

FINANCING THE START UP VENTURE

by

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NYS Bar Association: Representing the Startup Business: Financing the Startup Venture

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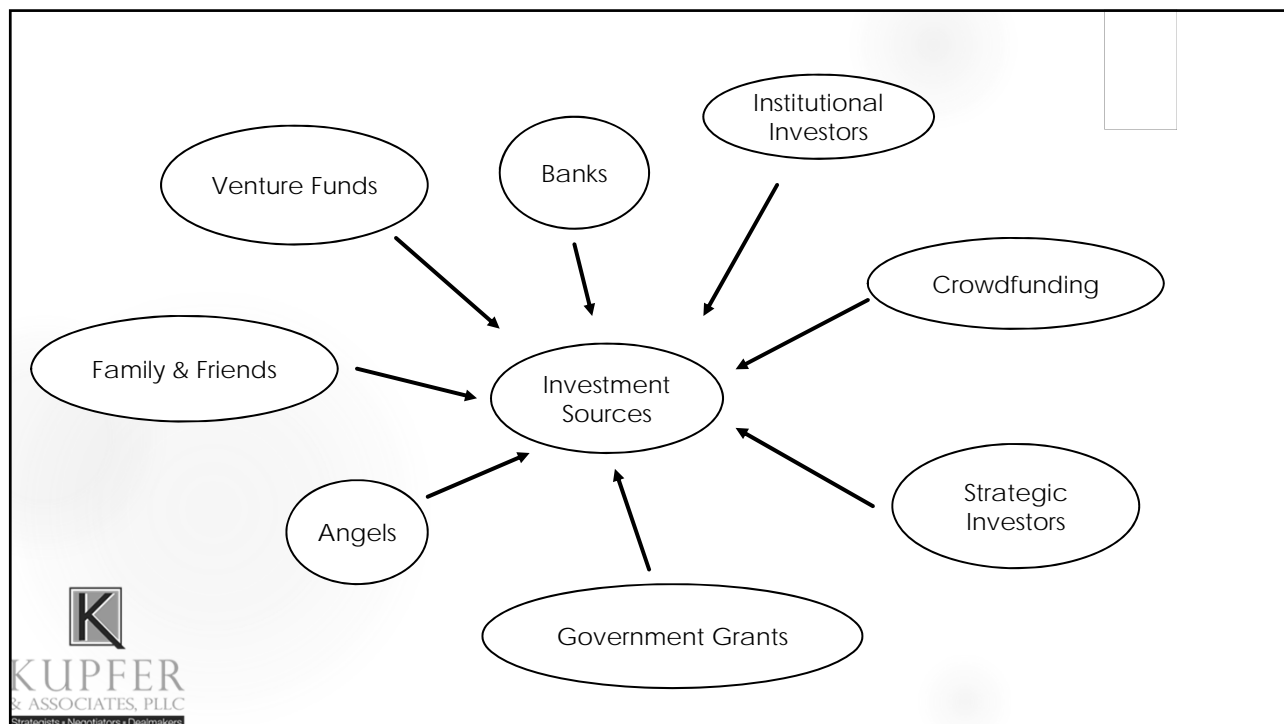
Strategists • Negotiators • Dealmakers

Key Attorney Skills for Representing the Start-Up Venture

- ▶ Legal knowledge and competence
- ▶ Industry Knowledge
- ▶ Deal Evaluation
- ▶ Understanding Deal Structures
- ▶ Valuable and Honest Advice
- ▶ Negotiating



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Types of Investors and How to Find Them

- ▶ Friends and Family
 - ▶ Seems obvious at first who these people are
 - ▶ But – what about friends of friends and friends of family or their friends?
 - ▶ Be careful of securities laws requirements/violations
 - ▶ Are you within Section 4(2) of the 33 Act so you do not run afoul of the public offering requirements?
 - ▶ Should you make Regulation D filing?
 - ▶ If you are not a securities attorney, where is the line when you may want to say “I need to bring some additional expertise”
 - ▶ Malpractice risk
 - ▶ Malpractice Insurance impact

Types of Investors and How to Find Them (cont'd)

- ▶ Crowdfunding
 - ▶ Previously gifts and recognition
 - ▶ Regulations just adopted re equity crowd-funding
- ▶ Angels
 - ▶ Usually wealthy individual investors who invest their own money in what they care about.
 - ▶ Groups/associations – e.g. New York Angels
 - ▶ On-line platforms – e.g.
 - ▶ AngelList
 - ▶ Gust



Types of Investors and How to Find Them (cont'd)

- ▶ Venture Capital
 - ▶ Invest OPM
 - ▶ Funds of various types that focus in different areas
 - ▶ A lot of capital available right now
- ▶ Institutional Investors
- ▶ Public Offering
- ▶ Strategic Investors vs. Financial Investors
 - ▶ Guiding your client regarding the differences
 - ▶ Impact on valuation

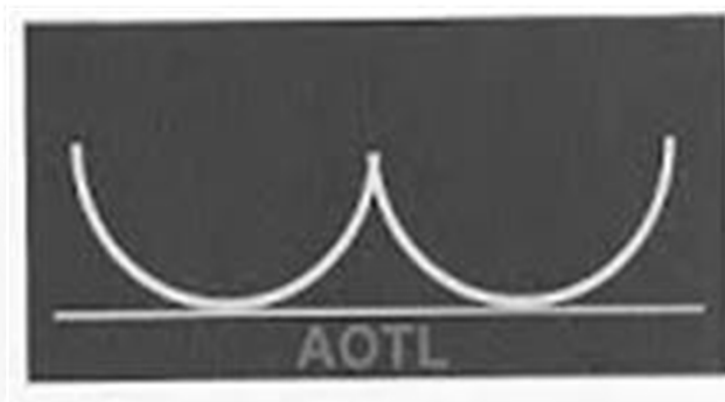


What Are the Various Types of Investors Looking For:

- ▶ Is a good idea enough?
- ▶ Track record
- ▶ Management team and prior success
- ▶ Historical financials/other relevant metrics
- ▶ Projections
- ▶ Deal structure and terms
- ▶ Passion of the entrepreneur along with a realistic understanding and acknowledgment of the risks
- ▶ Knowing your numbers
- ▶ Clearly stated assumptions underlying the projections and a good understanding of them by the business-owner
- ▶ If everything above is there, what is the one other key requirement without which sophisticated investors will not invest?



Commitment



Structuring/Desires and Demands of Various Types of Investors

- ▶ Type of entity
 - ▶ LLC
 - ▶ S-Corp
 - ▶ C-Corp
- ▶ Types of equity
 - ▶ Common
 - ▶ Preferred
 - ▶ Capital return preference
 - ▶ Coupon
 - ▶ Liquidation preference
 - ▶ Voting/Non-voting
- ▶ Convertible debt



Structuring/Desires and Demands of Various Types of Investors (cont'd)

- ▶ Board Seats
- ▶ Contractual major decision veto rights
 - ▶ Major corporate transactions
 - ▶ Board control
 - ▶ Employment of key executives including the founders
- ▶ Springing or conditional rights
- ▶ Rights to participate in future financing rounds
- ▶ Registration rights



Risks

- ▶ Relationship risk
- ▶ Issuing too much equity too early
- ▶ Making it too complicated early/too many different deals for different investors
- ▶ Not properly anticipating the need for additional capital (especially, in the case of rapid growth)
- ▶ Dilution/loss of control
- ▶ Triggering/springing investor rights – the risk of optimistic projections (the selling vs. benchmark tension)
- ▶ Agreeing to anti-dilution rights – NO, NO, NO
 - ▶ Use rights of first refusal/matching rights and discounted future valuation rights instead.
- ▶ Doing a deal with the wrong investors



Key Ways You Can Add Value to a Client Considering Financial Deal

- ▶ Support the client in a rigorous evaluation of whether entering into a finance deal of any type is in their best interest.
 - ▶ Generally, the top performing financed companies have the largest and quickest growth.
 - ▶ But, the percentage of successful financed companies (especially VC/PE financed companies) is shockingly small.
 - ▶ Review the work of John Mullins is an Associate Professor of Management Practice in Entrepreneurship and Marketing at the London Business School.
 - ▶ Percent of venture funds that outperform the S&P
 - ▶ Percent that achieve desired returns
 - ▶ Percent of companies within the highly successful funds that are highly successful
 - ▶ The adverse impact on the ability to innovate and pivot



Key Ways You Can Add Value to a Client Considering Financial Deal (cont'd)

- ▶ Assist the client to identify and clarify their goals and objectives
- ▶ Help the client design a financing and deal strategy
- ▶ Advise the client in determining what are the best types of investors and where to find them.



Key Ways You Can Add Value to a Client Considering Financial Deal (cont'd)

- ▶ Prepare the client for the deal:
 - ▶ What it takes to get a deal done
 - ▶ Due diligence preparation
 - ▶ Negotiating
 - ▶ Deal Structuring
 - ▶ Closing
 - ▶ Post-closing impact on culture, decision-making and operations
- ▶ Do all of this while keeping in mind the business opportunity as well as the business and legal risks.





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