutral

(–) = Negative but issues can be overcome

(/)Very Negative, issues cannot be overcome

Due Diligence Checklist

This checklist is designed to be appropriate for early stage investments. The "Information Request" and "Tasks" columns list those items and tasks, respectively, that are generally required, at a minimum, to complete diligence. The "Key Questions" column is representative of typical questions the diligence effort should address. The information request, tasks, and key questions should all be reviewed and revised, as needed, for the particular situation. The "Summary Points" column may be used by the team to summarize the answers to key questions in preparation for drafting the diligence report. Thank you to Launchpad member Gail Greenwald for her help developing this checklist.

Diligence Topic	Information Request	Tasks	Key Questions
Leadership Assessment	Resumes for key leadership team members	Review resumes	Does the CEO possess the experience and leadership abilities to succeed?
	Professional references for key team members	Interview references (see interview guidelines)	Do they have skills for where they are going, as opposed to where they have been?
	Resumes and contact info for board members and advisors	Gather additional information from network as available (asking around, checking LinkedIn - anything to find blind reference checks)	Do the CEO and team have a proven track record?
		Assign team member(s) to spend time with CEO	Does the team possess the appropriate balance of experience and skill sets?
		Assess CEO and team for leadership, integrity, track record, required competencies	Are the board members and advisors suitable and committed?
		Assess suitability and commitment of board members and advisors	What key hires are needed to address gaps?

Diligence Topic	Information Request	Tasks	Key Questions
Technology, IP and Product Roadmap	Descriptions of technology and product	Review information and meet with technical team	Is the technical team qualified and experienced?
	Relevant technical publications	Assess critical technologies, tool choices, software architecture choices, scalability of solution	How strong are the technology and IP positions?
	Patents and patent applications	Assess IP defensibility	Is the product roadmap achievable?
	Related IP info (defense: Freedom to Operate (FTO)?, offense: enforceability?)	Conduct additional secondary research as needed	What are the remaining risks related to technology, IP and product roadmap?
	Product roadmap with key milestones	Conduct additional expert interviews if needed	Are their superior technologies on the near term horizon?
	Competing technologies and commercialization status	Assess remaining technical risk, IP defensibility, competitive technical position	
Regulatory Strategy	Regulatory strategy, if relevant	Review regulatory strategy	Is the regulatory strategy well thought through and feasible?
	Status of dialogue with regulatory authorities and/or consultants, copies of relevant communications	Interview regulatory experts	Are the company's financial resources sufficient to implement the regulatory plan?
		Assess comparable regulatory pathways for other products as appropriate	Are assumptions about partners/acquirors' roles in the regulatory plan reasonable?
		Assess regulatory climate	What are the remaining regulatory risks?

Diligence Topic	Information Request	Tasks	Key Questions
Customer Need and Go-to-Market Plan	Go-to-market plan with key milestones and granular detail on sales approach	Review information and meet with marketing and sales team	Is the GTM plan reasonable?
	Partner identification and relationship status	Interview customers, partners, prospects as appropriate	Is the sales pipeline adequate, and are key metrics for adoption rate, conversion rates, etc. conservative?
	Sales pipeline by stage, factored to be truly realistic and achievable	Gather information on industry comparables as appropriate	Do customers confirm the need and likely adoption rates?
	Any current marketing, joint venture, distribution agreements	Collaborate with financial team to assess revenue and pricing model	Beyond verifying some demand, do we understand the customers buying priorities? Is this Oxygen, Aspirin or Jewelry?
	Customer, prospect, and partner references (see guidelines for interviewing customers)		What are the major risks in marketing awareness, customer adoption rates and sales cycle?
Uniqueness and Competition	List of current and prospective competitors	Gather additional competitive intelligence as needed	Is the company well positioned with respect to current and likely future competitors?
	Competitive analysis including market share, relative strengths and weaknesses	Assess competitive environment, competitor positions, barriers to entry	Is the founding team well-informed about their market and industry? Do they have a good competitive sense, or are they unaware of key issues?
			What are the major risks in marketing awareness, customer adoption rates and sales cycle?

Customer Reference Check Questionnaire

Question	Response
What are the reasons for purchasing company's products/services? What problem does this product/service solve for you?	
Is this product a "Need to Have" or a "Nice to Have" for your organization?	
What are your expectations / goals for this (e.g. improved revenue, reduced costs, etc.)?	
Does the ROI for this product justify the current pricing? Would you expect to pay more or less for the product?	
Have you used similar products/services before?	
On your list of the top problems in your organization, where does solving this problem fall on your priority list?	
Is your company generally an early or late adopter of new solutions?	
Which products/services from the company do you use? Do you expect to add additional products/services in the future?	
Did you look at any competitive products?	
Why did you select company over other competitors?	
As a customer/prospect for (company's) products/services, how did your interaction with the company go? Did they meet your expectations?	
What is your impression of the company's management team?	

Management Assessment Questionnaire

Question	Response
What are {CEO Name's} strengths?	
What are some areas for further development?	
What's the best way to tell {CEO Name} something you know he/she doesn't want to hear?	
How does {CEO Name} use advisors? Does he/she share everything and ask for reaction, or does he/she just come with specific (e.g. narrow questions / concerns?) How open is he/she to influence from advisors (e.g. investors?)	
If {Company Name} were to fail due to leadership, it would be because of what characteristic of {CEO Name}?	
Does {CEO Name} show sufficient emotional intelligence to be able to navigate the typical ups and downs of an early stage company?	
Do one or more members of the management team have a proven track record and does prior track record include successful exit(s)/ returned money to investors?	
Does the management team have applicable domain expertise?	
Does the management team have complementary skills?	

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