

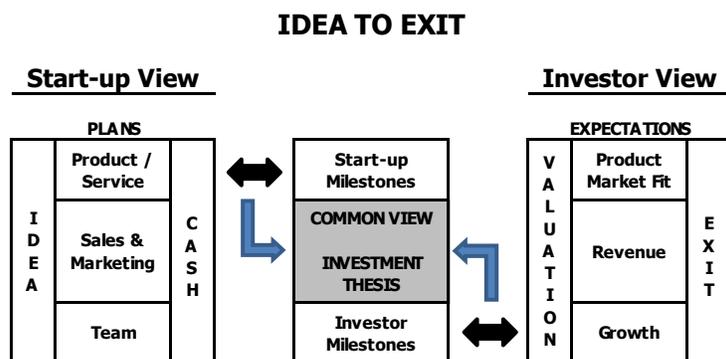
THE *ENTREPRENEUR'S EQUITY ROADMAP*TM : RAISING MONEY WITHOUT GIVING AWAY THE BUSINESS

By Gary Hazen and Stew Nelson, MODG

Let's face it – it's not easy for a start-up to get funding. It may seem like it should be easy – a great idea, an outstanding team, great plans – all you need is the money to get started. So, why, after talking with several investors, do you find that they begin evading you or not returning your calls? And even after getting initial funding, the situation seems to get worse. Investors expect more than the start-up can deliver; initial funding is insufficient; investors are not happy; and founders find they must give away too much equity in future rounds.

The problem: Founders and investors don't have the same yardsticks. Founders frequently underestimate what it is going to take to get to proven value, and investors don't understand what the start-up needs. Therefore, results don't match expectations; communications break down; and the flow of money stops. Or, to cover their perceived increased risk, investors demand more equity for additional investment, which rapidly dilutes the equity the founder retains to carry forward into future rounds and retain for the team.

Here is how the "Idea to Exit" process depends upon the proper reconciliation of plans and milestones to support the investment process:



Founders and investors don't see the world the same way. Founders see it from the perspective of what it takes to get the 'product' built and to market. Investors see it from the perspective of limiting risk and maximizing financial returns, all with the objective of increasing valuations and exiting on very favorable terms. Frequently, as founders and investors begin to talk to each other, the investor expects that the founder understands the investor point of view when they do not. The lack of a common perspective starts to make discussions difficult, and the founder frequently interprets this as the investor not understanding the start-up's 'big idea.' As a result, founders try to further explain their product value rather than talking about the business plans that the investor needs to hear about.

Frequently, even after an investment gets made, these communication issues continue, with performance not being in line with investors' expectations even when the founder believes they are doing everything they promised. Too often, the results are:

- The start-up fails to get sufficient funding to get to their goals.
- The start-up fails to meet investor expectations.
- The investor begins to offer to 'help' the start-up to protect investment, but is reluctant to invest more money.
- The start-up falls short of goals without needed additional funds.
- The investor loses confidence in the start-up. Trust is the bond; without it, there will be no more money.
- Additional funding stops despite having shown progress and results, or investors demand too much equity for further investment.

The remainder of this whitepaper outlines an approach (the *Entrepreneur's Equity Roadmap*TM) that deals with these issues. It ensures that investment stays in step with start-up/investor milestones, anticipates the needs of future financing rounds, and helps preserve founder equity to make the process work.

The Founder's View

Founders wonder why, after talking with several investors, they find that the investors are not returning calls and don't seem to be willing to help.

Let's take a look at the founder's point of view (simplified):

- Founders have an incredibly strong commitment to their idea, and they think that investors should be willing to invest because the idea is so good.
- Because the idea is so good, the valuation of the company should immediately be high.
- Because the idea is so good and the valuation is so high, investors should be willing to invest a lot without expecting a lot of equity.
- Because the above is true, founders should be able to retain more than 50% equity.

Founders attempt to defend these positions by preparing a Business Plan, an Executive Summary, and an Investor Presentation. Too often, these end up being a defense of the idea and its implied value rather than a presentation of what the start-up team plans to do to demonstrate value in the marketplace.

Example:

- Say a start-up has not yet developed a 'proof of concept' product that has been taken to potential customers to confirm the value of product features in the marketplace, but the founder is asking for investment to create a Minimum Viable Product (MVP) to take directly to a large number of customers. Given the lack of value confirmation, it is unlikely that investors will give all the funds requested. Without sufficient funds, it is unlikely that the start-up can deliver anything near the planned MVP. Therefore, when the money runs out, there is no product and no confirmation of value. The result: no additional investment and a failed start-up. It would have been better to have asked for a lower level of investment, sufficient only to produce the 'proof of concept' that could be taken to customers and used to confirm the product value. Achieving this shorter-range milestone would have provided the basis for trust and additional investment.

The Investor's View

While the typical founder's Investor Presentation gives the investor the basics about the start-up, the typical investment process does not sufficiently address a common basis for evaluation and communication.

Let's take a look at the investor's point of view (simplified):

- Investors want to exit at 10x investment within 5 years.
- At each stage of investment, investors want to minimize risk by limiting investment until successive levels of return on investment are proven by the start-up.
- On the other hand, investors want to have a clear idea of what level of investment is needed to ensure success at each stage and wants to invest enough to ensure success.
- Investors want to see incremental increases in both equity and valuation at each stage that:
 - Initially, gets them 'into the game.'
 - Ensures early proven marketplace fit and revenue potential to get the start-up 'over the hump.'
 - Demonstrates the basis for increased valuations at each milestone, bringing with them the ability to attract additional funding that maximizes the value of equity at exit.

This is a more demanding point of view than what the start-up frequently understands and knows how to address. On each side of the investment equation, both start-up and investor, are expectations of what will occur at specific milestones that will support an ongoing investment relationship.

The Need

For the founder, presenting their information in a way that investors will understand is sometimes called 'The Investment Thesis.' This presents the start-up's point of view in terms that provide investors, in investor terms, why investors should invest. Without the founder understanding how to do this, this is frequently a failed effort.

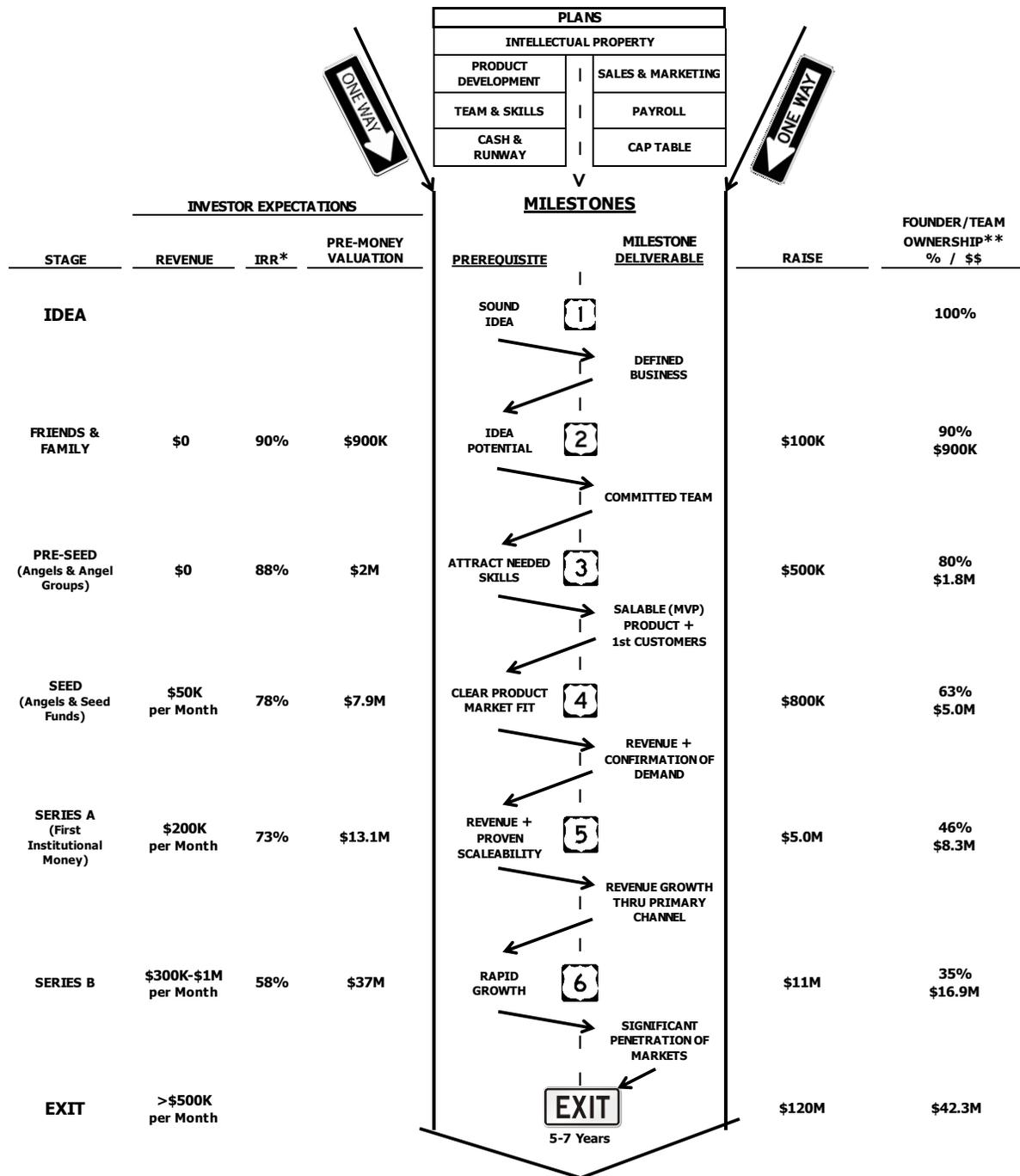
This is because insufficient attention is given to start-up milestones and their impact on investor/start-up Valuation.

So, the key is to ensure that Start-up Milestones match Investor Expectations; and that Milestones ensure a recognizable increase in Valuation at each stage that justifies further investment.

The Solution: THE ENTREPRENEUR'S EQUITY ROADMAP

The Entrepreneur's Equity Roadmap ensures that start-up milestones, investor expectations, and valuations are in alignment.

ENTREPRENEUR'S EQUITY ROADMAP™



The Golden Rule: He who has the gold, makes the rules. [And the Investor is the one that has the gold!]



* IRR (Internal Rate of Return) is the result of cumulative returns from investment through exit; these are not individual milestone measures or goals.

** Without Option Pool

Here are the components:

- Investment Rounds (Pit Stops) – Friends & Family through Exit. These are the points that additional funding will be added to the business.
- Investor Expectations – These include key factors, revenue (and growth), and resulting valuations.
- Milestones – Beyond Friends & Family, these are the points at which results from the start-up provide the basis to increase valuation of the business and justify additional investment.
- Plans to Achieve Milestones – Product, Sales & Marketing, Team, Head Count/Payroll and other plans that explain how milestones will be achieved. (These are also the basis for financials.)
- Raise – Additional investment amounts that parallel the milestones and valuations.
- Founder Ownership – The progressive managed dilution of founder equity while achieving significant increases in founder value.

Results from Using the *Entrepreneur's Equity Roadmap*

It is the responsibility of the founder to prepare the *Entrepreneur's Equity Roadmap* – getting assistance and iterating as needed.

Critical Elements:

- Milestones that are consistent with 'the big idea', plans, cash requirements, and the Investment Thesis.
- Updated plans that reflect the need to adjust milestones based upon investor expectations.
- Consistent view of funding – valuations and raises – that ensures sufficient capital with managed preservation of founder equity and value.
- Feedback from investors that opens communications to ensure the *Entrepreneur's Equity Roadmap* is consistent with investor goals and that milestones are consistent with the Investment Thesis.
- Iterate and update as necessary.

A well-prepared *Entrepreneur's Equity Roadmap* provides the founder the basis for improved communications with investors, a better basis for planning the business, and an increased likelihood of getting investment when needed. This leads to increased chances of success for the business and preservation of equity and maximum value to the founder.
