



Angel To Exit

The Team

with host
Fred Cohen

Overview

- **Background**

- What investors care about
- How investors evaluate the team
- Getting your team together

A briefing for the
Founder Institute
2017-05-01



Background



LEHIGH
UNIVERSITY

University of
CINCINNATI



California
Sciences
Institute



California State University
MONTEREY BAY

1969

**Fred Cohen
& Associates**



Advanced
Systems
Protection



Sandia
National
Laboratories



TechVision
RESEARCH

2017

White Glove

Pocket-Sized Bootable
CD with X11



KEIRETSU



FORUM

Many years
of startups
including
CEO, due
diligence,
and ABs

Today:

- Equity in ~50 early stage+ companies
- Collaborating closely with 2 universities
- Several national laboratories startups
- ~8 incubators / accelerators and growing
- Advisory boards of ~10 companies growing
- Valuations of early stage companies
- President of K4PB chapter
 - World's largest private angel investment group**
- Member Angel to Exit
 - Helping startups succeed**
- Industry analyst (Tech Vision Research)
 - Scores of large enterprise clients**
- Webster Innovation and Entrepreneurship program
- CSU-MB Startup Challenge judge, mentor, sponsor





Due diligence and the team

- For serious angel investors and venture capitalists
 - Due diligence is critical to the investment decision
 - People who claim they went to a big 10,000 person meeting, met an investor, and got \$15M, are almost never supported by or accurately reporting the facts
- I look at ~1 company/mo in depth (DD or ID process)
 - We spend a lot of time on the people (team)
 - We talk to the team members and their advisors
- If the team is not right, there is no chance I will invest
 - The DD report will also reflect this issue strongly
- There is a lot of information out there
 - I find most of it is not supported by facts – I like facts



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Investors care about the team

- The CEO is ultimately the most important player
 - They judge the CEO by a number of things
 - High on the list is the team they have built
- The importance of the team
 - The team needs to match the plan
 - If it's a race, you need fast horses
 - If it's driven by sales, you need great sales
 - If it's driven by technology, you need great texperts
 - If it's heavily dependent on operations, ...
- The team is about the expertise to execute
 - Knowledge, skills, training, education, experience
 - Do we trust the team to execute on and adapt the plan



Trust in the team

- I will not invest in people I do not trust
 - **Honesty and competency are an absolute necessity**
 - If I see a hint of dishonesty I will run away
 - If I see inconsistency, it is a big red flag
 - The people and the team as a whole provide those facts
 - **Big egos have big problems**
 - I want people smart enough to win
 - I want people polite enough to succeed
 - Due diligence is a “stand and deliver” process
 - **If you don't have the answers, don't make them up**
 - Good people don't lie or make stuff up
 - Everyone makes mistakes – even you – even me!
- **Want my money? Gain my trust! Pass the BG check!!**



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The CEO

- The key person on the team
 - Just because it's your idea
 - Doesn't mean you should be the CEO
- Biggest mistake
 - Inventor/technologist as CEO
 - Almost never works
 - Inventor starts with an idea realized or vision
 - Friends and family support the inventor
 - Entrepreneur gets involved
 - Go to angel funding
- Find a CEO right for the company
 - Knowledge, experience, skills, education, training



The executives

- Suited to the need (horses for courses)
 - Knowledge in the critical things needed for this business
 - Skilled in the general field of the company and position
 - Trained and educated in the relevant disciplines at issue
 - Experienced in the things they will do here
- The CMO of IBM likely sucks for CMO of a fast food joint
 - Ideally, they were an executive of the same sort in a previous startup of the same general type that had a great exit last year
 - Their connections in the industry are critical for some positions and cases, but not in others
 - You cannot always get the best, but it really helps!



The advisors

- Advisors are often more important than executives
 - Advisors bring connections, strategies, and avoid traps
 - Good advisors bring good investors (and executives)
 - Advisors find problems (fatal or not) before they happen
- But they are advisors, not part of the execution team
 - They provide options often not taken. The CEO decides.
 - They provide alternatives to span the space.
- Contract terms - perception vs. reality
 - 2/3 of advisors are paid in equity PLUS (deferred) cash
 - ~5% of startup equity goes to the advisory board
 - Early advisors are usually not investors (except as fees)



Operations, sales, and marketing

- All critical to the team
 - Nothing happens till someone sells something
 - Sales without fulfillment destroys reputation
 - Marketing builds reputation → more sales
- Evaluating the team
 - Are the leaders right for the company
 - Does the team fill all the needs of sales, marketing, and execution, or are there gaps
 - Is all the expertise needed for the plan on the team?
 - Can the team work well together (at all levels)
 - Are there enough resources to meet the need?
 - 24x7 → 5 shifts – do you have 5 shifts worth?



Outsourcing, offshoring, etc.

- All acceptable in some circumstances, not in others
 - They should fill the gaps in the team
 - But communication and management must be addressed
- It's often good to outsource non-core elements
 - Tradeoffs between employees, 1099s, B-B, channels, etc.
- The people you work with should know
 - What you are doing
 - Why you are doing it
 - Who is doing it
 - How you will evaluate performance
 - What you will do based on evaluations
- DD will check on that when we interview them



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Growing the team with time

- Scaling and scalability are often fatal flaws
 - CEO sells to clients and takes 30 days of effort to close
 - We will scale by a factor of 4 each year for 3 years
 - CANNOT WORK! 12 sales/y is all the CEO can make
 - There are only so many top flight folks out there
- Growing a team with time requires adequate:
 - Supply of qualified candidates
 - Training processes to get them to do what you need
 - Integration into teams and business processes
 - Cash to build the team and sustain it
 - Your growth had better address personnel needs
- There are lots of tricks, but you need to show how!



Executive compensation

- All you have is equity and cash! (and early, only equity)
 - Most company failures come when they run out of cash
 - First in get equity, but after a point you need to stop
 - Different folks view this differently
- Founders are typically all equity till funding, then cash
 - Various combinations of gaining equity v. cash over time
 - Vesting is tricky and problematic and often deceptive
 - Many such things end up in law suits
- Early executives want equity plus cash if they are good
- Later executives may also vest equity over time but it's usually more like a bonus than a stakeholder



Advisory board compensation

- Equity vs. cash vs. both
 - I create and run ABs
 - Typically 3-6 people with the right mix to meet the need
 - Good AB members not cheap
 - You get what you pay for*
 - Would you work for free if you made your living at it?
 - They don't get paid unless you succeed (to some level)
 - Members change with time (how do you manage it)
- Lots of claims about AB members, deals, and contracts
 - I did a small study to test it out
 - ~66% of AB positions are not equity only
 - AB members (in total) get ~5% of startup equity
 - *"Fair compensation" is ~\$5K/mo (deferred) +5%



Overall equity breakdown

- Average at exit (not you) based on historical data
 - 5% Advisory board (plus cash compensation)*!
 - 25% Founders and seed (10% \$150K to get to traction)*!
 - 3% Non-founder executives and workers (like a bonus)
 - 33% Angel investors (\$600K to get you to \$5M)!
 - 33% Venture investors (\$5M to get you to \$50M)
- The pie is only so big, and after dilution, common shares are not worth very much – preferred! non-dilutive*
 - Employees and later executives are compensated by cash and what equity is left – usually not much
 - Usually not preferred and dilutive
 - Many founders make mistakes here and allocate too much to employees, ending up with far less



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Questions?



Thank You



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