BEST PRACTICES
FOR BUSINESS ANGELS
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Introduction to Best Practices for private high-growth investments

FiBANs “Best Practices for Business Angels” has developed over time and is continuing to live and change; we are regularly adding good advice as we learn. FiBAN is the biggest network of private investors in Finland, and actually one of the biggest ones in Europe in terms of the amount of members. FiBANs Best Practices are meant for our members own use only and we keep all rights to this document. We have of course also borrowed from, and quoted, other “gurus” in this field and in those cases are the names always mentioned. The first version of these Best Practices is based on the collective work of a team of experienced FiBAN founding members, who together have experience of making over 100 investments, leading dozens of start-ups and succeeding to do several profitable exits.

We have in 7 chapters collected Best Practices and advice to consider as a Business Angel when looking and preparing for an investment, managing the investment and exiting the investment. This summary is of course not the final word on these topics, the work continues and input from members is appreciated. We cannot, and will not, take any responsibility for bad investments or wrong decisions based on this paper.

Who is a Business Angel?
There are about 300 registered Business Angels in Finland and around 20-30 M€ are invested on an annual basis. It is often thought that you have to be very wealthy to be a Business Angel, but in fact many start with investments from around 10.000 €. But remember that your money likely will be tied up for several years so it must be money outside your normal financial needs. Business Angels generally put between 10.000 and 500.000 € in an investment. Investments are usually made in return for shares in the business. Most Business Angels will take a portfolio approach and invest in more than one company to give a spread of opportunities to diversify their risks. In fact, it is recommended that you invest in at least ten companies to avoid too much risk.

Business Angels are an important but under-utilized source of money for new and growing businesses. There are two kinds of Business Angels, those who do it fulltime and those who do it part-time, both are however active. A completely passive individual is not a Business Angel, just an investor. A typical Business Angel makes one or two investments a year, either individually or by linking up with others to form a “syndicate”. Business Angels often invest as part of a group called a syndicate, organized through personal contacts or a Business Angel Network. One of the investors will generally act as Lead Investor, sometimes referred to as the “archangel”. He or she will act on behalf of the whole syndicate, which helps the entrepreneur because the group then speaks with one voice.

As well as investing money, Business Angels also bring valuable know-how, contacts and experience to the businesses in which they invest. This is an essential part of the idea, separating Business Angels from the big public that let their banks invest their savings. We talk about “smart money” when referring to Business Angels and other active and professional investors.

Business Angels invest across most industry sectors and stages of business development, but especially in young high-growth businesses. Most prefer to invest in companies within a 2 h drive from where they live or work. Investors in technology companies tend to be more prepared to travel longer distances. Also, investors in very narrow fields tend to accept, or are forced to accept, longer distances.

Also have a look at the best international sites, like:
American Capital Association, www.angelcapitalassociation.org
UK Business Angels Association, www.bbaa.org.uk

We also suggest all capable of reading Finnish to read Matti Lainema’s book “Enkeleitä, onko heitä?” which is available through FiBAN.
1. Reasons to become a Business Angel

Our advice: Do it for earning money, but remember to have good patience.

Business Angels rarely have a connection with a certain company before they invest in it, but they often have experience of its industry or sector. The commitment of Business Angels is usually very strong. The majority of Business Angels make investments for financial reasons. However, there are also other motives for investing, for example:
- taking an active part in the entrepreneurial process,
- enjoying being part of the success of a good investment,
- helping young or new entrepreneurs,
- making use of acquired knowledge and experience and
- putting something back in to society.

What to consider before becoming a Business Angel?
- Think about obtaining help from an accountant or someone with corporate finance experience in assessing business plans and conducting due diligence, as well as providing tax advice.
- Be sure that you have money outside your normal financial needs.
- Plan how and when you intend to achieve a return on your investment, for example from dividends, fees and capital gains.
- We suggest investing alongside an experienced Business Angel in the beginning; FiBANs network will help you find a group, syndicate or partner.
- Be patient, finding the right company (or companies) takes longer than many Business Angels anticipate.

2. Finding investment opportunities

Our Advice: Rather friendship based on an investment, than an investment based on friendship.

Opportunities for Business Angel investments are usually presented in so called pitching events, where start-up companies and already operating companies present their ideas for potential investors. Many Business Angels also find out about new investments through their present investments or their own networks. FiBAN continuously maintains a list of potential investment opportunities.

Personal investment strategy

The investment opportunities might find you (for example if you are a well-known former CEO), but usually a Business Angel needs to be active in looking for good cases. In order to be able to look efficiently from the start, a clear focus should be defined. It is a good idea for a Business Angel to clarify his/hers personal investment strategy in the very beginning. Consider and answer the following questions:
- what are my own reasons for making investments (expectation of great returns, participation in the development of interesting companies, giving back to society, helping Finland succeed, an opportunity to work with dynamic young people etc.)?
- how much in total do I plan to invest in start-up or early-stage companies and during what time?
- do I have the money, even if it takes much longer than expected to develop the companies or many of them go into bankruptcy?
- which fields of business (i.e. what markets, technology, products, manufacturing or service etc.) do I know and/or interests me?
- what kind of added value or help can I offer to the companies in addition to my money?
- how much own time do I have to offer?
• am I the kind of person who will give enough space for the entrepreneur as well as active enough in controlling and steering the development of the business?

Also take into account that in most cases the business plan will not happen as expected and the surprises tend to be negative ones. Therefore an additional round (or several) of financing with similar valuation than the initial one is very normal, even though not anticipated in the business plan. You should reserve some of your planned investment for the target company to these later rounds.

As in any kind of investment strategy – diversifying your portfolio is wise. The failure rate of start-ups is quite high and all eggs in one basket is not a good plan. Diversifying means investing in start-ups and other assets, as well as investing in more than one start-up.

3. Screening and analyzing

Our advice: Never listen only to the entrepreneur; he/she is always an optimist.

Your personal investment strategy and areas of interest will determine your selection of the companies you want to look closer at in the available deal flow. Normally the first things to find out about are the markets served, is there a real demand for the product or service? What is the added value of the company’s proposed innovation or offering and does the team seem competent enough to build up the business? Below, we provide you a sample of checklists, which hopefully can help making the analysis.

Collecting information

The entrepreneurs will of course provide you with a business plan and other information, but it is a recommended to collect information also from independent sources before engaging in close negotiations with the company. The more information you get from different sources, the better off you are. And the more informed you are when talking to the entrepreneurs, the better questions you can ask them.

Try to find somebody who is knowledgeable about the market and industry trends, if you are not an expert yourself. You need to question and validate the assumptions in the business plan. Get references – if the company already has customers, ask to meet some of them. Ask to meet the whole team; it is not enough to talk to the person who happens to be at the pitching event. The team will be critical for the success of the venture. Find out if the team is 100 % committed to the venture, or are some of them just part timers or looking for something else to do? Ask about competitors and see what you can learn from and about them. Do not accept the answer that “there are no competitors” (look at the Top Ten Lies of Entrepreneurs below).

Checklist

When considering a new investment opportunity, it is important to stay calm and avoid getting overexcited about the company or its products, at least too early. Checklists prepared by experienced investors can help in finding the right questions to ask, as well as analyzing the answers. All entrepreneurs are optimistic; otherwise they would not be entrepreneurs. Some are also nervous, poor, uninformed or naive. That can be accepted, but you need to sort out the big liars, the cheaters and the incompetent. A good way of doing this is asking for a reference, but instead of listening to that reference (who will be prepared by the entrepreneur), you ask this reference to give you another reference (i.e. the reference’s reference) who might give you a valuable objective view.

We provide the following checklists for your use:

A) Business plan checklist – use this list to evaluate the business plan of the potential investment.
B) **Strategic plan checklist** – use this list to find out how good the strategy of the potential investment is.

C) **The new business road test** – this list by John W. Mullins helps to view different dimensions of the potential investment.

D) **Top Ten Lies of Entrepreneurs** – this slightly sarcastic list of in fact 11 (not 10) “lies” entrepreneurs are telling investors is made by Guy Kawasaki. It is a helpful way to keep your critical sense working during your discussions with the entrepreneur(s) of the potential investment.

### A. Business plan checklist

This list can be used while listening to the pitch and when reading the business plan.

**Current situation**
- Where is the company now?
- Where is their product or service?
- What is their market?
- How will they reach the market?
- How will they produce the product?
- Who are the people?
- How reliable are the financial projections?
- How much money will you need?
- What are the risks?
- How do they ensure the working capital?
- What is present value?
- What is the exit strategy?

**Is there something in the business?**
- Exclusive rights or patents?
- Proof of concept?
- The concept works like claimed?
- Proof of market, is there a customer demand?
- What value can be created?
- Are there paying customers?
- A competitive advantage?
- Is there proof of the business model?
- Is it scalable, profitable and efficient?
- What is the prospect of return?
- Is the position interesting?
- Can a growth story be created?
- Large opportunity with multiple approaches?

**How will the company reach the market?**
- How can you make the product known?
- Which selling methods?
- Sales channeling?
- Which kind of distribution?
- Value sharing in the chain?
- Retaining customers?
- Dealing with technological change?
Typical mistakes:
- Too close to the product to describe it clearly
- Providing too many product details
- Cannot describe the customer benefits
- Failing to assess the durability of the advantage
- Skills needed and team not in balance

B. Strategic plan checklist
This list of questions helps you evaluate the strategy of the company.

Need for existence of the company
- What is the pain of the customer, which part can the company solve?
- Is this easily identified?
- How does the customer value the solution?
- In what alternative ways can the customer solve the problem?
- Does the solution present the customer with better flexibility/benefits compared to others?
- What will the customer value when working with the company?

The company's position in the market
- Is this business interesting?
- Does the market grow, how much and who says?
- What is the basis of the growth, is it sustainable?

Position in the value chain
- Which players have the power of suppliers?
- Which are the key factors in competition?
- Does the product or service have real interest with the customers?
- What other factors may enter into customer’s choice of supplier?
- What networks have power in the value chain?
- How will a new supplier win the trust of the customer?

Traction
- Where are the first opportunities for invoicing?
- Where is the best profitability?
- How are first opportunities to enter the market created?
- Which customers are the fastest to decide?
- Which deals are easiest to close?
- Where does profitability come from?

Strengths
- Which are the strong competitive advantages of the company?
- Which competitive factors are the most risky?
- What strengths exists today?
- Where will new opportunities be created (in short term and long term)?
- What will increase the company's trustworthiness as a supplier?

Mission
- How does the company serve the customer with its current product set?
- Which small improvements must be made immediately?
- How big can the company be next year, and three years from now?
C. The new business road test
This is especially created for businesses within new fields of business, where both the markets and the players are changing rapidly.

Top level issues
- Are both market and industry attractive?
- Does the opportunity offer compelling customer benefits as well as sustainable advantage over other solutions to the customers?
- Can the team deliver the results they seek and fulfill their promise to others?

Market macro-level, market attractiveness
- Is the market large enough to support the competing suppliers, are growth trends encouraging?
- Overall market size (number of customers, aggregate money spent, number of usage occasions)
- Where is the market on the “S curve” – is it nascent, growing or saturating?
- Trends in broad categories – demographic, socio-cultural, economic?
- Technological and regulatory issues?

Market micro-level, target segment benefits and attractiveness
- Is there a market segment for the product and support of future growth?
- Target segment benefits and attractiveness – customers buy benefits, not products or features
- How large is the segment and how fast it is growing – combination of primary and secondary data
- Who you would like to be your FIRST customer – can you name that customer?
- Clearly differentiated solution with value delivery unambiguously stated
- Does an entry in a segment facilitate lateral entry in other segments?

Industry macro-level, industry attractiveness
- Is it a good industry, how about entry costs, supplier and buyer power, substitution threats and competitive environment?
- Is it an attractive industry – certain industries are perpetually sick and others are cyclical
- Does the industry as a whole have entry barriers, technology lock-ins or need economies of scale?
- Every time an industry doubles its size, a new structure for it emerges – consolidation or disaggregation?

Industry micro-level, sustainable advantage and how long will it last?
- Do you possess or develop proprietary elements, that other firms cannot likely duplicate or imitate?
- Sustainable competitive advantages, how long will your edge last?
- IP protection – patents, copyright, trade secrets?
- Superior organizational processes that are difficult to replicate?
- Is your business model viable – i.e. there is availability of finance (for long term needs and for working capital) and the contract enforcement and revenue collection cycles works?

Team, mission aspirations, propensity for risk
- Is the founding team prepared for what it means personally and professionally – what are the individual and corporate attitudes to risk?
- Do they have a shared vision and total commitment to it?
- Aspirations, motivation and propensity for risk taking
- Accepted wisdom – there is a lot of ideas, who will execute?

Team, ability to execute on critical success factors
- Is the executive team up to achieving the success factors for a business in the proposed industry?
• Ability to execute on critical success factors (CSF) that are unique to each industry market segment – better, cheaper, faster?

Team, connectedness; up, down and across the value chain
• Is the management team well connected across all elements of the value chain?
• Financers give as much (if not more) importance to team as ideas
• Connectedness up, down and across the value chain – ability to move from Plan A to Plan B, identification of all the CSF in the industry

D. Top Ten Lies of Entrepreneurs
Guy Kawasaki, a founding partner of Garage Technology Ventures, has provided this story: “I get pitched dozens of times every year, and every pitch contains at least three or four of these lies. I provide them not because I believe I can increase the level of honesty of entrepreneurs as much as to help entrepreneurs come up with new lies. At least new lies indicate a modicum of creativity!”

We have slightly simplified the language and shortened Kawasaki’s text a little bit. For the complete list, go to the Internet.

1. “Our projections are conservative.”
An entrepreneur's projections are never conservative. If they were, they would be zero. I have never seen an entrepreneur achieve even her most conservative projections. Generally, an entrepreneur has no idea what sales will be, so she guesses (too little and my deal is uninteresting, too much and I look hallucinogenic). As a rule of thumb, when I see a projection, I add one year to delivery time and divide the amount by ten.

2. “(Big name research firm) says our market will be $50 billion.”
Every entrepreneur has a few slides about how the market potential is tens of billions. It doesn't matter if the product is bar mitzvah planning software or chips. Venture capitalists don't believe this type of forecast and entrepreneurs would do themselves a favor by simply removing any reference to market size estimates from consulting firms.

3. “(Big name company) is going to sign our purchase order next week.”
The funny thing is that next week, the purchase order still isn't signed. Nor the week after. The decision maker become sick, the CEO gets fired, there's a natural disaster, whatever. The only way to play this card is AFTER the purchase order is signed, because no investor you'd want will fall for this.

4. “Key employees are set to join us as soon as we get funded.”
If it is true that key employees are ready to rock and roll, have them call the venture capitalist after the meeting and testify to this effect.

5. “No one is doing what we're doing.”
This is a bummer of a lie because there are only two logical conclusions; a) no one else is doing this because there is no market for it, and b) the entrepreneur is so clueless that he cannot even use Google to figure out he has competition. As a rule of thumb, if you have a good idea, five companies are doing the same thing. If you have a great idea, fifteen companies are doing the same thing.

6. “No one can do what we're doing.”
If there's anything worse than the lack of a market and cluelessness, it's arrogance. No one else can do this until the first company does it, and ten others start-ups will start in the next ninety days. The world is a big place and there are lots of smart people in it. Entrepreneurs are kidding themselves if they think they have any kind of monopoly on knowledge.

7. “Hurry because several other venture capital firms are interested.”
The fact that you are reading a blog about venture capital means you're not one of them. For the absolute top, there is competition for a deal, and an entrepreneur can scare other investors to make a decision. For the rest, do not think you can create a sense of scarcity. Read about the lies of venture capitalists, to learn how entrepreneurs are hearing “maybe” when venture capitalists are saying “no”.

8. “Oracle is too big/dumb/slow to be a threat.”
There's a reason why Oracle is where it is, and entrepreneurs are where they are, and it's not because it is big, dumb and slow. Competing with Oracle, Microsoft and other large companies is a very difficult task. Entrepreneurs who say this look at best naive.

9. “We have a proven management team.”
Says who? Truly “proven” in a venture capitalist's eyes is a founder of a company that returned billions to its investors. But if the entrepreneur were that proven he; a) probably wouldn't have to ask for money and b) wouldn't be claiming that he's proven. A better strategy is for the entrepreneur to state that; a) she has relevant industry experience, b) she is going to do whatever it takes to succeed, c) she is going to surround herself with good directors and advisors and d) she'll step aside whenever it becomes necessary.

10. “Patents make our product defensible.”
The optimal number of times to use the P-word in a presentation is one. Just once, say: “we have filed patents for what we are doing”. The second time you say it, venture capitalists begin to suspect that you are depending too much on patents for defensibility. The third time, you are holding a sign above your head that says “I am clueless”. Patents are good for impressing your parents – you won't have the time or money to sue anyone worth suing.

11. “All we have to do is get 1% of the market.” (Here's a bonus since I still have battery power)
There are two problems with this lie. First, no venture capitalist is interested in a company that is looking to get 1% of a market. Frankly, we want our companies to be the biggest. Second, it's not that easy to get 1% of any market.

4. Due Diligence

*Our advice: Have at least one other person, professional or not, to help you with your due diligence.*

Due diligence refers to all the examination, fact finding and investigation of the target company, its business plan and markets that you do after you have decided to be interested in a company and before actually doing the investment.

It is very important to invest the time to do a reasonable due diligence and to do this in a calm and factual manner – do not get overexcited about the company, the team and the products but instead dig for all the facts available. In fact, research has shown that a more extensive due diligence correlates with bigger returns in a later exit. This is your last stop before committing your money. Ask a friend or colleague to help you with the due diligence, or seek professional assistance if possible.

There are three categories of due diligence to be done: Business, Legal and Financial.

**Business Due Diligence**

Understanding the business logic, evaluating the markets and believing that the team and company in question will be able to answer to the demand is all included in doing the business due diligence. This you should have done already, but you can go back to the checklists section – work these through once again with your latest understanding and information.
Legal Due Diligence

You can ask a legal firm to do this, but if you don’t want to spend the money, then these are the minimum things you need to look at:

- is the company in the corporate register (Kaupparekisteri) and has a register number (Y-tunnus)?
- who are the shareowners at this time, are there any commitments, options or other potential claims on the shares?
- are there IPR’s and are they owned by the company, or for example some shareholder?
- what agreements exist between the owners regarding the shareholding?
- are there any tax depths or other unsettled business with the authorities?
- what agreements does the company have, other than normal sales agreements?
- who are the employees of the company at this time, what are the terms of employment and other commitments (like the right to future options) to employees?
- are there any legal proceedings concerning the company, any open claims towards the company?

Financial Due Diligence

The idea with this part of the due diligence is not so much to evaluate the financial potential in a certain business, but to make sure that the financial situation is under control. We recommend you to:

- get the latest financial statements from the company,
- demand information about possible significant financial events after the last statements,
- check it there are any large overdue invoices to or from the company,
- look who the company owns money to and if there are booked but unpaid salaries and
- get an example of the management reporting (if any) used by the company.

All the above is quite normal to ask and get from the company before the investment takes place. A company, which does not want to, or cannot, deliver this information, should be handled with care as an investment case.

Additionally, sometimes it may be a good idea to get a personal evaluation of the key managers in the team – this can be done with the help of recruitment companies for example, but with some cost. It is also worth evaluating other possible risks combined with the key members, like for example their health, their financial situation and need of money, their other options, their age and their family relations.

5. Making an angel investment

Our advice: Do not be too eager just because you love the product or want to do something.

After selecting your investment target and conducting the necessary due diligence it is time to conclude the actual investment. This section provides information, which will help you at this stage. The main point is that no deal is good at any price (there is always a maximum price worth paying even for the best of the best), but many (perhaps even most) deals will be good at some (low) price. And remember, it is not only the price, it is also the other issues, like the duties and right of different parties. “Trust and check”, as the old saying goes.

We wish to emphasize the following:

- It is highly recommended that you get legal advice for assessing documentation, structuring the deal and drawing up agreements.
- Find out enough about the entrepreneur and management team's background and track record in a potential case, check whether the entrepreneur or any of the management team have been bankrupt or been a director of an insolvent company.
Also be patient after the investment is made, it usually takes a lot of time to increase the value of the company, being a Business Angel is rarely a fast way to make profits.

Finally, never invest without considering how and when you will exit.

The process of investment
The shareholders’ meeting has to decide upon giving out new shares (or changing the share capital). The investment should generally be paid before a certain date to the defined account of the company and registered as an increase of share capital or shares as soon as possible, latest within a month.

Valuation
Valuation refers to the total value of the equity of the company. We speak of either pre-money or post-money valuation. Pre-money valuation is the value of the company before the proposed investment, calculated with the share price offered to the investors. Post-money similarly is the total value after the investment has been made. An example: The entrepreneur is offering the investor a 20% share of the company in return for a 200,000 € investment. Then the pre-money valuation is 800,000 € and post-money valuation is 1,000,000 €.

There are financial models for calculating the value of an enterprise, but these are normally based on discounted future cash flows and not applicable in a start-up or early stage company. In a start-up or early stage investment case there are some guidelines to consider in determining the value;

- the motivation of the entrepreneur and/or team is a critical factor for success and they should be left with a large enough equity stake after the investment – a majority is a reasonable expectation,
- the amount of funds to be invested compared to expected total needs of the company – i.e. what level of additional financing is expected to be needed and when (at which valuation) and
- the expected value of the company in a future exit – what will the part acquired in the original investment be worth then, taking dilution (and perhaps also inflation) into account.

At the end of the day it is a price discussion as any other – how much equity will the entrepreneur team give the investors for the proposed amount of money and which investors are ready to pay that price? No rocket science. It is not always the best policy to fix the valuation at the investment time; it may be left to depend on the success of the company also.

It is worth remembering that risk and return go hand in hand. The higher risk a certain segment has, the higher the possible expected return needs to be. If an investor invests in 20 companies and perhaps 10% will be really successful, those two companies needs to give ten times back in order to compensate for all the others. Do not pay too much in the beginning.

Structuring the investment
Most investments in start-up and early stage companies are done as direct equity investments (osakesijoitus) – i.e. the company issues new shares, which the investor(s) get in exchange for money. The main benefit for the investor(s) is that this is very straightforward and easy to understand. The benefit for the company is the same, and also that the funds after the transaction come to the company and are available to the company immediately.

In some cases a convertible equity loan (vaihtovelkakirjalaina) can be advantageous for the investor(s). Here there will be conditions agreed on which the loan will be exchanged for equity at a future date (to be agreed) and most importantly; the rate of exchange can be tied into some measurable success indicators from the business plan. This is a good way to solve a disagreement on valuation, where the investor(s) would agree to a higher valuation provided that all goes well and where the entrepreneur would agree to accept a lower valuation in the case that some things didn’t go according to plan. Also a combination of equity and convertible equity loan is possible and sometimes used. It might be useful for both the entrepreneur and the
investor to have a combination of loans and equity in cases where a positive cash flow is expected within a reasonable short time, because loans are easier to return.

**The lifeline of a company**

It is wise to try to project the whole life of a company. We know that it usually takes five years or so in “the valley of death” for the start-up to become a profitable business. You should not believe that an initial round that takes in the money needed for one or two years will be the only one. It is likely that the “cash burning rate” will increase during the second or third year of operations, due to the need of personnel and marketing, and it is also likely that the start will take something close to the average five years. The following step is going from a “profitable business” to a “big profitable business” and the growth will almost certainly cost money. In the best case all the money the company is making, otherwise more money from the investors. There is seldom an exit-chance yet at this stage. Depending on the kind of business, it can also be a phase of intense technical (and other) development, costing a lot of money. It is essential to imagine the whole lifeline (and all money needs) of a business before jumping on board.

**Term sheet**

The term sheet is a document, which is sometimes used to agree on the most important terms and conditions, which the parties agree that will be the basis of the proposed agreement to invest. Typically a term sheet includes:

- identification of the investor(s) and the company,
- the size of the investment,
- the timetable for the investment,
- what percentage of shares will be given,
- possible special benefits for the investor, like a place on the board, veto powers etc. and
- liquidation preferences (the right of investors to get their invested money out first in an exit, with or without interest and possible leaving the entrepreneur(s) without anything).

Typically the term sheet is signed by the investor(s) and the company/entrepreneur, but is not binding. It does however provide for confidentiality and usually stipulates that the company cannot engage in other negotiations during the validity of the term sheet, which must be limited to a reasonable time. The term sheet is a document of engagement while the actual investment is the marriage.

**Shareholders agreement**

When investing in start-ups or early stage companies it is important to agree on several things and to also document these in a shareholders agreement. It makes sense to take your time to think through the things you want and need to agree on. The following are normally issues to be discussed and agreed:

- restrictions on transfer of shares, normally other shareholders have a preferential right of purchase,
- commitment of the key entrepreneurial team to continue working with the company, possible forced selling of shares at discount if leaving early,
- confidentiality of all information,
- equal spreading of all information and real-time updating (and possibly majority approval) on important decisions for all shareholders,
- non-competition of shareholders and entrepreneurs,
- the duties and rights of the management,
- members and constitution of the board,
- possible veto rights of investors,
- exit situation, minority and majority (tag-along and drag-along) protection clauses,
- liquidation preferences, if agreed, and
- further financing – rights and obligations of investors.
A lesson learned is that there should not be any decisions, which will require all parties to agree unanimously. These situations create an opportunity for blackmail or simply sabotage by one single disgruntled party. It also makes sense to agree on the changing of the shareholders agreement (a small minority should not be able to prevent this either) and on the inclusion of new parties into the agreement. There are several model agreements to look at, but it is usually a good idea to let a lawyer check the agreement before closing. And we strongly advice not to make too complicated shareholders agreements, they might be very hard to get out of in a changed situation, and a possible process gets complicated and expensive.

**Syndication and Lead Investor**

Syndication generally means that there are several Business Angels participating in the investment. This is very much the norm, rather than the exception, in most countries. Syndication can be done on a case by case basis, but it is also possible to organize it a bit more formally and create practices and contracts. There are two main forms, a) you put the money in advance and a majority of the members can decide where the collected funds are invested or b) you work as a group, but everyone takes his/her own decision for each investment. The group appoints a Lead Investor who will represent all the investors towards the entrepreneur (in order to make it easier for both parties) and who will do most of the work. He/she sometimes receives a small pay or some other form of benefit from the group. The Lead Investor often takes a seat in the board. In Finland we are still learning and looking for examples. FiBAN hopes to be able to lead the way to more organized syndication investments in Finland in the future.

**Sweat equity**

Sweat equity refers to an investor contributing to a project in the form of effort instead of (or besides) financial equity, which is a contribution in the form of capital. Other terms used are: "stocks for services" or "equity compensation".

Sweat equity is time and knowledge put into a business to make results. It can be of almost any kind: sales work, management, business development, technical contribution, R&D, IT-work or "opening doors". It is very important to have a clear agreement and documentation regarding the expectations from the sweat equity and how it is compensated.

The actual equity can be granted as options, with or without cost, or as shares, either given in advance or based on delivered contributions.

As the receiver will become a shareholder of the company, he/she will also have to sign a possible shareholders agreement.

**6. Increasing the value**

*Our advice: If you don’t work hard with your start-ups, your odds are better at the stock exchange.*

Making the investment is only the start – at that point the real work for the Business Angel actually begins, i.e. increasing the value of the company! There is usually a lot to be done in early stage businesses and a Business Angel either takes an active role or makes sure that somebody else does what needs to be done.

After the investment is made it is essential to make sure that company engages actively to fulfill the business plan, which was the basis of the investment. This is of course a task for the board, and the board should make sure that there is urgency and momentum in the execution.
Evaluate and put pressure on the following:

- Are the required resources in place – especially for sales and marketing?
- Is the management up to the task? It is quite normal, that the CEO (in the beginning usually a founder) needs to be replaced as the company grows and requirements change.
- When the business starts to fall behind the plan, as often happens, it is important to act fast (and not to wait for a miracle) – things do not normally get better by themselves.
- Is the strategy clear and executable – it may need some fine tuning based on early customer feedback – why did the customers buy or not buy?
- Are we solving the right problem? For example, do we want to sell a product or a service?
- Get the routines in place (see Board meeting practices).

**Administration**

Administration and governance in a start-up is not very complicated but the same laws and regulations, which the large companies follow, are to be followed.

There is certain paperwork, which needs to be up to date all the time and this usually is the responsibility of the CEO, as start-ups do not normally have a finance and/or administration department in the beginning. The following should be dealt with:

- minutes of shareholders and board meetings signed, filed and easily located,
- monthly tax declarations, all employer duties and financial statements should be accurately done,
- shareholder register up to date, including all information about granted options and
- all official filings (Kaupparekisteri) concerning board members, signing rights etc. are up to date.

It makes sense to use an accounting service provider for the bookkeeping and formal accounts as well as tax declarations.

**Advisory boards**

In addition to a competent board a start-up can sometimes benefit from an active and well organized advisory board. If useful advisors, willing to work with the company, can be found, then this opportunity should not be neglected. They might be people who do not want to sit on the company board because of the risks, their main occupation or other duties or personal reasons. Things to be considered:

- advisors should be selected based on their competence and expertise, not based on some other criteria like entitlement,
- an advisor group typically meets 2-4 times per year, meetings take 2-3 hours and are usually combined to lunch or dinner, which is normally the only compensation given,
- compensation in the form of options can also be considered,
- advisors need to be selected also based on their motivation to give time and effort for the benefit of the company,
- it makes sense to have different backgrounds and profiles included in a way to provide new points of view to the CEO and the company board,
- the CEO and chairman of the company board need to commit to preparatory work for the advisory board meetings and also to the facilitation and documentation of the meetings,
- typical topics for discussion are the company’s strategy, looking at different macro-scenarios, evaluating markets and marketing plans – the “big picture” in general and
- discussions are confidential, which needs to be agreed and documented in a specific NDA (for those members who have not signed the shareholders agreement).

**Company board**

A well-functioning and competent board is essential to the success of any start-up. As the law states the board is responsible for the management of the company and this responsibility extends towards the
shareholders but also towards all outside parties, suppliers, customers, employees and the society (the state). The following is worth trying to achieve;

- the board should not be too big (big generally meaning >5-7 persons),
- the board should consist of people with different strengths and qualifications,
- the board should preferably not include any employees,
- the board should have at least one outsider, i.e. not an investor, founder or employee and
- the board should come together at least once a month.

In a start-up there are the following to pay attention to in addition to the normal duties of the board (as defined in the law and the company’s own articles of association);

- channeling the additional value that the private investor(s) can bring to the company,
- taking an active part in formulating and working with the strategy,
- overseeing the actions and work of the founder(s) and
- following up that all the administrative tasks are completed.

Often start-up companies end up with a board, which is a combination of all those who feel that they have an entitlement to a board position. Clearly this is not always the best board from the company’s point of view. Following points should be taken into account when electing the board;

- the chairman will need to invest reasonable amount of time and energy in running the board, at least twice the amount required from normal members,
- all members should be willing and able to invest their time, it is normal to have meetings monthly or at least every second month,
- it is good practice that the CEO is not a member of the board, but will participate in the meetings,
- it is a learning that employees of the company should never be members of the board, even if they are major shareholders – they should nominate their representatives,
- membership should be decided on based on the needs of the company, not on the needs of a certain owner (or owner-group) to have representation.

Board meeting practices
The following are good practices for Board meetings;

- the agenda must be sent out to all members well in advance of the meeting,
- all supporting material should preferably be included at this time and
- the board meetings have a standard agenda to which topical items will be added as required.
- the standard agenda consists of at least the following;
  - bringing the meeting to order,
  - minutes of the past meeting (check of existence and signature),
  - financial situation based on a fresh cash flow forecast,
  - report on sales and orders,
  - personnel issues, new employments and possible layoffs,
  - time and place for the next meeting and perhaps
  - board review (some time without the presence of the CEO, no minutes).

- the meeting should not be too long in order to be efficient, it is wise to define the ending time, and
- the minutes of the meeting are prepared within reasonable time (normally the duty of the CEO).

Managing the management
Experience shows that in many cases problems do develop over time, if some formal practices are not put in place (also read the proposal for a compensation committee under “Incentive systems”). There should be some rules agreed upon with the CEO immediately when the new board starts working after the investment. It is much easier to decide these things upfront than to try to get them in place later on. For example, travel approval and travel claims – the chairman should approve at least costly travel in advance and also check the travel claims before payment. It is also worth thinking about demanding the chairman’s signature on all payments to the CEO. In start-ups the CEO normally pays the bills and will also be paying himself. In short,
the investor needs to make the entrepreneur accept that he/she also has a boss and should follow certain principles like any employee.

**Strategy process**

At the time of the investment the strategy of the company is outlined in the business plan. The immediate focus for the board (generally newly elected after the investment) is to make sure that the company is putting actions in place to execute this strategy – not to think about changing it. However, it makes sense to plan a process for the company, anchoring yearly reviews and updates to the strategy. It is good practice to agree in advance that strategy review takes place a certain month every year. This helps to make sure that it is not forgotten or overrun by day-to-day issues.

There will of course be situations in a start-up, where the strategy needs to be changed much faster. That does not take away the need for a yearly review, which always is a good opportunity to document and also communicate the latest agreed strategy. It is a good idea to include key personnel, advisors and shareholders outside the board in the strategy process. The board will get a wider view and better perspective when more people are involved. It also helps to anchor the strategy with all stakeholders.

**Investor cooperation**

It is normal to have more than one Business Angel and perhaps also some institutional investor in a case, especially if the company already has some age. It is a good idea to plan, and agree upon, the cooperation and sharing of information right at the start of the cooperation. Typically some, but not all of the investors will be members of the board (or have a representative). There is naturally a huge difference in the information available to the board members compared to the other investors. Normally the shareholders agreement guarantees the right to information about the company to every investor at any time, but there is normally no easy system for spreading this information. The best practice proposal is to organize a shared file, for example a Dropbox-folder or similar (password-protected) solution. The items of information that should be included are for example:

- minutes of board meetings,
- financial reporting provided by the CEO to the board,
- periodical financial statements,
- outlook papers provided by the CEO, including views on markets and strategy,
- information about major deals and
- public presentations, press releases and basic material for marketing.

**Second-round investment**

Although the business plan may indicate that the initial investment will be sufficient to carry the company to a position of strength, there are nearly always negative surprises on the way. Most likely a second-round investment or many additional investments will be necessary.

From a Business Angel point of view an additional investment is OK only if the Business Angel has planned for it and he/she has the funds available to participate in it. Otherwise his/her share will be diluted – possible at a bad valuation. Always expect to invest at least the same amount as in the first round during the next two years following the initial investment.

Entrepreneurs sometimes speak about “investment rounds”, and indicate that the amount requested during pitch-time is sufficient “until next round” – this is a clear red flag for the private investor. Who will be investing in that round? What will the valuation be? What kind of additional rights will the new investors claim over the current investors? A next round is only good news if the company has developed so well that it can claim significantly increased valuation – if this happens, the company is usually so strong that it also could survive without the next round.

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Incentive systems
The investors and board members in a start-up are normally very eager to see results regarding product development and sales. They do not often enough actively focus on things like the salary structures etc. and deal with issues one by one as they come up. It is advisable for the board to nominate a remuneration committee, as in large companies, which simply is tasked to formulate and oversee the salary and incentive practices in the company. Major decisions will naturally come to the whole board, but this kind of committee is a good partner for the CEO to work with as these issues come up. The following are items that need to be decided on;

- utilization of the “grand-father principle” – i.e. all salary and hiring and firing decisions are to be approved by the manager's manager – in a start-up this normally means that CEO cannot alone decide but must get the approval of the board,
- which union contract will be adhered to – every company must choose as the contracts are by law universal (yleispätevä),
- the salary levels, in a start-up it is normal to pay only modest salaries (even to the CEO),
- link the sales salaries to performance, this can be volume or profit based depending on the nature of the business but care must be taken to make sure that these salaries do not get unreasonably high in special circumstances (and coordinate the bonus pay-out with when the customer pays),
- option plans, which are a good way to motivate personnel who are not shareholders to start with but need to be carefully designed for all circumstances.
- option prices and time regulations when the options can be used (unused options are normally lost when a person leaves the company) and
- following up possible sweat equity, option or other benefits to board members and advisors.

Need to go international
Why is there need for a firm to become internationalized? You have no choice but to look at the world not merely as a market to exploit but also as a potential gold mine to reduce your cost structure, recruit talent and tap for new ideas. The way of doing business has become global and it is likely that your competition at least to some extent will be international. An international company will have better access to talent, production, research and markets. The question for your company is first and foremost not “if” but “when”.

How to go global?
How should you build the necessary global presence? Find your competitive edge in global competition, starting by analyzing what your strengths are on the home market. Without systematic analysis, purposeful thinking and careful orchestration, widespread global presence can easily degenerate into managerial distraction, resource duplication and inefficiency.

Is the mindset of your management sufficiently global? Knowledge, skills and experience regarding how to navigate in a global environment will increasingly become a core requirement for leaders. It is suggested that you choose a CEO especially for the purpose of going global when the time is right.

Questions a company planning to go global need to raise:
- What factors make some markets more strategic for us than others?
- Is the management and personnel up to the task?
- Which of our products/services should be taken international?
- What should we consider in determining the right mode of entry?
- How should the corporate DNA be transplanted as entering new markets?
- What approaches should the company use to win the local battle?
- How rapidly should the company expand globally?
**Go-to-market strategy**

Global expansion forces companies to develop at least three types of capabilities: Knowledge about foreign markets, skills at managing people in foreign locations and skills at managing foreign business. The launching should act as maximizing returns while minimizing the risks associated with early internationalization moves. These first moves represent experiments with high learning potential and when succeeding they build confidence and credibility for the organization.

The sequence with which a company enters various markets should depend on two factors; a) the strategic importance of the market and b) the company’s ability to exploit that market. The importance of a market should be estimated though the current and future market size, as well as the learning opportunities offered by that market.

Company can rely on traditional export, distribution networks or licensing. There are different types of ownership control modes. Choosing the right mode of entry is critical. Inappropriate decisions can impose unwanted and undesirable constraints on the options for future developments.

Alliance based entry modes have the advantage of permitting the firm to share the costs and risks associated with the market entry and allows rapid access to local know-how. A major downside of alliances is their potential for various types of conflicts stemming from differences in corporate goals and corporate cultures.

One of the ingredients in establishing local presence is an understanding of the uniqueness of the local market. Which aspects of the company’s business model require to be changed, locally adapted or reinvented? Securing presence is strategically important, how to create the long term marketing position, innovations and competence?

**The role of a private investor**

There is a general expectation that a private investor, i.e. Business Angel will bring value to the company in addition to the investment itself. There are different roles for the private investor to make him/her useful for the company:

- Board members have the best opportunity to help, and they should be selected with this in mind, remembering that diversity brings value.
- Outside the Board investors can be part of an advisory team, if such is put in place.
- Even without any formal role, the board or CEO can ask an investor for opinions or help in reaching certain persons or companies, where contacts exist.

It should be noted that investors should not disturb the CEO with frequent phone calls or other contacts to enquire about “how is it going” – it is up to the board to organize regular and sufficient information for all shareholders and it is important to leave the CEO focused on the many tasks at hand.

**7. Exiting**

*Our advice: Think about – and plan – your exit from the day you invest in the company!*

While there can be other reasons for making an equity investment in an early-stage company, in most cases the investor hopes to realize a profit from the investment. Exiting the investment is the way for investors to regain their investment hopefully with this profit. The exit is the point at which the investment and any profit are returned to the investor, and therefore is a very important event and deserves a lot of planning and preparation. The exit can take many different forms and sometimes it can be a sale of only some of the
shares or involve only one class or some subset of the investors. The most common case, however, with earlier stage companies is a sale of the total company or all of the shares of the company. Finding the exit opportunity is a challenge and depends on a number of elements, including the company, the industry, how the company fits into the industry and how it addresses emerging needs in the industry, how much overlap exists between the company and the existing players, the degree of validation and/or revenue achieved, and many other factors. Regardless of the above, the company will be best positioned to obtain an attractive exit if the company is as successful as possible in its business.

**Preparing for exit**

Preparation for exit starts at the very beginning of the investment process, with the signing of the shareholders agreement, where the main rules about the exit need to be described (for example, tag-along & drag-along rights, see “Shareholders agreement”). It is particularly important to provide a mechanism to enable efficient decision making in cases where all investors do not agree. It is also important to make sure that all shareholders are reachable (recording each investor’s address, phone number, e-mail) because decisions sometimes need to be taken quickly.

As the company moves forward in time, two events can set in motion an acquisition-type exit. One of these is the receipt of an unsolicited acquisition offer. The other is a decision on the part of the board to explore potential acquisition situations. In a situation where the company is valued on the basis of its financial performance, an unsolicited offer can fairly easily be assessed. Otherwise, it is important for the board to periodically discuss the business basis for acquisition, the acquisition environment, and to be mindful of the universe of potential acquirers.

Prior to or at the latest coincident with the start of a process that may lead to an exit, a number of items should be considered, including:

- when to inform the shareholders and employees of the situation, the opportunity and its approaches,
- agree on the roles in the negotiations for board members, shareholders, CEO and whether or when to engage potential external advisors (investment banker for example),
- think if it may be practical for the board to nominate a subcommittee to manage the negotiations,
- review the agreements with key personnel (typically CEO, R&D and sales managers) – these persons normally need to stay with the company, and their incentive to do so needs to be affirmed,
- agree on the responsibility of all information sharing to all the shareholders and also agree on the guidelines for external informing,
- note that legal experts need to be engaged, and often it is important to make sure that they also have expertise in the practices of the buyer’s country’s legal system,
- suggest that the shareholders have their own legal representation (for their own tax issues etc.) which is normally not paid by the company,
- possibly deciding that only one person should act as the official spokesperson and
- analyze the proposed terms and contracts well before the signature date.

It is worth remembering that not all companies are looking for an exit, at least not at every given moment. A company that is not ready for an exit, should not even accept to receive offers. The timing needs to be right both regarding preparations and in sense of the stage in which the company is.

**Structuring the exit deal**

We talk about an exit also when the investor exits a company for no money or if the company goes bankrupt. Unfortunately it is a form of exit an active Business Angel almost certainly will come across. Our only advice is that an inevitable rundown should be done as soon and clean as possible. There might be a chance to sell some parts of the company or to find someone to continue to some extent. These other alternatives are often better than just filing for bankruptcy. Also remember to make sure your own name is safeguarded in the
event of insolvency. Keep notes and material on the decisions made (and not made) and be open with you bank. Check out FiBANs offer concerning the “Ref-form” (Ref-lomake, Asiakastieto).

A good exit
What is a good return? A common rule of thumb in Business Angel investing is that approximately half of your investments will return little or nothing, 30-40% will give you your money back (perhaps with a small profit, often just covering the “interest” for the time it took) and approximately one in ten will give you a real gain. One case should in other words compensate for the half that became nothing and give the upside for the whole investing activity, meaning a return of ten times the investment or more. Achieving the success of exiting a company at a good valuation is not necessarily the end of the story. The actual deal in the exit can take various forms, depending on the situation. The following are typical cases, roughly in order of desirability;

- outright purchase of all existing shares or majority of shares in the company for cash – very straightforward and easy to understand (and analyze the outcome) for each shareholder,
- a share-swap where existing shares are traded in for shares in the buying company – here we have two alternatives:
  - the buyer is a listed company – in this case there often are limitations imposed on when the acquired shares can be sold, so you can determine the value of the shares at transaction time, but there remains the risk of changes before you eventually can sell the shares.
  - the buyer is a private company, the shares are not traded anywhere and their final value will be determined in a possible later exit of this company, which means it can be difficult to determine the actual value of the offering.
- A structure that includes what is called an “earn-out”, in which some amount of cash or stock is paid at closing and some additional consideration may be earned depending on the achievement of milestones by the acquired company after the closing. These tend to be favorable to the buyer, as the seller is often more optimistic about the future prospects of the company, and the buyer is controlling the operation of the company. it is also possible that only some assets (such as IPR’s (liiketoimintakauppa)) are bought from the company and the proceeds then remain in the company to be distributed between the shareholders (and creditors of course).

Another outcome not mentioned above which can be quite attractive is the listing of the company at the stock-exchange – while of course very desirable, this is very unlikely in Finnish start-up companies. All the above cases can have very different outcomes for the private investor in the actual situation and they also can have very different tax consequences. It is advisable that private investors seek expert advice to understand the outcome both financially and in the tax perspective.

Good luck with your investments, unfortunately – like most things in life – successful investing also depends on luck!