

# Funding Your Innovation: Capital Options; Equity Economics; Working with Investors

University of San Diego, MRH Warren Auditorium  
September 21, 2018; San Diego, California

*Disrupting*  
*Old*  
*Habits*



**Martin Kleckner III PhD MBA**





**Strategic  
Partners**

**From Their Perspectives**



# **3rd of a Four-Part Series**

**July 12, 2018: SBIR STTR – The Basics**

**August 23, 2018: SBIR/STTR Phase II – Beyond the Basics**

**September 21, 2018: Funding Your Innovation: SBIR Phase I & II Grants, SBIR Phase III Support, Business Alliances, Private Equity; Corporate Funding; Term Sheet – Economics & Control Parameters; Capitalization Table**

**October 18, 2018: Roadmap to Commercialization**

FRIDAY

21

SEPT

TODAY

# Agenda

APPOINTMENTS

TASKS

8

9

10

11

12

1

2

3

4

5

6

7

8

**USD the Brink:  
"Funding Your  
Innovation"**

JOURNAL

## For Our Discussion

- 1) Setting the Stage:  
Buy-In Behavior
- 2) Positioning Ourselves
- 3) SBIR Seed Reiteration
- 4) Commercialization
- 5) Early Stage Investing
  - Business Model
  - Alliances



## **Some Other Time**

## **Addendum**

I – “Crossing the Chasm”

II – “Investor Pitch Academy”

III – Overviews

- The Term Sheet:
  - (a) Economic, (b) Control
- Capitalization Table
- Convertible Debt

IV – Telling Our Story



# Where I'm Coming From

## 1) Six Launches; Two Exits

- RegeneMed
- InSilicoMed
- SpyFinder (Sold)
- Sal-Flex (Sold)
- + RefluxMD, U P Labs



Adjunct Faculty/Advisor: University of Southern California, California Institute of Technology, U C Irvine, Georgia Tech, U C Riverside, Ohio State, SDSU, CSU Fullerton

## 2) Not-For-Profit 501 (c) 3 pediatric cancer research institute

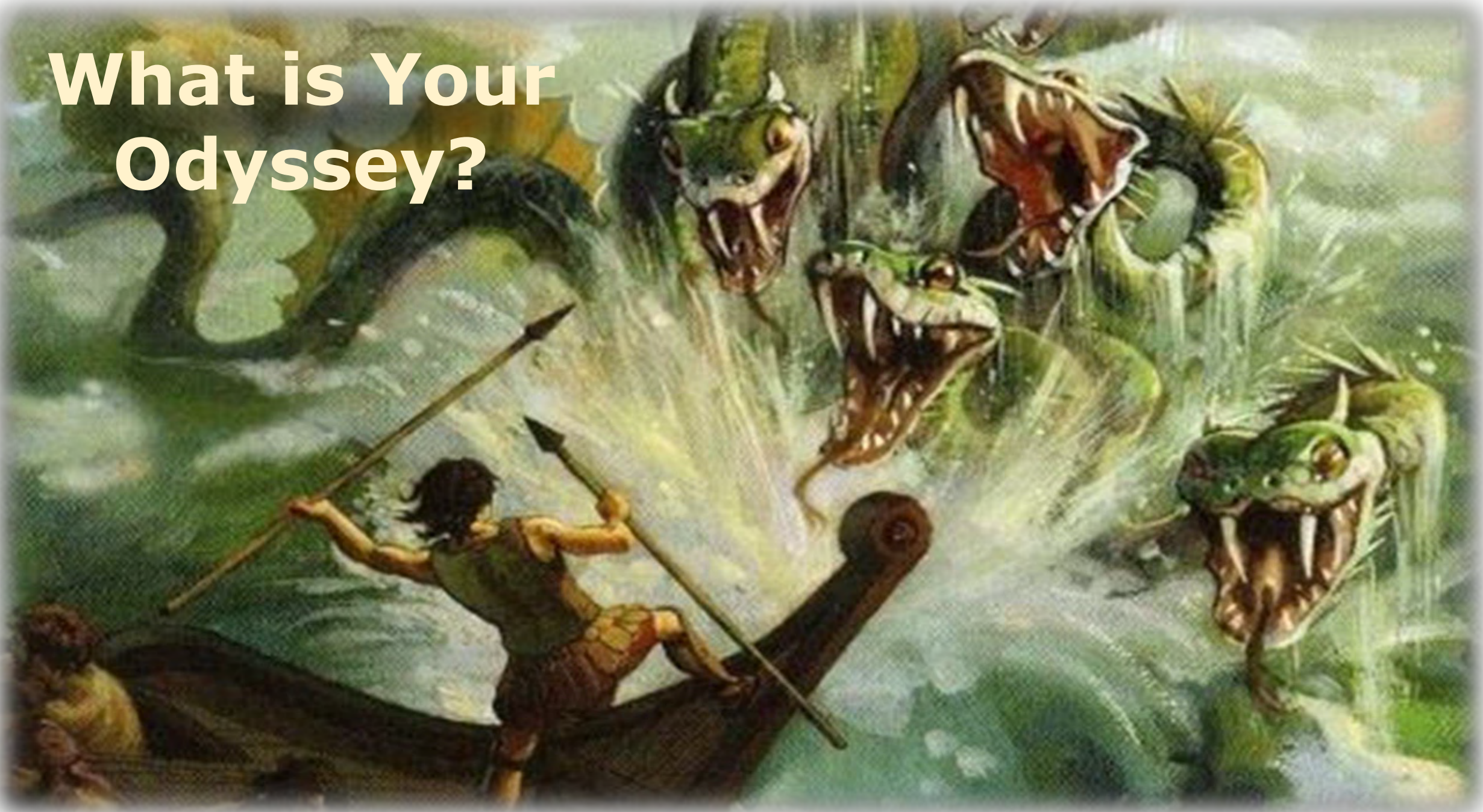
## 3) SBIR/STTR: NSF, NIH, DoD, DOE, DOT, DoEd, USDA, Coulter, Drexel; University of California; Cal State; L. A. BioMed Research Institute

## 4) General Electric, Roche, Toshiba; Honeywell (Europe, Asia, Americas)

## 5) \$39.5 MM in Capital & Grants Q2 2016 – Q2 2018

## 6) *Tech Innovation & Commercialization (BRINK) Univ of San Diego*

**What is Your  
Odyssey?**



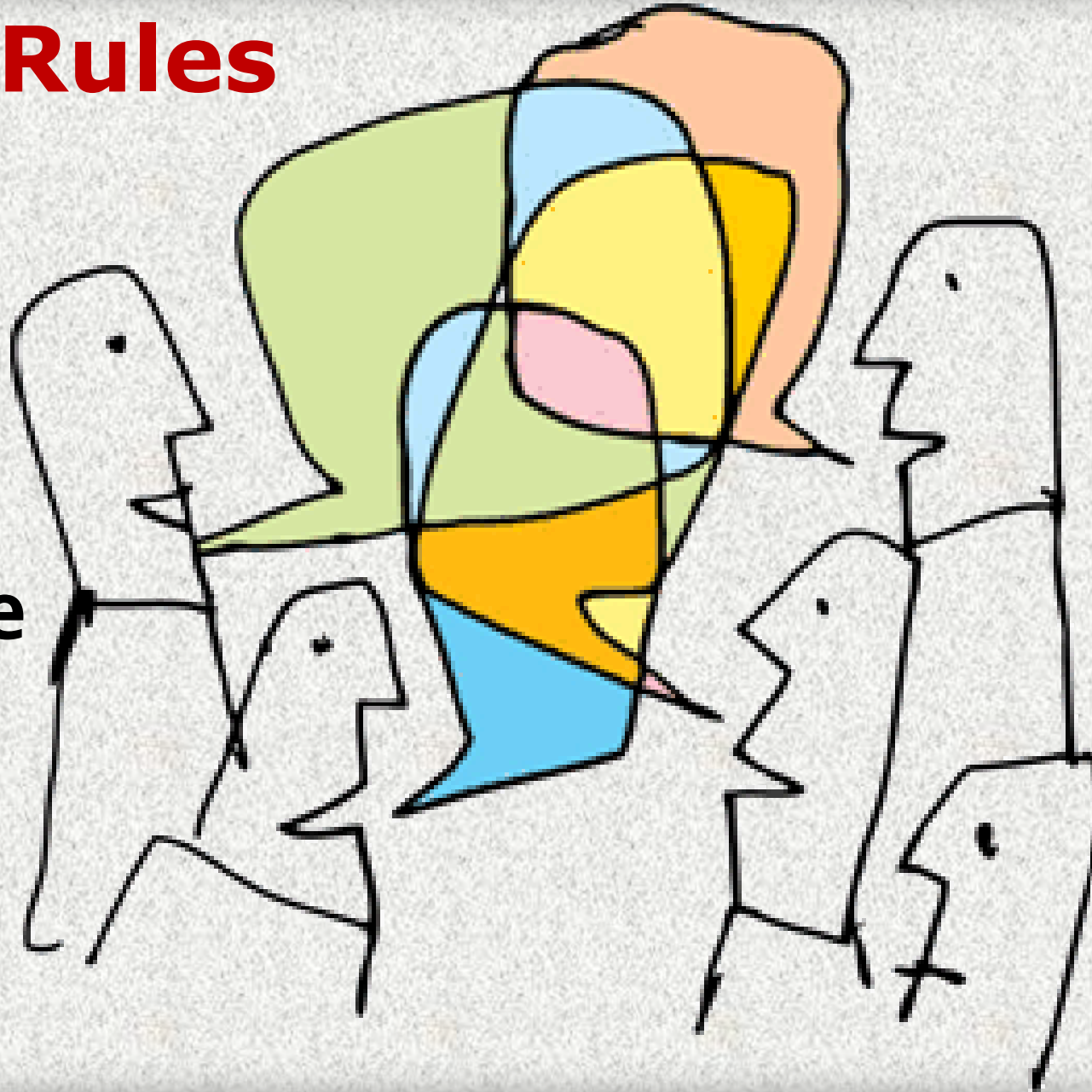


# Essential Rules

**1. Ask  
Questions**

**2. Participate**

**3. Discuss**

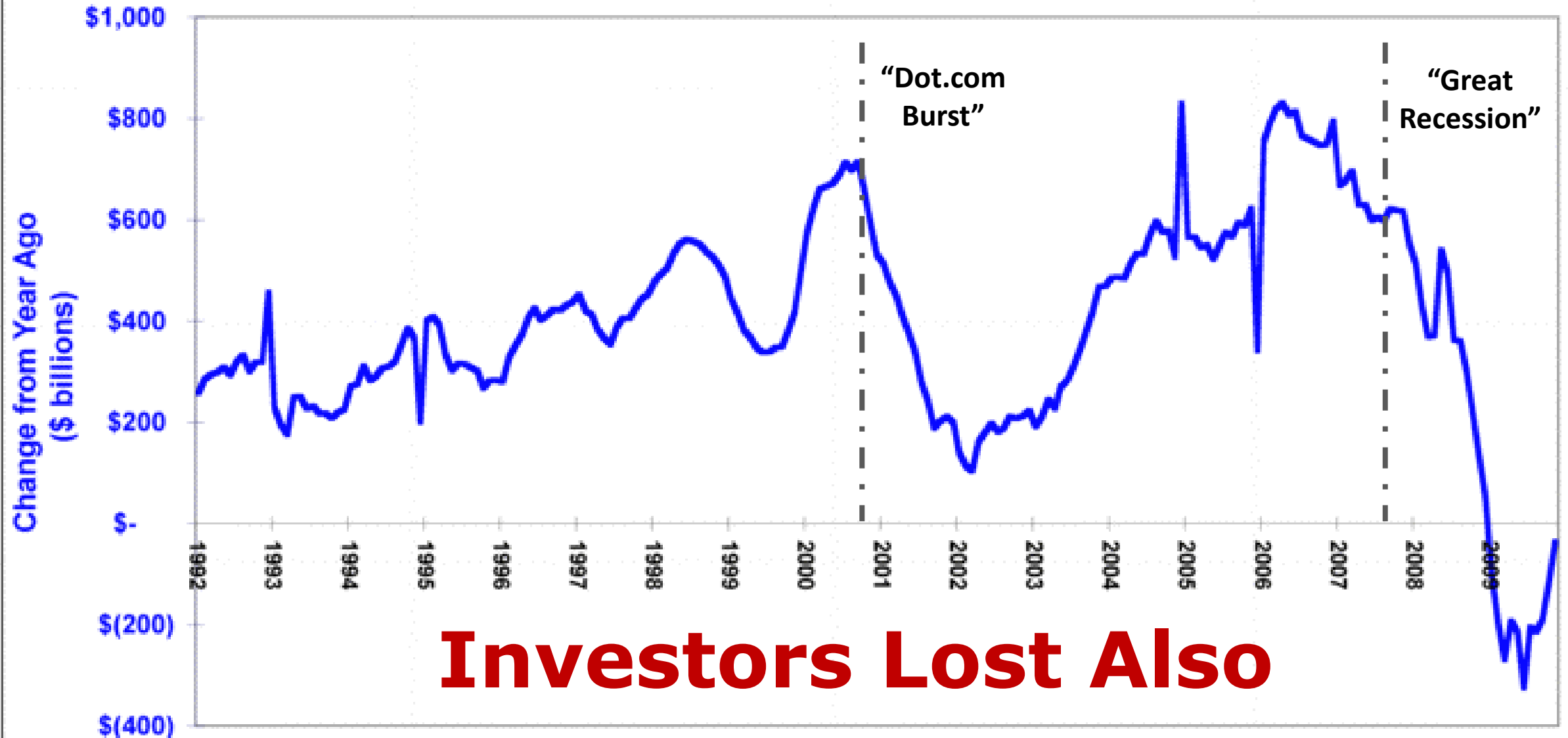




# Setting The Stage

# Great Recession Fallout

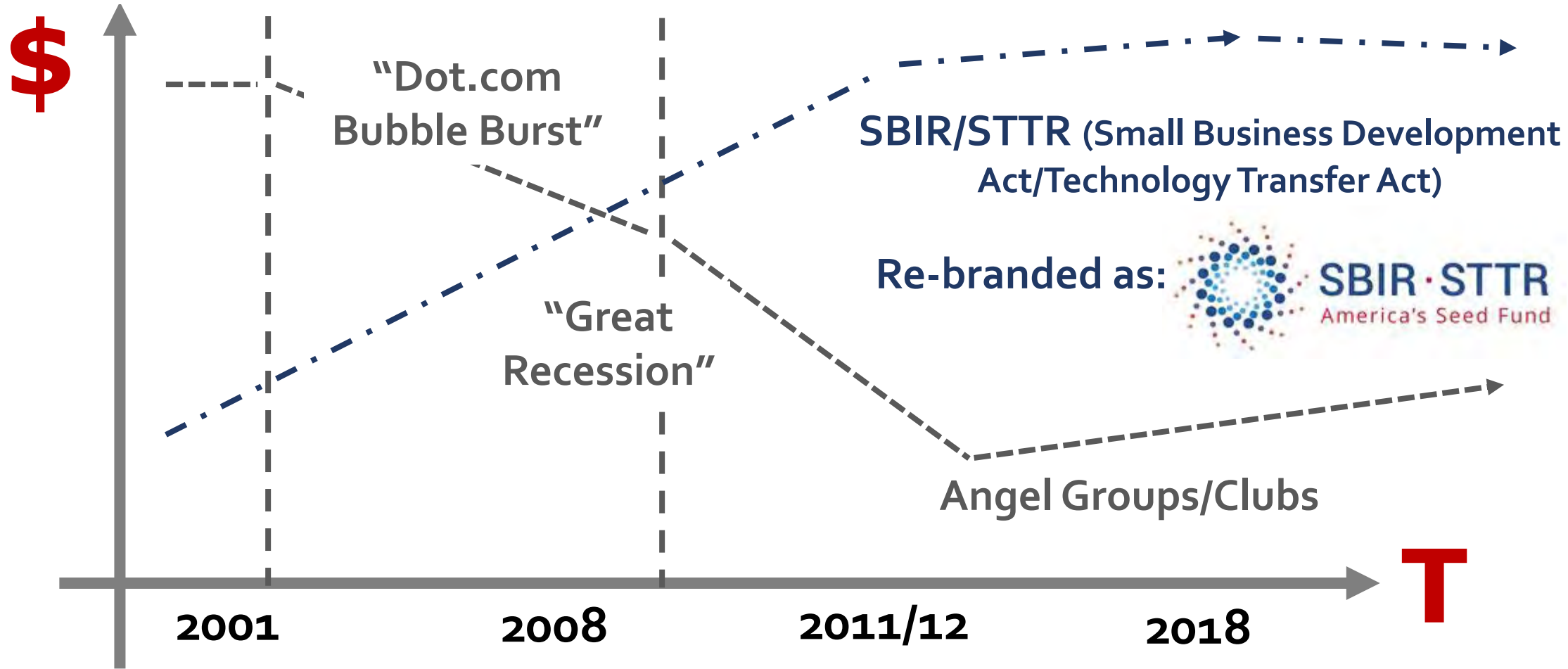
## Personal Income



**Investors Lost Also**



# Shifts in Early Stage Seed Funding



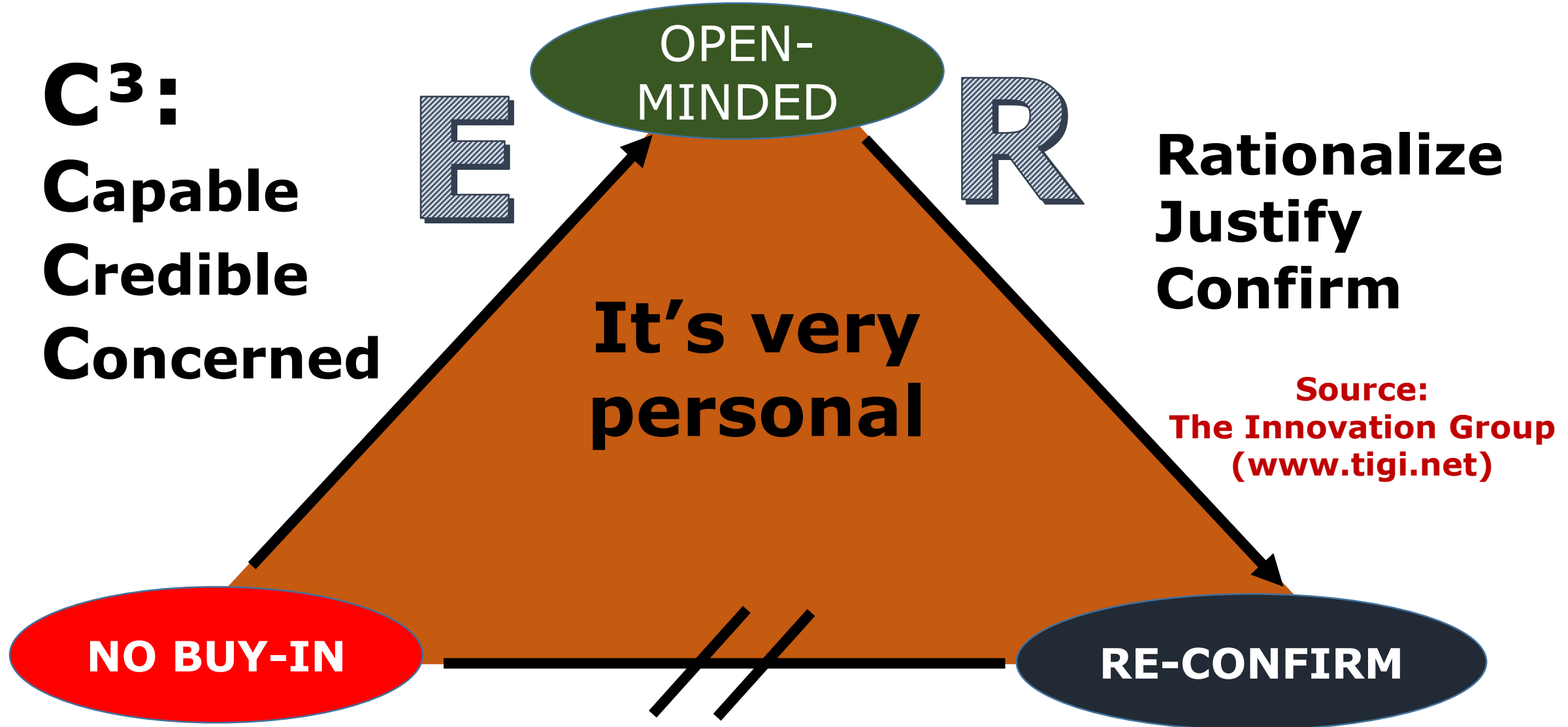
<https://techcrunch.com/2016/05/13/interesting-trends-in-angel-investing/>  
<https://www.fundivo.com/stats/angel-investment-statistics/>

Not to \$\$ Scale

# **Influencing Buyer Behavior**

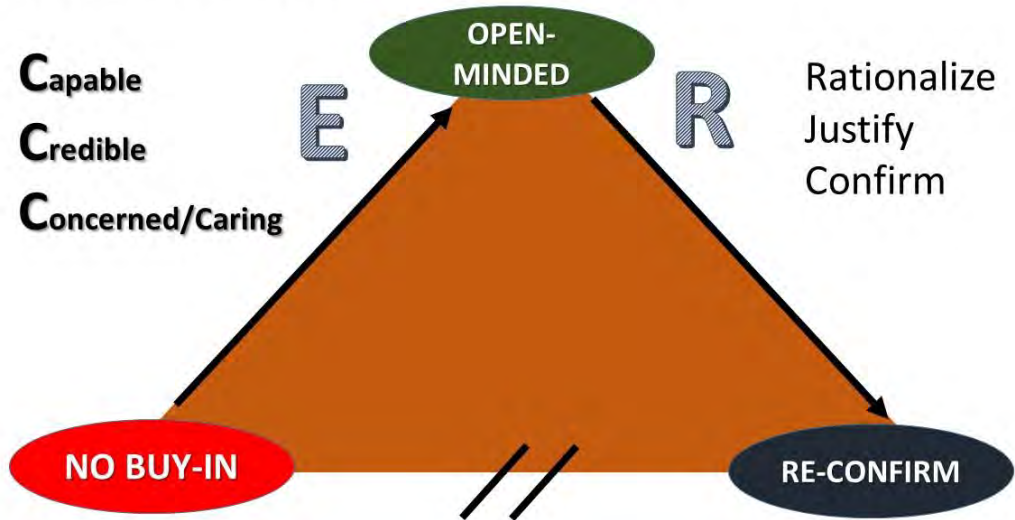


# People Buy Emotionally, Rationalize Later



# How (Customer) Decisions Are Made

People Buy Emotionally, Rationalize Later



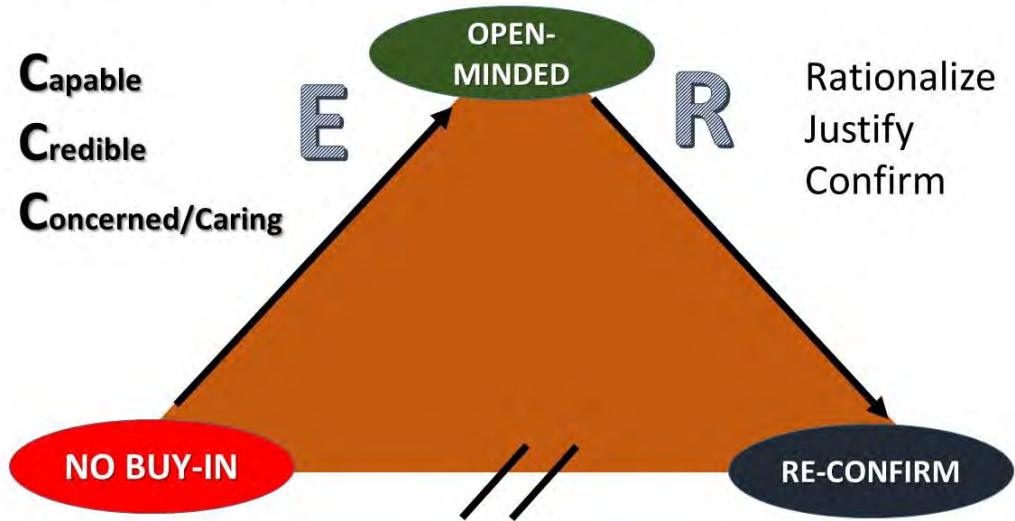
**How Well Do You Understand (Know) Me?**

- 1) Decisions often occur in this precise, psychological order
  - About us
  - About our company
  - About our product or service
  - About our ask/price
  - About the time to invest/buy
- 2) Two Key Issues: (a) Our Integrity, (b) Our Judgment [aka: Us]
  - How well does our product knowledge match our understanding of their needs?
  - WE . . . Will Be Assessed
- 3) Most importantly: About Themselves



# How (Investor) Decisions Are Made

People Buy Emotionally, Rationalize Later

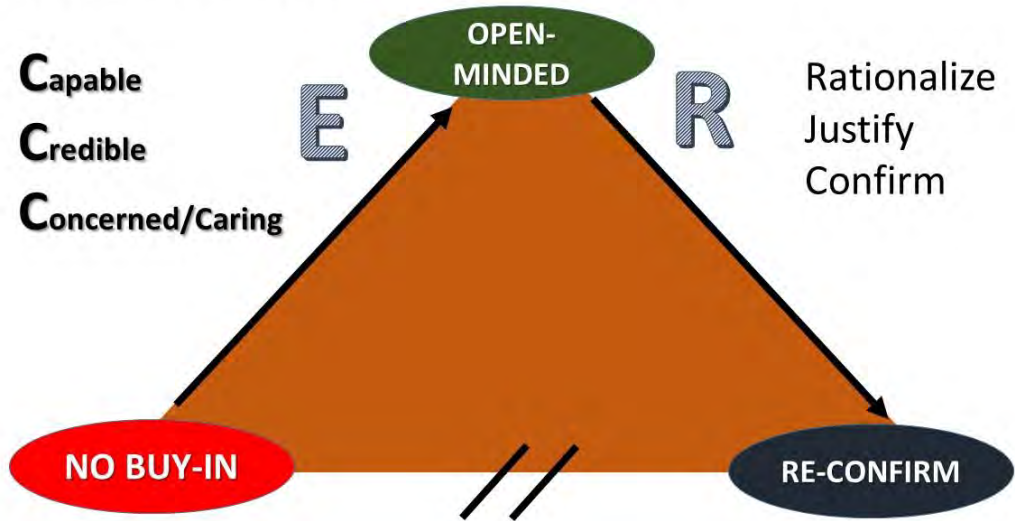


How Well Do We Understand (Know) **Them?**

- 1) Decisions often occur in this precise, psychological order
  - About us
  - About our company
  - About **our venture/innovation**
  - About our ask/price
  - About the time to invest/buy
- 2) Two Key Issues: (a) Our Background, (b) Our Capabilities [aka: Us]
  - How well does **our background** match our understanding of **their decision criteria**?
  - WE . . . Will Be Assessed
- 3) Most importantly: Their Interests

# How (Investor) Decisions Are Made

People Buy Emotionally, Rationalize Later



How Well Do We Understand (know) **Them?**

1) Decisions often occur in this precise, psychological order

- About us
- About our company
- About our **Evidence (Proof)**
- About our **Traction**
- About the time to invest/buy

2) **Three Key Issues: (a) Our Integrity, (b) How We Think, (c) Communicate/Listen**

- How well does our background match our understanding of their decision criteria?
- WE . . . Will Be Assessed

3) **Most importantly: Their Interests**



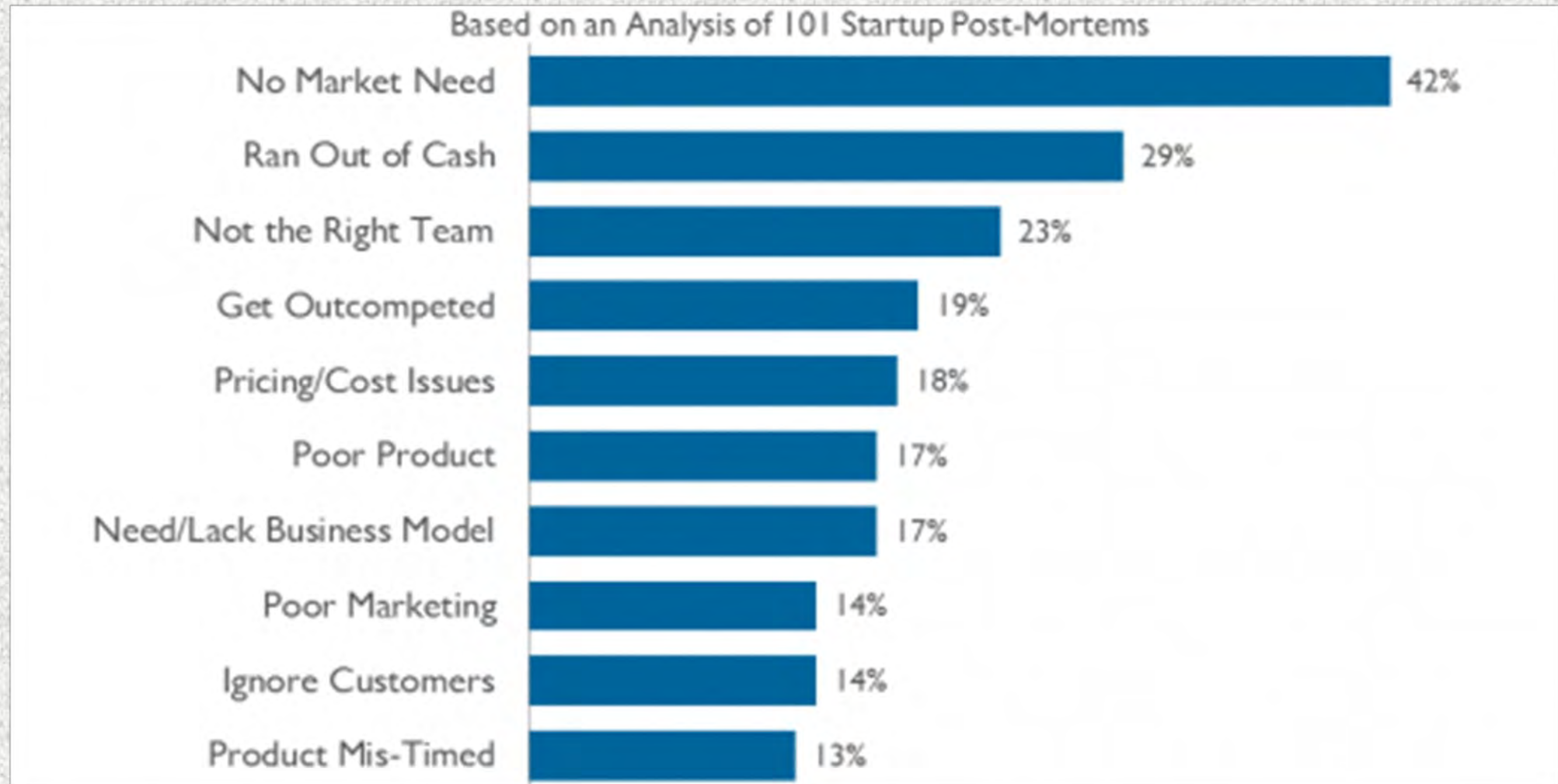
**We're turning the  
industry upside down**



**So, How Should  
We Position  
Ourselves?**

# Why Do Start-Ups Fail?

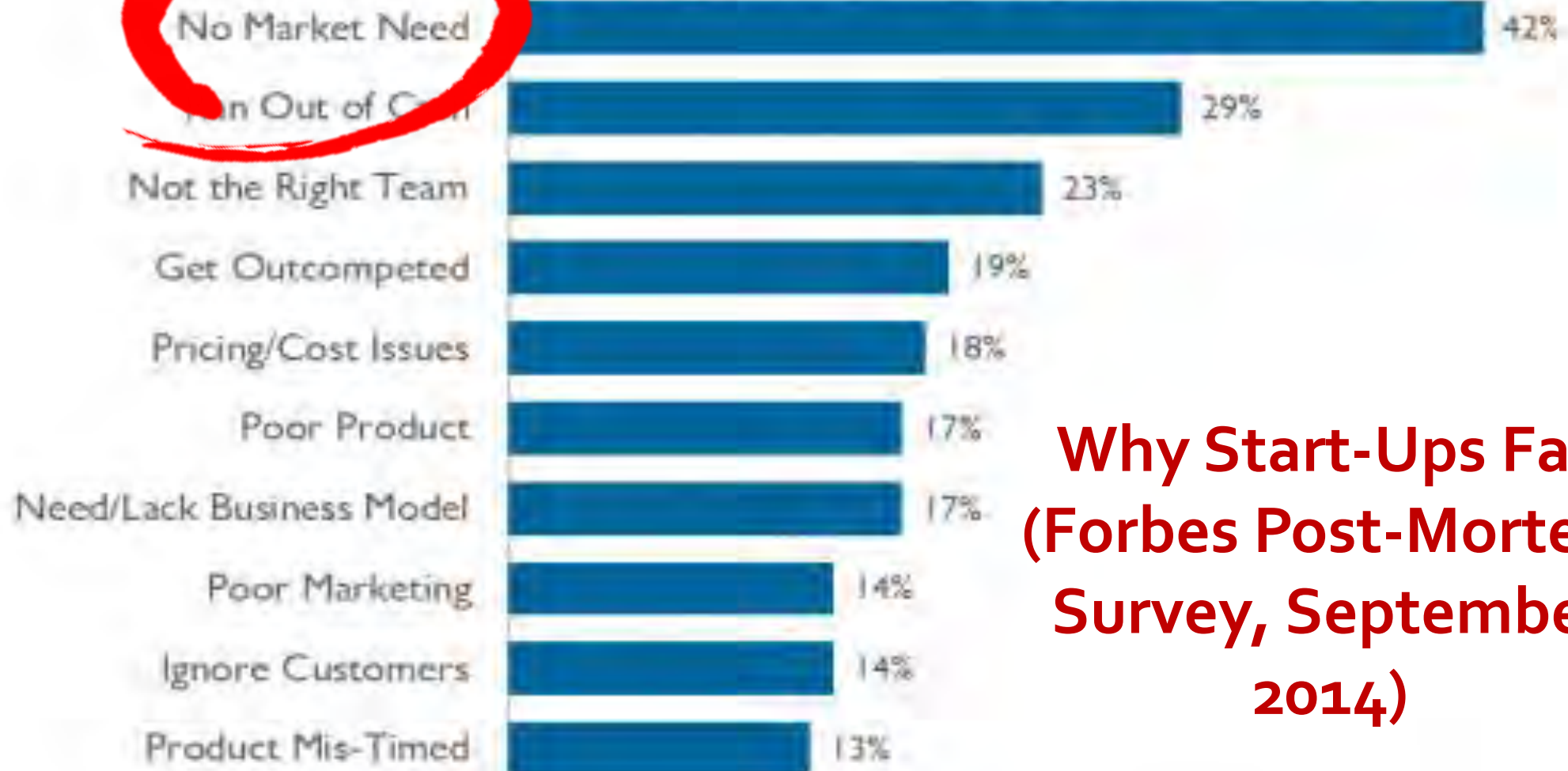
# Why Do Start-Ups Fail?



[Fortune.com/2014/09/25/why-startups-fail-according-to-their-founders/](http://Fortune.com/2014/09/25/why-startups-fail-according-to-their-founders/)



Based on an Analysis of 101 Startup Post-Mortems



**Why Start-Ups Fail  
(Forbes Post-Mortem  
Survey, September  
2014)**

[Fortune.com/2014/09/25/why-startups-fail-according-to-their-founders/](http://Fortune.com/2014/09/25/why-startups-fail-according-to-their-founders/)

**More startups fail from  
a lack of customers than  
from a failure of product  
development**

# Investor Questions

- 1) What is our **Business Model**?
- 2) **How** did our Model **come about**?
- 3) What **Traction** have we gained?





National Institute  
of Health



**This is True for  
SBIR Funding as  
Well: Criteria for  
Investment**



## NIH Reviewer “Marching Orders”

1. Significance

2. Innovation

3. Approach

4. Investigators

5. Environment

6. Overall Impact

Title  
Abstract  
Problem  
Solution  
Specific Aims  
Research Strategy  
Facilities  
Biographies

**Focus: Key Criteria**





- **Intellectual Merit**
- **Impact on Society**



1. Advance Knowledge and Understanding
2. Benefit Society

3. Creative, Original, Innovative, Transformative
4. Well-reasoned; well organized; sound rationale; **mechanism to assess success**
5. Your Qualifications

# DOE External Peer Review: CRITERIA



- At least 3 technical reviewers
- 1 reviewer for the Phase II Commercialization Plan
- **Review Criteria (equally weighted)**
  - 1) Strength of the Scientific/Technical **Approach**
  - 2) **Ability** to Carry Out the Project Cost Effectively
  - 3) **Impact**

## Panel Composition/Affiliation:

- 1) National Laboratory (49%)
- 2) University (32%)
- 3) Government (10%)
- 4) Private Sector (9%)



# DoD Evaluation Factors



- 1) Military & Program Relevance
- 2) Research Objectives
- 3) Scientific Excellence
- 4) Impact/Outcomes
- 5) PI & Key Personnel Qualifications
- 6) Facilities
- 7) Budget
- 8) Commercialization Strategy

Source Selection Authority & selected team; specified factors noted in Program Solicitation; includes performance history.

**SBIR/STTR Desk Reference:**

**“Evaluation & Selection”-**

([http://www.acq.osd.mil/osbp/sbir/sb/resources/deskreference/02\\_eval.shtml](http://www.acq.osd.mil/osbp/sbir/sb/resources/deskreference/02_eval.shtml))

# Beyond Technology: Market Buy-In



Study Approach  
Ability/Credentials  
**Impact**



**Significance**  
**Innovation**  
Approach  
Investigators  
Environment  
**Impact**



Relevance  
Objectives  
Scientific Excellence  
**Impact**  
Qualifications  
Facilities  
Budget  
**Commercialization**



Intellectual Merit  
**Impact/Benefit**  
Advance Knowledge  
Creative, Original,  
**Transformative**  
Well-Reasoned  
Qualifications  
Resources

# REJECTED?



## Common Problems

- 1) *"They Don't Get It"*
- 2) Problem Is Not Significant (Enough)
- 3) Not Innovative
- 4) We're Not Qualified
- 5) Flawed Study Approach

# Common Problems

## 1) Our Proposal Is NOT CLEARLY WRITTEN

- Use peer review to improve solution and pitch

## 2) Our Proposal is NOT INNOVATIVE

- NOT CLEARLY DIFFERENTIATED: Position Technology Solution Relative to Current Standard & Alternative Solutions/Offering Being Developed
- NOVEL COMBINATION Of Existing Approaches: Emphasize Novelty AND Clinical Need

## 3) Team is NOT QUALIFIED

- Add collaborators and consultants
- Create a Multi-PI Group (To Address Experience Issues)



# More Common Problems

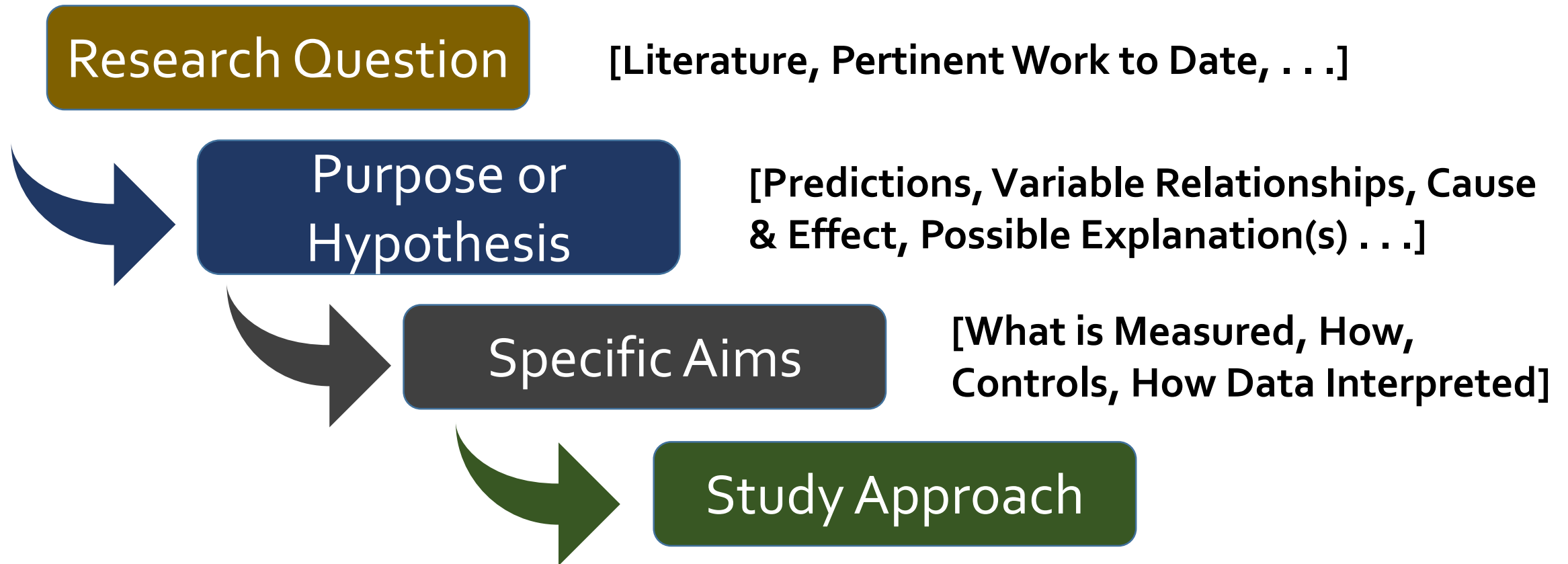
## 4) We're Not Working on a SIGNIFICANT PROBLEM

- Sell on Problem Importance: Repercussions/Ramifications
- Be More Specific and Quantitative
- Get Letters of Support in re Problem and Buyers/End Users

## 5) Reviewers Are Critical of OUR APPROACH

- Respond to Their Criticisms
- Revise the Approach
- Have Others Review and Critique Approach

# “Deal Killers” for Some



# Why 65% of SBIRs are Partnerships

## Study Design

e.g. Single/Double Blind  
Study Population  
Sample Size/Power Anal.  
Outcomes/Endpoints



## Study Procedure

e.g. Sampling Plan, Criteria  
Recruitment Procedure  
Screening  
Randomization (if applicable)  
Study Intervention  
Assessments & Activities



## Analysis Plan

Statistical Methods  
Background

# Bottom Line . . .



**. . . For Financial and Strategic Investors (Steps 2 & 3):**

- 1) Proof of Concept, Feasibility (SBIR/STTR Phase I)**
- 2) Proof of Efficacy (SBIR/STTR Phase II) & Market**
- 3) Evidenced-Based Commercial Traction (Phase III)**  
**[Business Model • How Generated • Traction]**



# Phase II-III Commercialization



# Congressional Emphasis: Commercialization

## Reauthorization Act of 2011

### 1) More Emphasis on Commercialization

### 2) Requirements

- SBC Applicant Registers at SBIR.gov (**Commercialization Database**)
- Phase II Awardee Commercialization History
- Phase II – Commercialization Process
- Phase III – Acquisition Preference

### 3) Added Agency Flexibility

- **VC/HF/PEF – Ownership Stakes**
- **Commercialization Assistance** programs
- Option for Non-Agency Commercialization Support

# **“Can Our Dog Hunt?”**

- 1) Our Past Record
- 2) Phase II Support Commitments
- 3) Phase III Funding Commitments
- 4) Phase I Performance

**In- Large Part: How We Are Considered for SBIR Phase II**



# Commercialization Plans

Agency	Phase I	Phase II
NIH/HHS	1/2 page	12 Pages
DOE	3 -5 Pages	15 Pages
NSF	6 – 8 Pages	15 Pages
USDA (SBIR-Only)	1 Page +/-	10 Pages



# Commercialization Support

- I. NIH:** Phase I “Technology Niche Analysis” (TNA)
- II. NIH, NSF:** Commercialization Assistance Program (Phase II)
- III. The I-Corps Program - Innovation & Technology Commercialization Methodology (“Lean Launch Pad”)**
  - The Business Model Canvas
  - The Customer Discovery & Validation Process
  - Supplemental, Special (e.g. Matching Funds)
- IV. DOE, DOT:** Commercialization Assistance Program

# **NIH Phase I Awardees: [Foresight Science & Technology]**



- **Technology Niche Analysis<sup>®</sup> (TNA)**
- **Commercialization Plan**
- **Go/No-Go<sup>®</sup> Assessment Report**
- **JumpStart<sup>™</sup>**
- **Market Overview**
- **Royalty Rate Analysis**

# **CAP for Phase II Awardees (NIH)**

**(<https://sbir.nih.gov/cap#cap-home>)**

Managed through a contract with Larta ([www.larta.org](http://www.larta.org)) of Los Angeles, CA - individual mentoring and consulting sessions, training workshops, access to domain experts



- 1) Commercialization Training Track (CTT)
- 2) Accelerated Commercialization Training Track (ACT)
- 3) Regulatory Training Track (RTT)

# DAWNBREAKER®



## Phase I Awardees

- Kickoff Webinar
- Commercialization Readiness Assessment (CRA)
- Market Research
- Specialty Webinars
- Business Mentoring: Phase II Commercialization Plan
- Road Tours (e.g. UCSD, UC Irvine, UCLA last year) + National)

[www.dawnbreaker.com](http://www.dawnbreaker.com)

<http://science.energy.gov/sbir/commercialization-assistance/>



# Phase II Match Funding (NSF “Phase IIB”)



- Aim: Extend R & D Efforts Beyond Current P-II Grant
- Further **Accelerate Commercialization**
- **50% of 3<sup>rd</sup> Party Investment Funds Up To \$500,000**
- Must Start Process At least 30 Days Prior to Phase II Award Expiration; Investment Minimum of \$100K
- (See: [https:// www.nsf.gov/eng/iip/sbir/Supplement](https://www.nsf.gov/eng/iip/sbir/Supplement))



# Comm./Strat. Partnerships

- NSF: “Technology Enhancement for Commercial Partnerships”
- Funding for additional **research that goes beyond the Phase II project’s objectives** to meet technical specifications or additional proof-of-concept requirements. (Submit w/in 18 months of PII award)
- Additional research to **enhance the commercial potential and lead to partnerships** with industrial partners & secure venture/angel investors.
- **Max Funding: 20% of the Phase II award, up to \$150,000**
- **Pre-submission Executive Summary + Letter from Commercial Partner**

(Reference: [www.nsf.gov/eng/iip/sbir/Supplement/instructions.jsp](http://www.nsf.gov/eng/iip/sbir/Supplement/instructions.jsp))

# Commercialization Assistance



- Funding to **secure the services of a third-party service provider** to assist in commercialization
- **Max Funding: \$10,000** per Phase II award (one per active Phase II grant)
- **Deadline: Within 12 months of the effective start date of Phase II award (*recommended*)**

<https://www.nsf.gov/pubs/2014/nsf14072/nsf14072.pdf>

**Often, our  
Commercialization Plan  
(for Phase II funding) is  
not well written.**





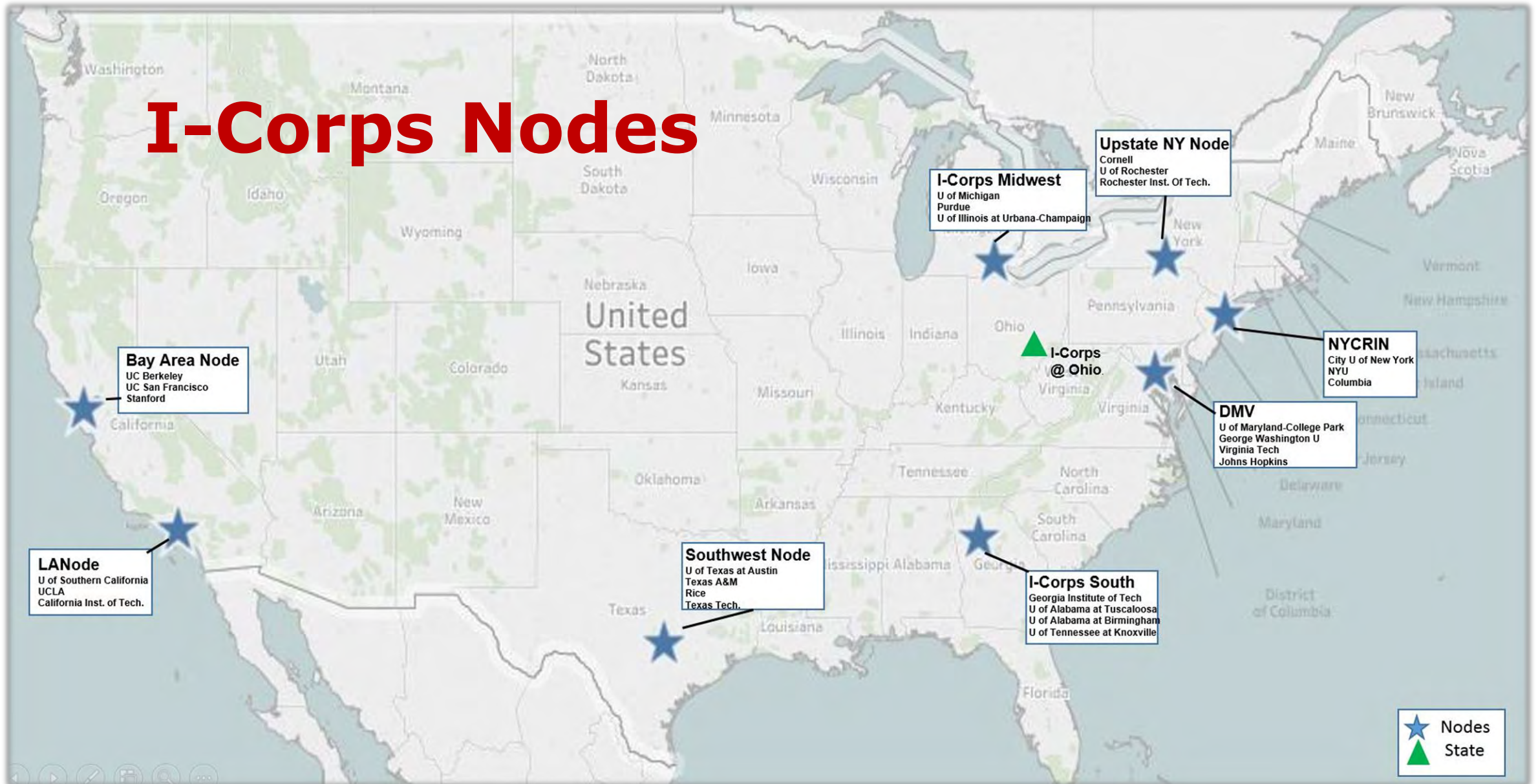
**SBIR·STTR**  
America's Seed Fund



**CORPS**  
NSF Innovation Corps



# I-Corps Nodes



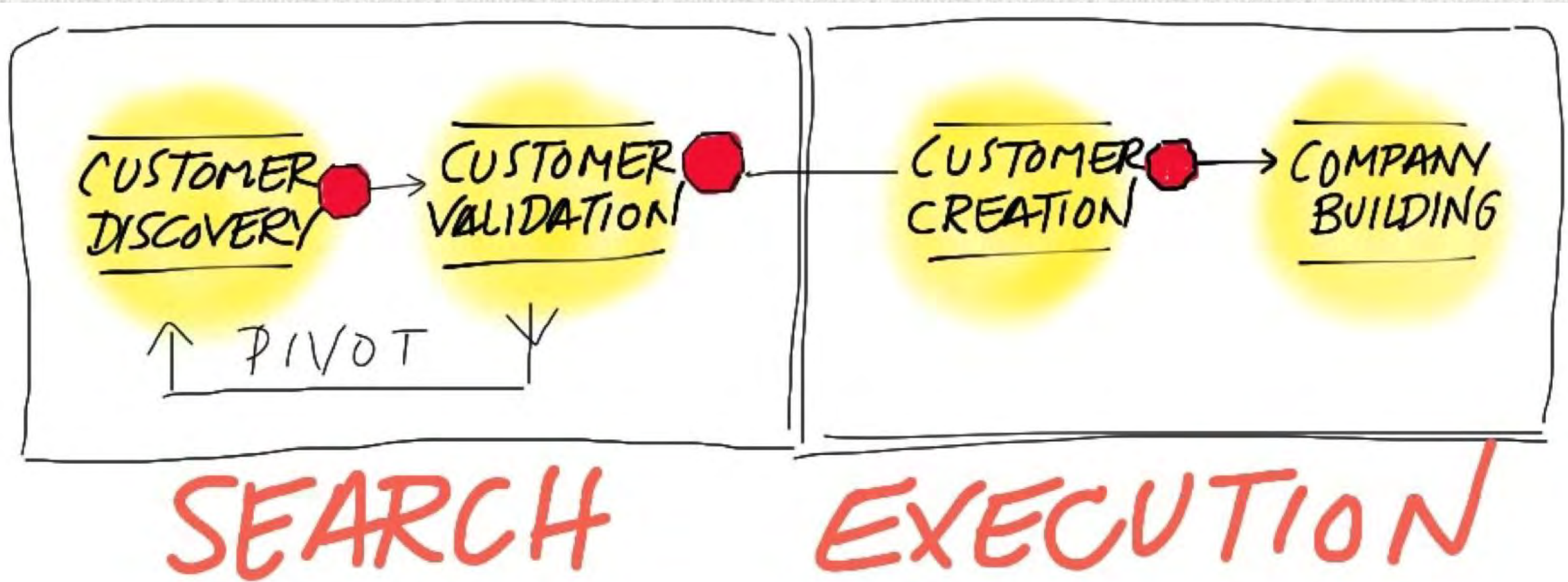


# I-Corps Sites

UCSD, SDSU, Northridge  
UC Irvine, UC Riverside  
USC, UCLA, Caltech  
(USD BRINK?)



# National Cohorts





# **Seven (7) Week Curriculum (Agency Grant-Funded: \$40K - \$70K)**

- **Precursor Competitive Programs**
  - e. g. “IN-LA” “Zap” & “Boom” (USC, UCLA, Caltech)
  - e. g. SDSU (Cal State system) CSUPERB BIO 2018 I-Corps
  - (May require SBIR Phase-I Award to get in)
- **3 - 5 + Week Site-Based Programs (UCI, UCR, UCSD et al.)**

**How do Early Stage  
Angels relate?**

# Investor Questions (Again)

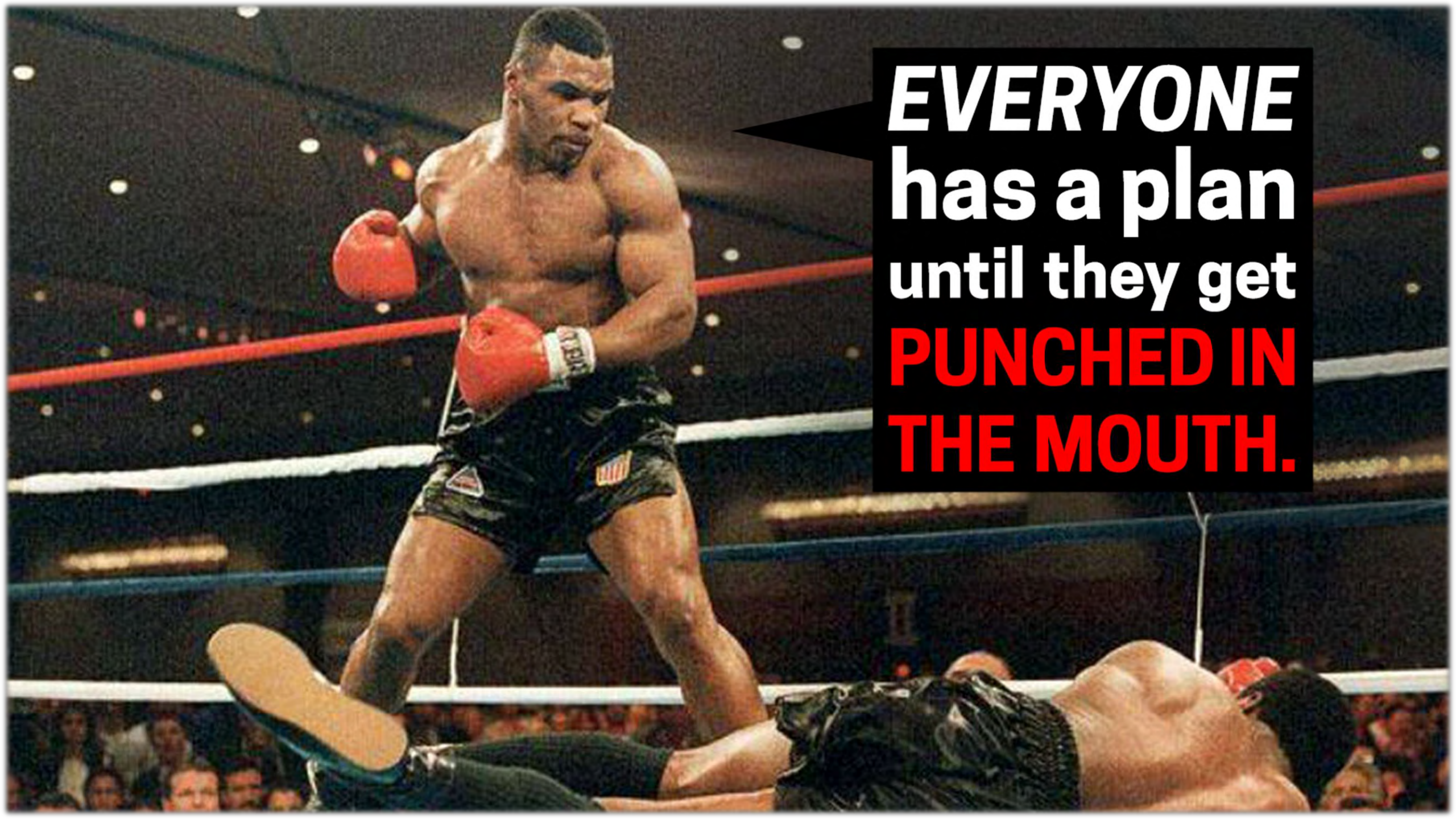
- 1) What is your **Business Model**?
- 2) **How** did your Model **come about**?
- 3) What **Traction** have you gained?

# **What About My Business Plan?**



# **What We Used to Believe**

**Start With a Business Plan  
and Financial Model**



**EVERYONE**  
has a plan  
until they get  
**PUNCHED IN**  
**THE MOUTH.**



**No battle plan survives first contact with the enemy.**

*- Helmuth von Moltke<sup>1</sup>*

**No Business Plan survives first contact w/ customers.**

*- Steve Blank<sup>2</sup>*

**We haven't read a business plan in over twenty years.**

*- Brad Feld/Jason Mendelson<sup>3</sup>*



(1) 19th-century head of the Prussian army; (2) Stanford & U C Berkeley (I-Corps); (3) Foundry Group, Boulder, CO

# **BUSINESS PLAN**

Prepared by:  
Clayton & Associates  
P.O. Box 2249  
Frederick, MD 21705  
(301) 695-4200



# BUSINESS PLAN

Prepared by  
Clayton & Associates  
P.O. Box 2249  
Frederick, MD 21705  
(301) 695-0500

	A	B	C	D	E	F	G	H	I	J	K	L	M	N	
32	Balance Sheet										Year				
33											1999	2000	2001	2002	2003
34	Assets														
35											\$4.27	\$6.38	\$7.62	\$8.83	\$7.00
36											\$20.58	\$24.39	\$28.77	\$34.11	\$32.00
37											\$26.73	\$30.45	\$36.75	\$43.27	\$38.00
38											\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
39											\$51.58	\$61.22	\$73.14	\$86.21	\$77.00
40											Fixed assets				
41											\$311.64	\$423.92	\$503.87	\$613.28	\$650.00
42											\$98.72	\$105.09	\$112.40	\$122.26	\$115.00
43											\$212.92	\$318.83	\$391.47	\$491.02	\$535.00
44											\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
45											\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
46											\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
47											\$284.50	\$380.85	\$464.61	\$577.23	\$612.00
48	Liabilities														
49											\$31.83	\$63.43	\$83.84	\$94.41	\$80.00
50											\$30.86	\$43.81	\$44.85	\$79.49	\$0.00
51											\$62.69	\$107.24	\$128.69	\$173.90	\$80.00
52											\$40.00	\$46.92	\$73.41	\$73.57	\$214.54
53											\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
54											\$102.89	\$154.16	\$202.10	\$247.47	\$284.54
55	Shareholders' equity														
56											\$90.00	\$180.00	\$180.00	\$220.00	\$200.00
57											\$91.81	\$86.67	\$182.51	\$189.76	\$117.46
58											\$181.81	\$266.67	\$362.51	\$409.76	\$317.46
59											\$284.50	\$380.85	\$464.61	\$577.23	\$612.00

# BUSINESS PLAN

Prepared by:  
Clayton & Associates  
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Frederick, MD 21705  
(301) 695-4500

	D	E	F	G	H	I	J	K	L	M	N
	Year										
	1999	2000	2001	2002	2003						
Cash and cash equivalents	\$4.27	\$6.38	\$7.62	\$8.83	\$7.00						
Accounts receivable**	\$20.58	\$24.39	\$28.77	\$34.11	\$32.00						
Inventories*	\$26.73	\$30.45	\$36.75	\$43.27	\$38.00						
Deferred income taxes**	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00						
Total current assets	\$51.58	\$61.22	\$73.14	\$86.21	\$77.00						
Fixed assets											
Cost*	\$111.64	\$423.92	\$593.87	\$413.28	\$450.00						
Accumulated Depreciation*	\$88.72	\$185.69	\$112.40	\$122.26	\$115.00						
Net fixed assets	\$22.92	\$238.23	\$481.47	\$291.02	\$335.00						
Intangible assets*	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00						
Other assets*	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00						
Total assets	\$284.50	\$800.45	\$484.61	\$577.23	\$812.00						
Liabilities											
Accounts payable	\$31.83	\$63.43	\$43.84	\$54.41	\$60.00						
Current debt*	\$30.86	\$43.81	\$44.85	\$79.49	\$0.00						
Total current liabilities	\$62.69	\$107.24	\$88.69	\$133.90	\$60.00						
Long-term debt*	\$40.00	\$46.92	\$73.41	\$73.57	\$214.54						
Other long-term liabilities*	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00						
Total liabilities	\$102.69	\$154.16	\$162.10	\$207.47	\$274.54						
Shareholders' equity											
Common Stock	\$90.00	\$180.00	\$180.00	\$220.00	\$200.00						
Retained Earnings	\$91.81	\$56.67	\$162.51	\$169.76	\$117.46						
Total Shareholders' Equity	\$181.81	\$236.67	\$342.51	\$389.76	\$317.46						
Total Liabilities and Shareholders' Equity	\$284.50	\$800.45	\$484.61	\$577.23	\$812.00						

**Plans are worthless, but  
planning is everything.\***

***- Dwight D. Eisenhower***

\* National Defense Executive Reserve Conference, Washington DC, November 14, 1957

# **Startups Search**

# **Companies Execute**

**Memo: Larry Bossidy, Execution – The Discipline of Getting Things Done (2002)**

**“Execution is a systematic way of exposing reality and acting on it.”**



**“Just get out there and build it;  
when you have something to play  
with . . . something tangible,  
that’s when the real learning  
happens.”**

Jack Dorsey  
Co-Founder, Twitter and Square  
Copenhagen Money 20/20 Conference  
(Monday, June 26, 2017)

**Instead of (*Before*)  
creating business plans...**

**Today we discover  
*business models.***

**Investors, Grant Reviewers**  
**Our Customers, Stakeholders**  
**Need Us To**

**DISCOVER & VALIDATE**





IAN BAKER.

“Excellent strategy, General...Though I fear the enemy might be full size...”

**Through  
Discovery We  
Engage** so that we  
can develop an  
understanding of (their)  
needs, desires,  
behaviors,  
characteristics, beliefs,  
influences, motivations,  
(dimensions) . . .



# Qualitative Research

Talking to Humans, Giff Constable (2014: 1<sup>st</sup> edition, V1.72,

Business Model Generation, A. Osterwalder & Y. Pigneur (2010)

Value Proposition Design, A. Osterwalder et al. (2014)

The Start-Up Owner's Manual Steve Blank & Bob Dorf (2012)

**“Success starts with  
understanding your customers.”**

Talking to Humans  
Giff Constable © 2014  
1<sup>st</sup> edition, V1.72

**“Seek First to Understand, then  
Seek to be Understood”**

Stephen R. Covey, The 7 Habits of Highly Effective People  
<https://www.stephencovey.com/7habits/7habits-habit5.php>

# Seek First To Understand, Then Seek To Be Understood\*

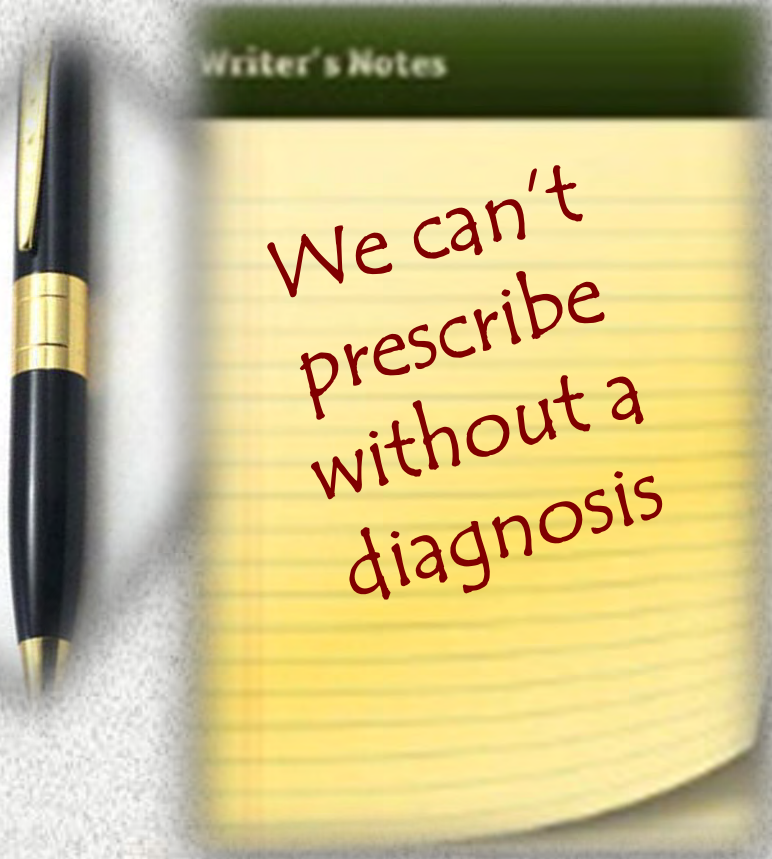


## How We "Listen":

1. Ignore
2. Pretend
3. Be Selective
4. Be "Active"
  - Mimic (Rephrase or Reflect)
5. Be Empathic

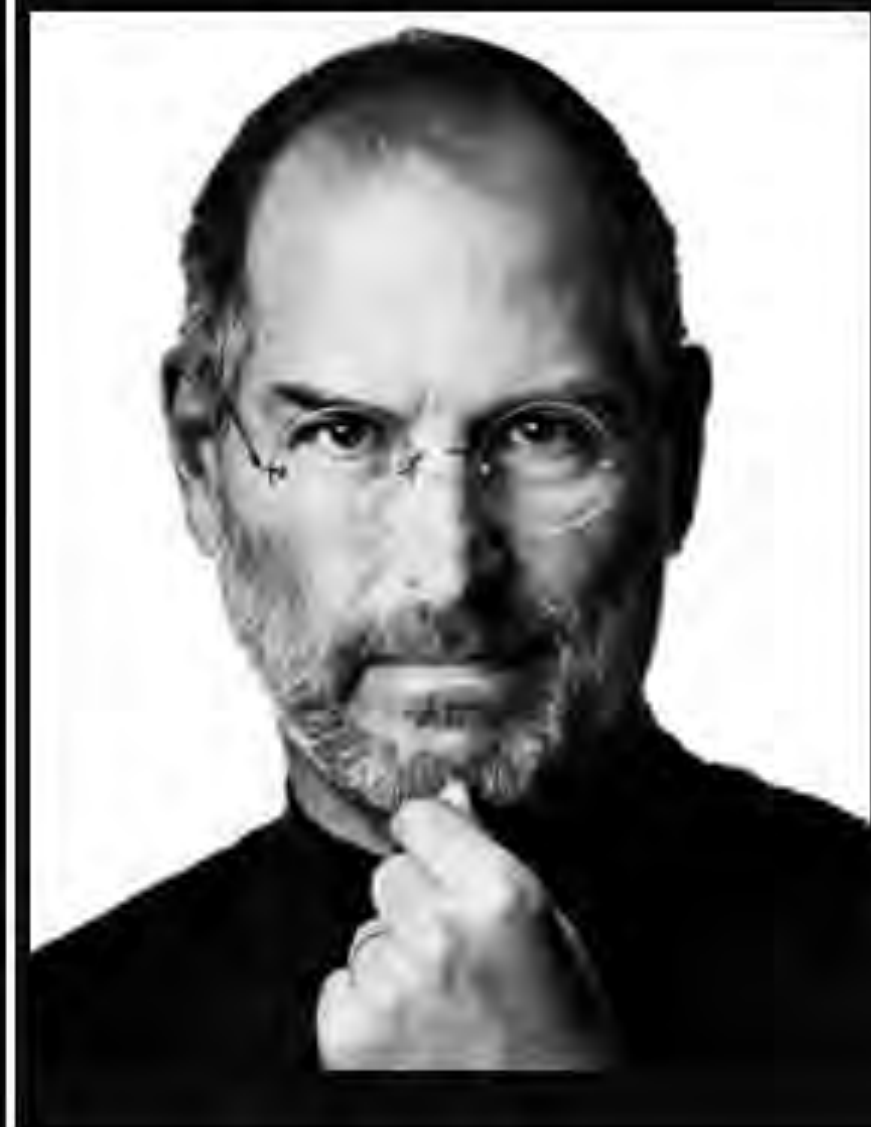


# Seek First To Understand, Then Seek To Be Understood\*



## How We "Listen":

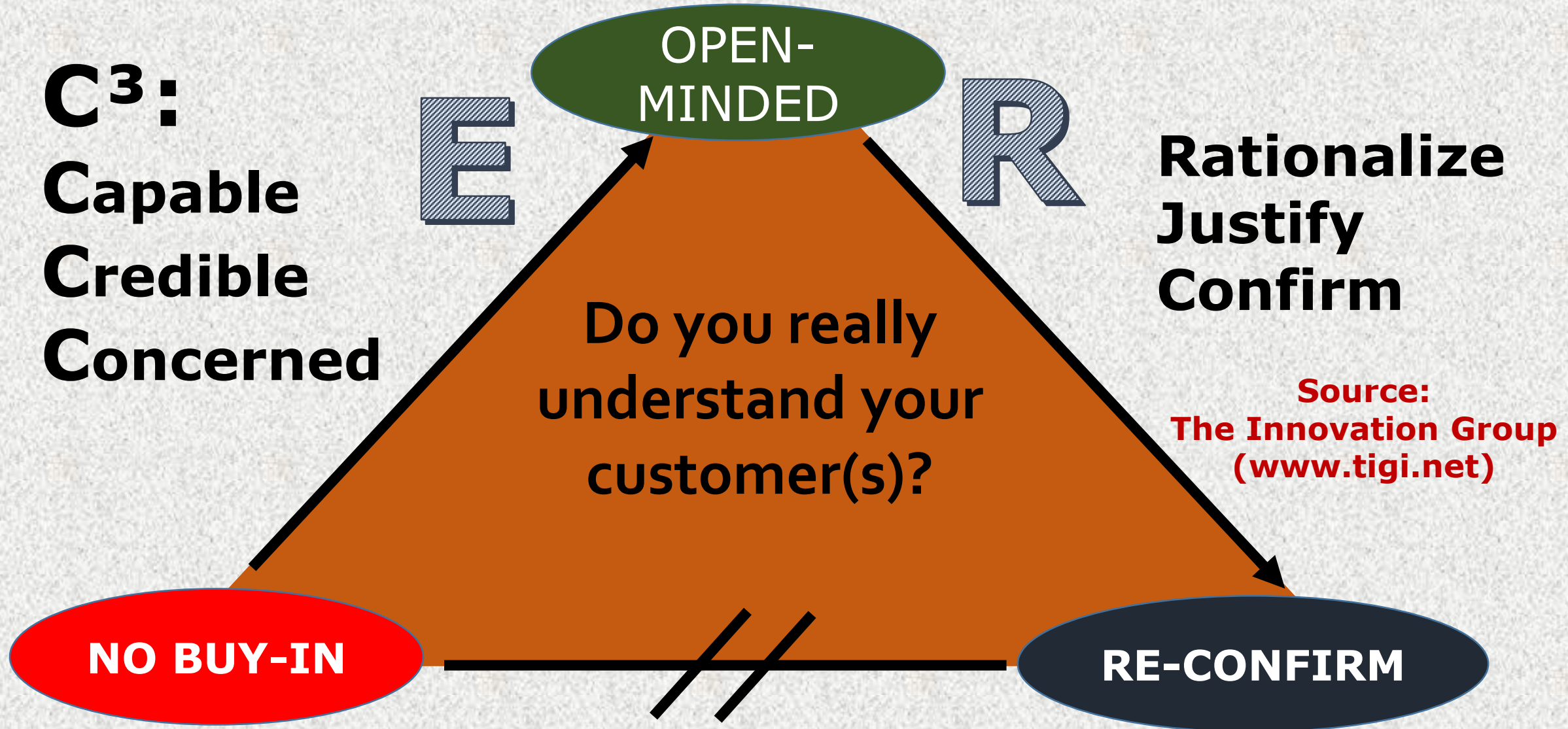
1. Ignore
2. Pretend
3. Be Selective
4. Be "Active"
  - ~~Mimic (Rephrase or Reflect)~~
5. Be Empathic



You've got to start with the customer experience and work back toward the technology - not the other way around.

(Steve Jobs)

# Remember: Balance Your Vision w/ Reality



# **Business Model Generation** **(Customer Discovery & Validation)**

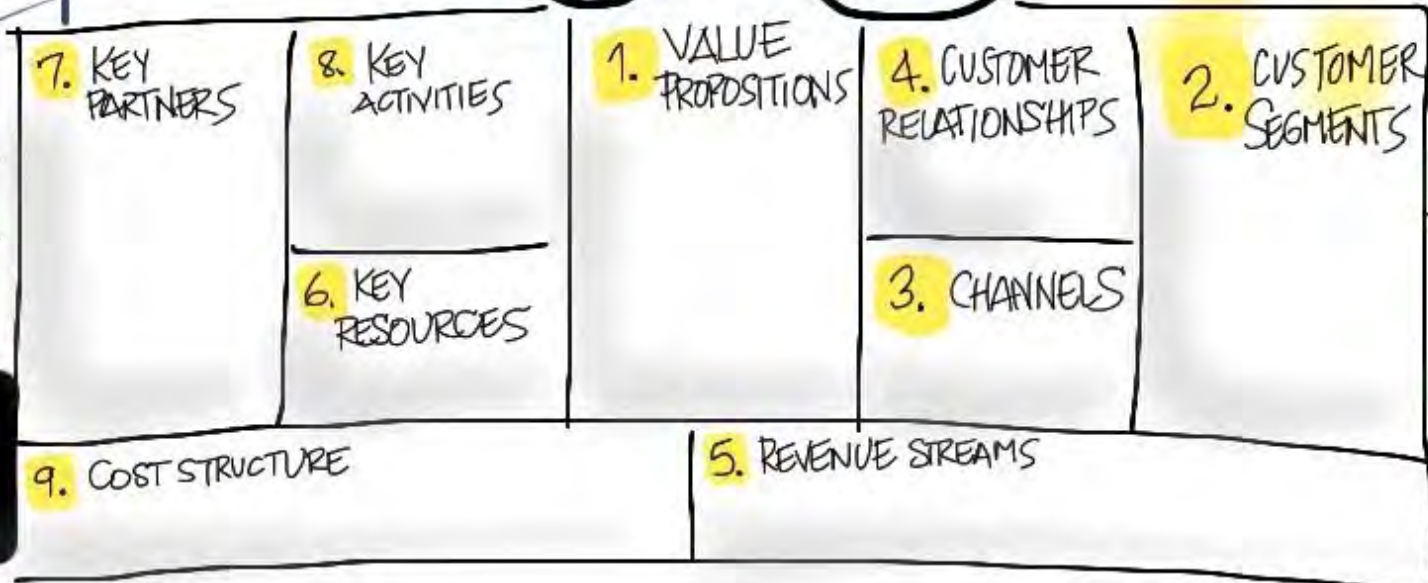
Alexander Osterwalder & Yves Pigneur, Business Model Generation (2010)



# WHAT is a BUSINESS MODEL?

How a company **CREATES VALUE** for ITSELF while delivering products or services for customers.

9 Components...



7. KEY PARTNERS

8. KEY ACTIVITIES

1. VALUE PROPOSITIONS

4. CUSTOMER RELATIONSHIPS

2. CUSTOMER SEGMENTS

**THE LOGIC OF HOW WE WILL MAKE MONEY**

**Customers - Offer - Infrastructure - Financial**

**AKA HOW "THEY" WILL PROFIT**

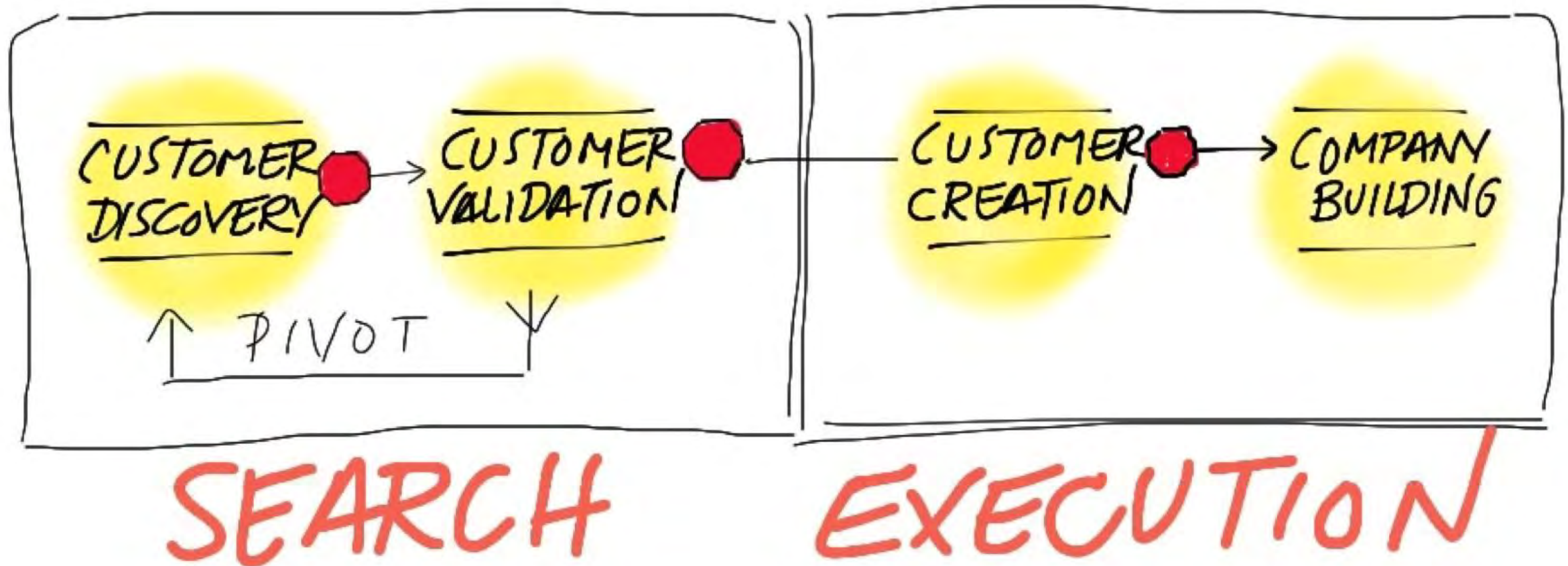
9. COST STRUCTURE

5. REVENUE STREAMS



# Before Trying to Sell . . .

## . . . Customer Development



7. KEY PARTNERS

8. KEY ACTIVITIES

1. VALUE PROPOSITIONS

4. CUSTOMER RELATIONSHIPS

2. CUSTOMER SEGMENTS

6. KEY RESOURCES

3. CHANNELS

9. COST STRUCTURE

5. REVENUE STREAMS



7. KEY PARTNERS

8. KEY ACTIVITIES

1. VALUE PROPOSITIONS

CUSTOMER RELATIONSHIPS

2. CUSTOMER SEGMENTS

6. KEY RESOURCES

3. CHANNELS

9. COST STRUCTURE

5. REVENUE STREAMS

7. KEY PARTNERS

8. KEY ACTIVITIES

1. VALUE PROPOSITIONS

4. CUSTOMER RELATIONSHIPS

2. CUSTOMER SEGMENTS

PRODUCT/MARKET FIT

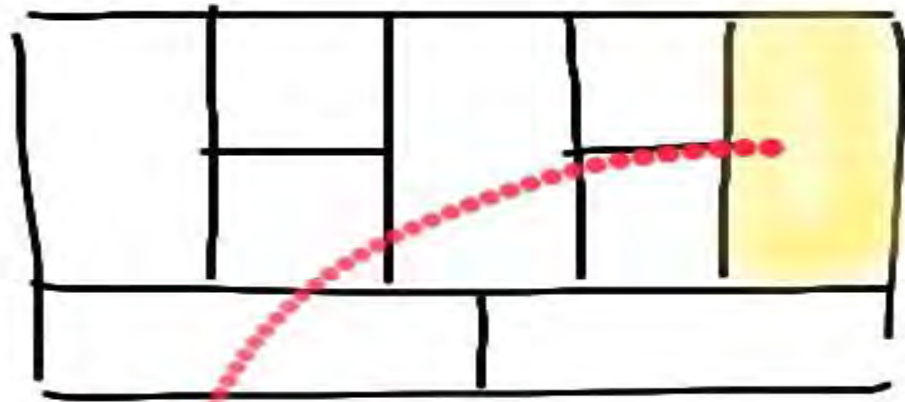
6. KEY RESOURCES

3. CHANNELS

9. COST STRUCTURE

5. REVENUE STREAMS





Customer  
ARCHETYPE..

**WHO** are they?  
**WHY** would they buy?

## 2. CUSTOMER SEGMENTS

- GEOGRAPHIC
- SOCIAL
- DEMOGRAPHIC



Your customers do not exist to **BUY**.  
You exist for them.



- ← 24 years old
- ← Male
- ← City dweller
- ← Avid social media user
- Single inc

# Customer Segments and Customer Types

A Customer Segment is a subset of the marketplace that makes decisions in a defined way for a reason.

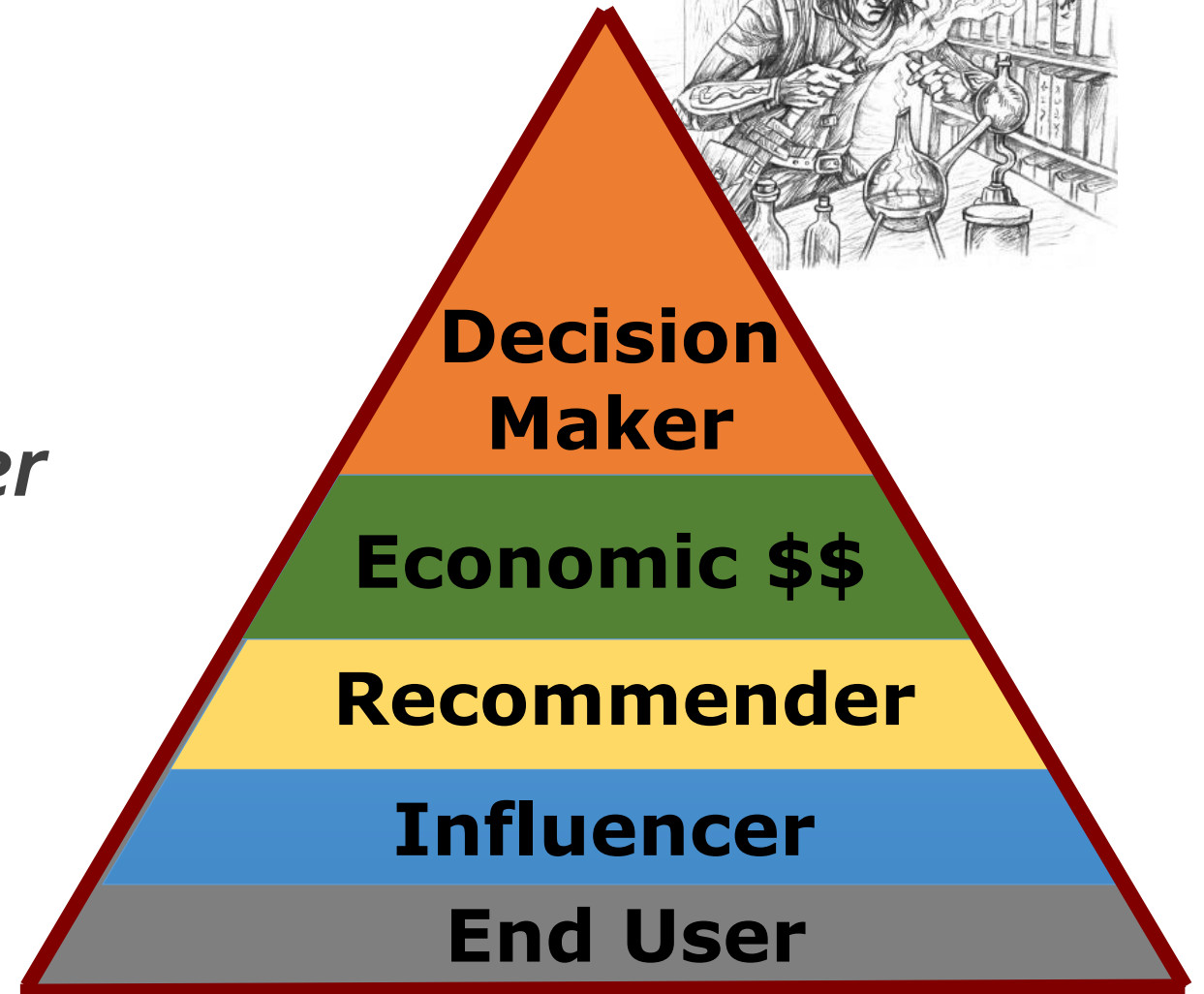
A Customer Type defines their role in the marketplace.

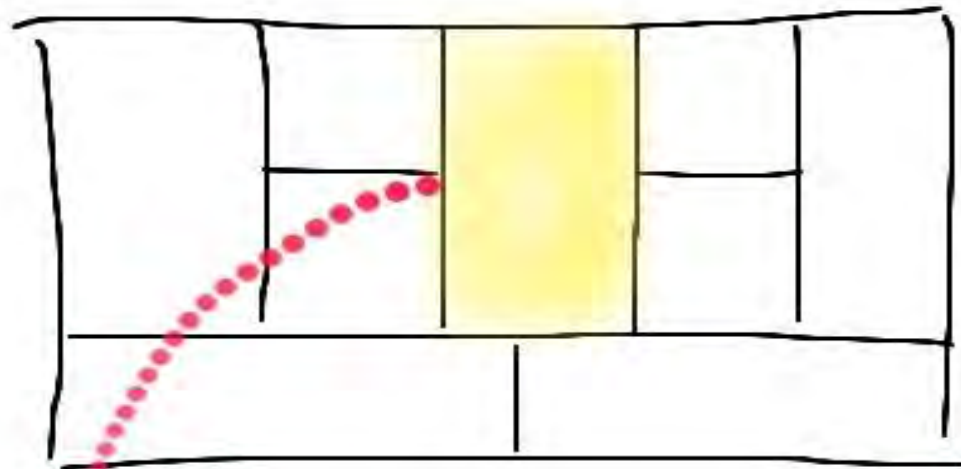


# Customer Types

- *End User*
- *Influencer\**
- *Recommender*
- *Economic Buyer/Payer*
- *Decision Maker*
- *Saboteur*

\* Remember William Dawes?





It's about SOLVING a **NEED** or **PROBLEM!**

HEAR YOU...

A cartoon character with a frustrated expression, looking upwards with hands on hips.

It's about **SATISFYING** a customer need.

YAY!  
I'm DELIGHTED!

A cartoon character jumping happily with arms raised.

# 1. VALUE PROPOSITIONS

✗ "It's not about your IDEA or PRODUCT!"

It's Not?

A cartoon character holding a large scroll that contains the text 'It's Not?'.

...and **WHO** are your customers?

7. KEY PARTNERS

8. KEY ACTIVITIES

1. VALUE PROPOSITIONS

4. CUSTOMER RELATIONSHIPS

2. CUSTOMER SEGMENTS

START WITH A BLANK CANVAS

9. COST STRUCTURE

5. REVENUE STREAMS

# Launching the Canvas

We begin with Hypotheses

Also known as Educated Guesses

We urgently need Facts



7. KEY PARTNERS

8. KEY ACTIVITIES

1. VALUE PROPOSITIONS

4. CUSTOMER RELATIONSHIPS

2. CUSTOMER SEGMENTS

1. Here's what I think (Hypothesis)
2. So, here's what I did (Experiment)
3. What I found out (Discover)
4. So, here's what I will do next (Test)

9. COST STRUCTURE

# Hypotheses Assumptions

My target customers will be . . .

The problem my customer wants to solve is . . .

My customer's need can be solved with . . .

My customer can't solve this today because . . .

The measurable outcome my customer wants to achieve is . . .

My primary customer acquisition tactic will be . . .

My earliest adopter will be . . .

I will make money (revenue) by . . .

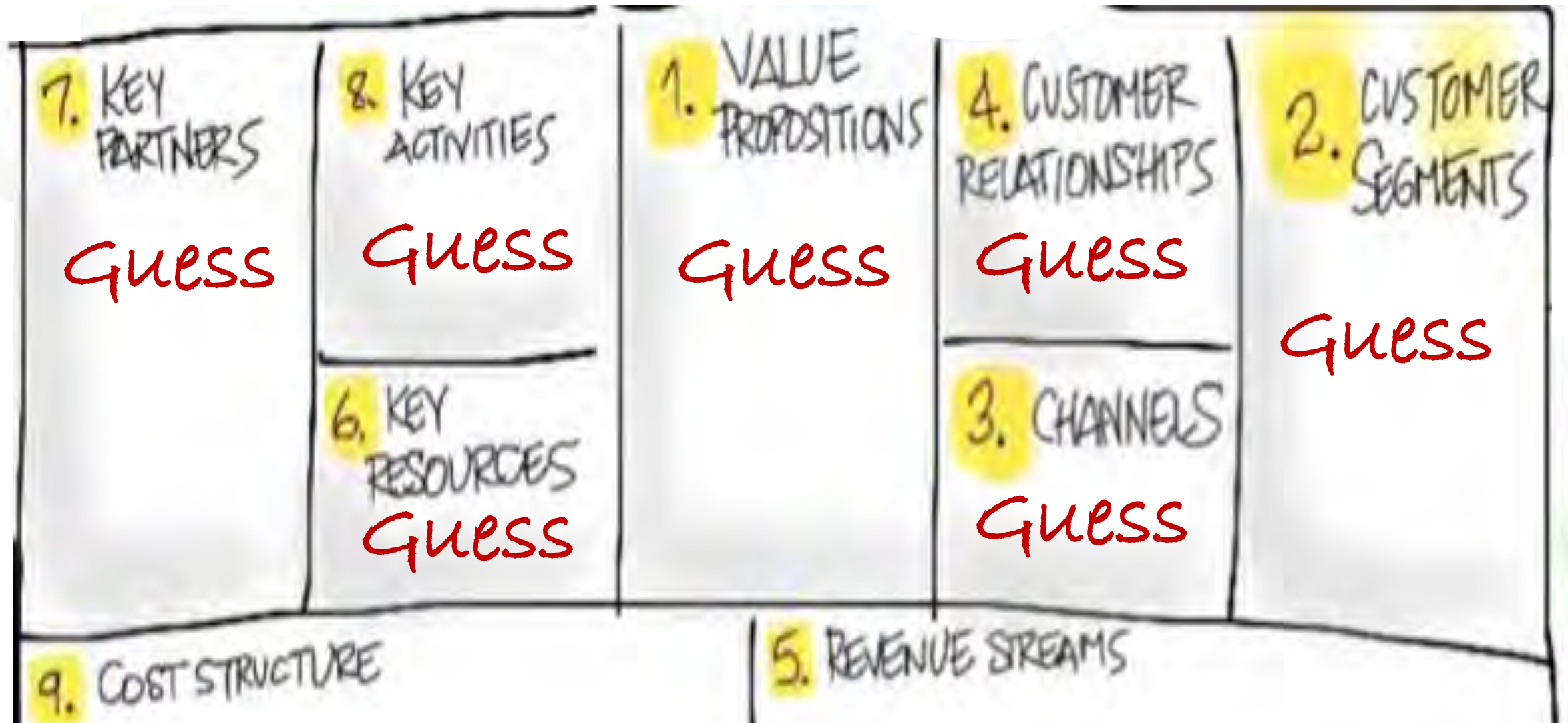
My primary competition will be . . .

I will beat my competitors primarily because . . .

My biggest risk to financial viability is . . .

My biggest technical risk is . . .

The assumptions, if proven wrong, will cause business failure are . . .



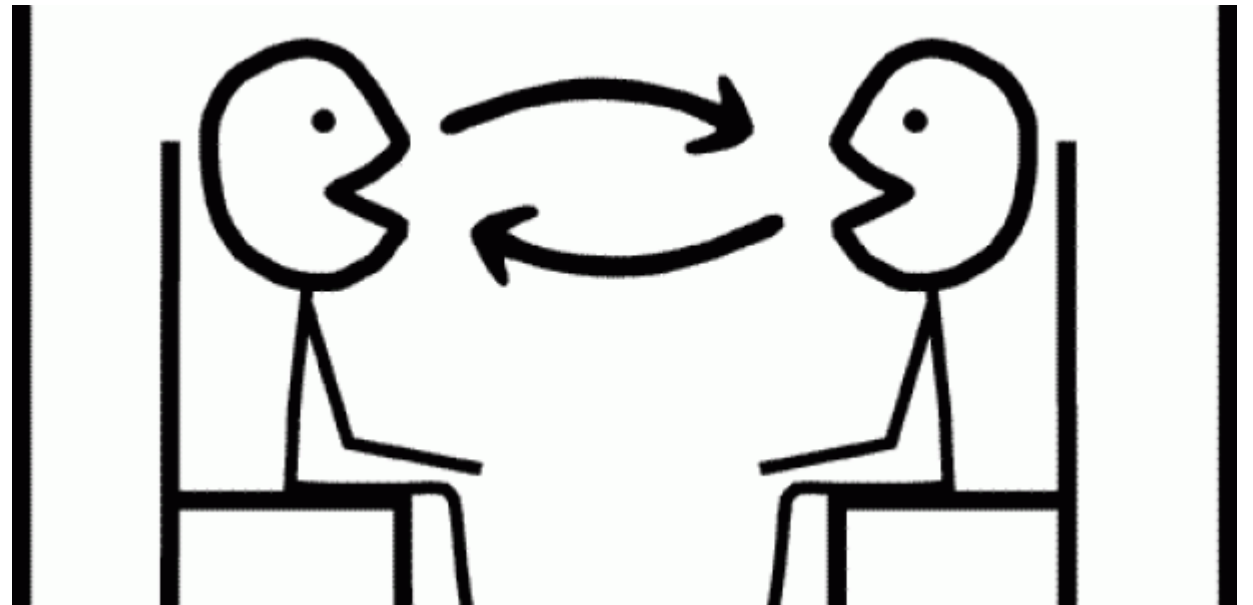
(1) State Your Hypotheses

## 2. Test Your Hypotheses

Identify customer  
*Problems* and *Needs*

Test hypotheses about CS  
and VPs...

... Iterate and Pivot



NO SELLING! EXPLORE & DISCOVER ONLY



7. KEY PARTNERS

8. KEY ACTIVITIES

1. VALUE PROPOSITIONS

4. CUSTOMER RELATIONSHIPS

2. CUSTOMER SEGMENTS

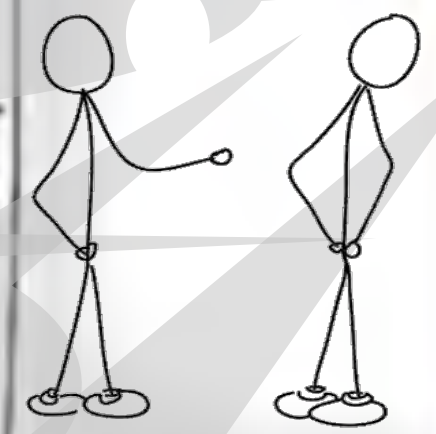
# (3) Gather Data

6. KEY RESOURCES

How are you solving it now?

3. CHANNELS

Where do you buy?



What are you dealing with?

9. COST STRUCTURE

5. REVENUE STREAMS

What is a solution to your problem worth to you?

**Talk to Strangers**

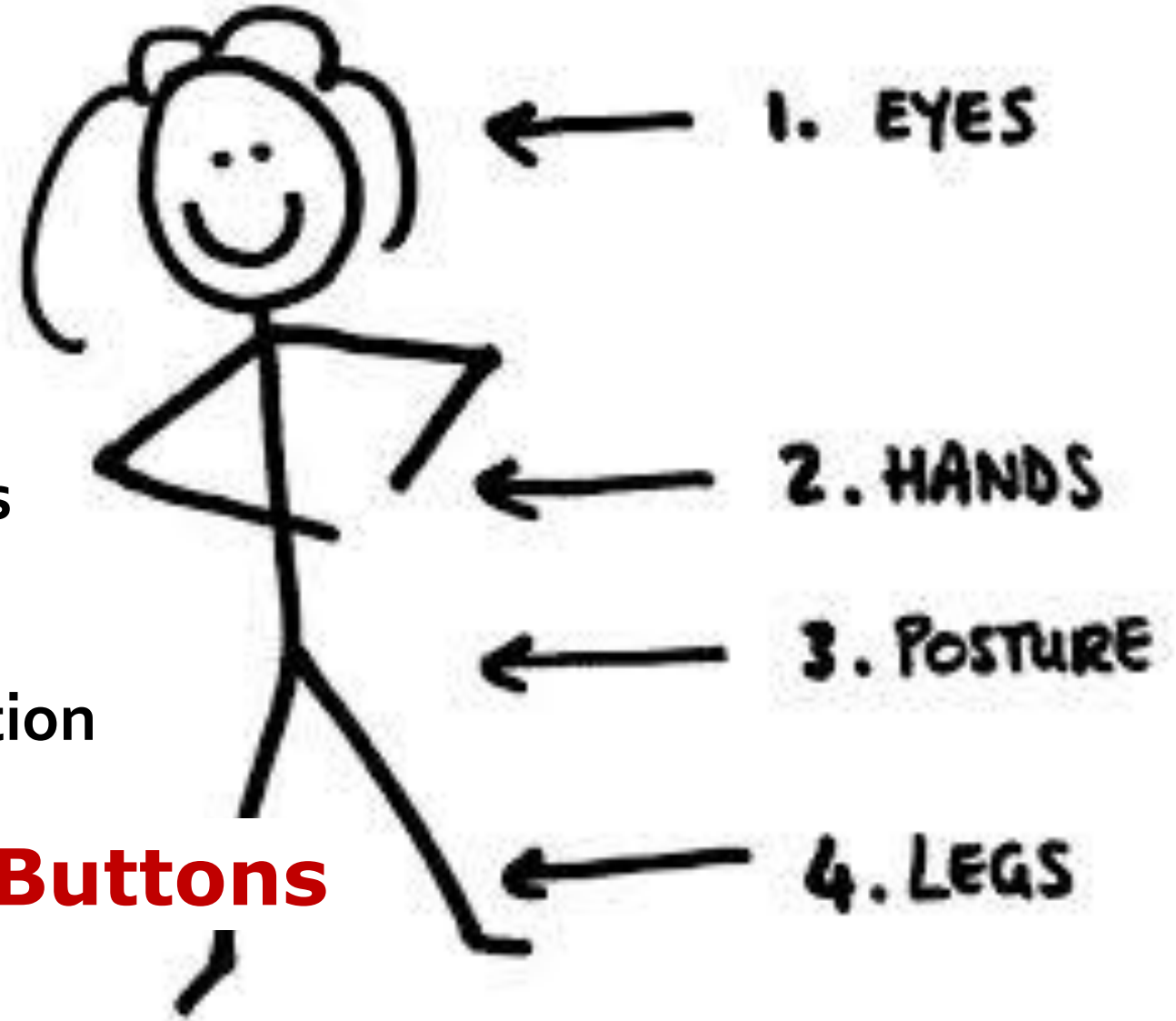
**Get Their Stories, not  
Speculation**

**Ask Open-Ended  
Questions**



# The Art of Asking Questions . . .

1. Closed v. Open-Ended
2. Controlling the Focus of conversations
3. Fact-Finding questions
4. Feeling-Finding questions
5. The Empathic Question
6. Avoid the Directive Question



**. . . & Finding the Hot Buttons**

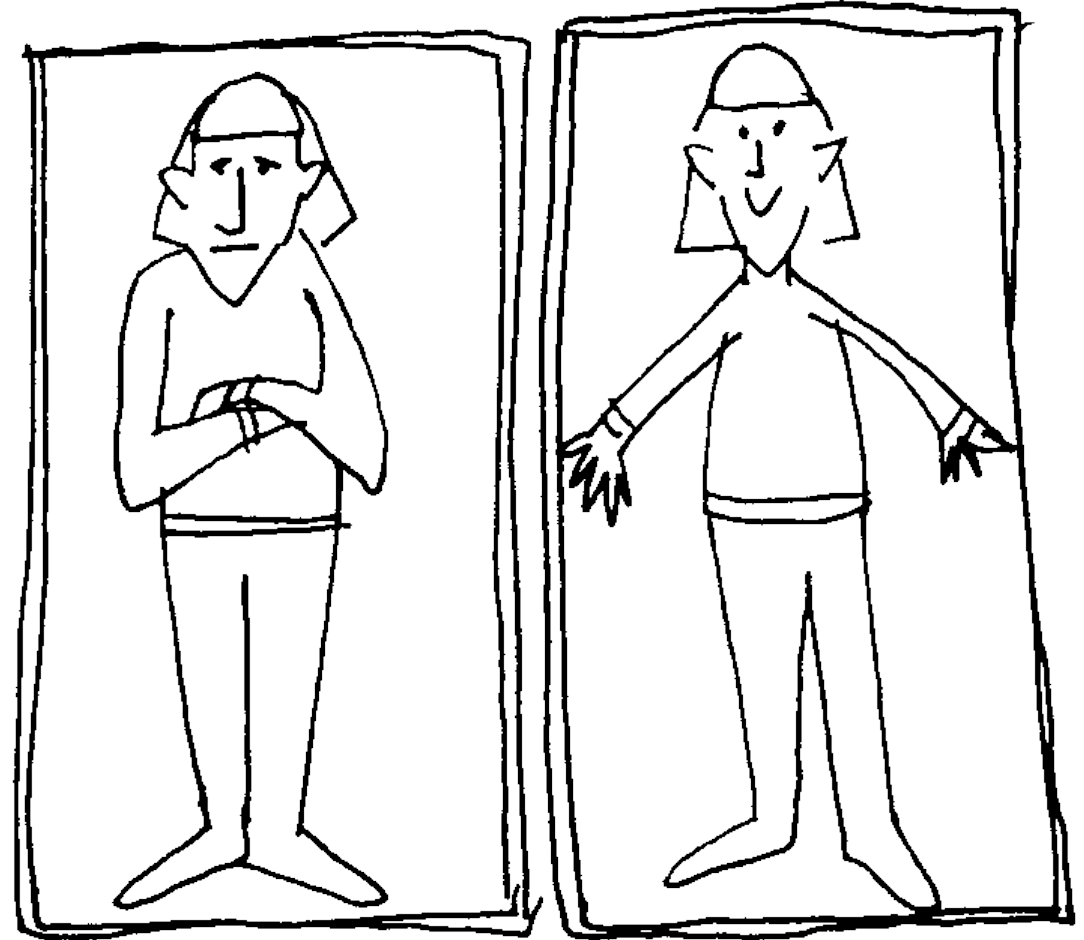
# The Approach

Watch for responses, reactions,  
body language

Discover the dominant buying  
motive (What emotions are you  
appealing to?)

They won't tell you what it is

**REMEMBER:  
GET THEM TO DO THE  
TALKING!**





# Our Investors Want Us . . . To Understand Buyer Behavior

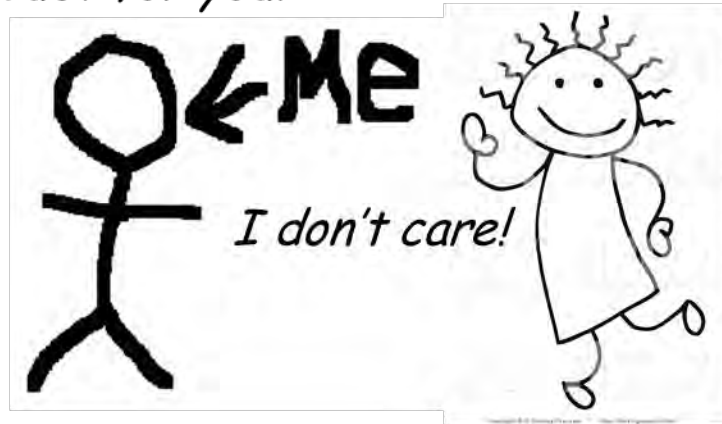
- 1) People don't care about our product or solution as much as we do (It really is about them).
- 2) They perceive innovation as risky and difficult.
- 3) They fear making mistakes.
- 4) It takes time: selling is building & maintaining a relationship.
- 5) Don't tell our buyer something that can be asked.

\*This includes Investors and Corporate Partner Executives: **Be "Coachable"**

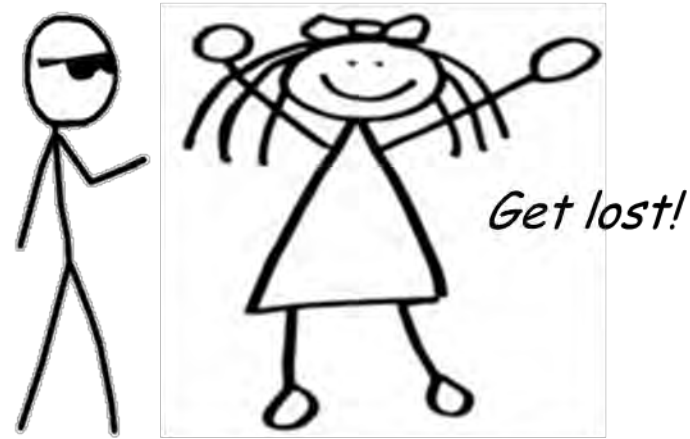
Source: Deanna Berg, Ed. D., "Ask, Don't Sell! Strategies for Selling Innovation"



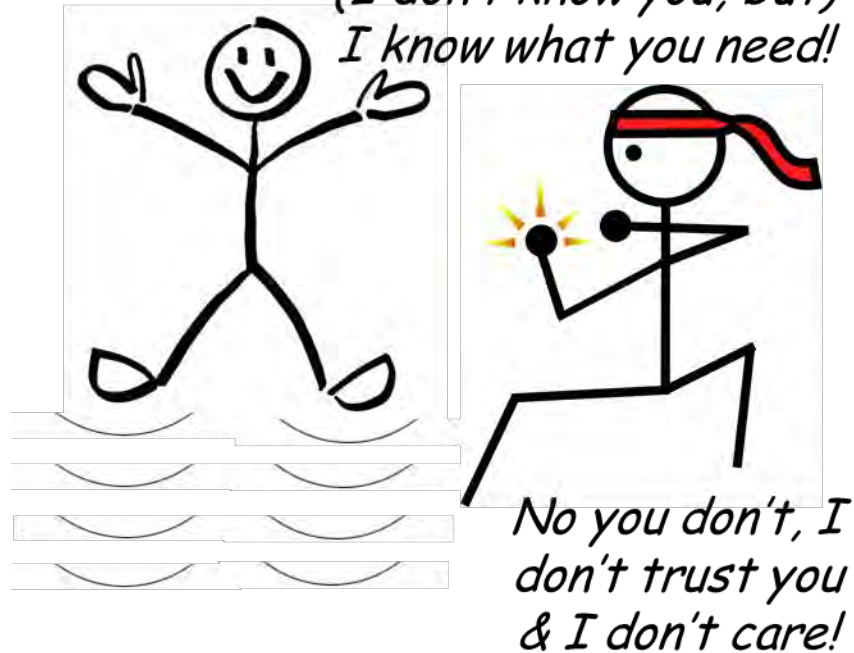
*I have a cool new tissue product for you!*



*My product is a disruptive innovation!*

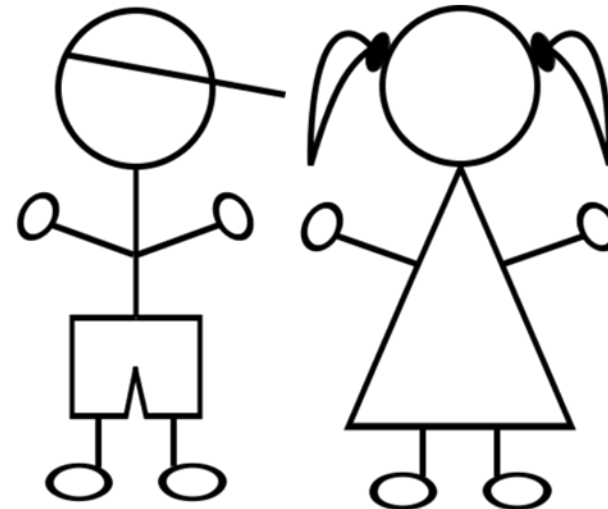


*(I don't know you, but)  
I know what you need!*



*ACK!! What  
do you want?*

*FINALLY!! I am  
glad you asked...*



# Cute Baby?

*(Beware of Cognitive Bias)*





# Confirmation Bias





**Where might our first customers come from?**





# Investors are interested in this

After 10, 25, 50, . . .  
100 interviews,

What's our story  
(lessons learned;  
insights gained)?



# **Corporations, Partnerships, Alliances as Investors**

# Alliances for Start-Up Ventures



- Investment; Need for Cash
- Access or Partner with Technological Advances
- Find a Viable Solution for a Tough Problem
- Fend off a Competitor
- Gain Market Share . . .
- . . . and Motivate Other (More Risk-Averse) Investors



# Who To Target

## Feasible Partner

- 1) Relevant Product Lines
- 2) Established Presence in the Market.

## Viabile Partners

- Good Financial Health
- Established in the Market with a Relevant Product Line
- Can Provide Capabilities - Relevant for Commercialization
- Possess Good Absorptive Capacity

# Match-Making Search Questions

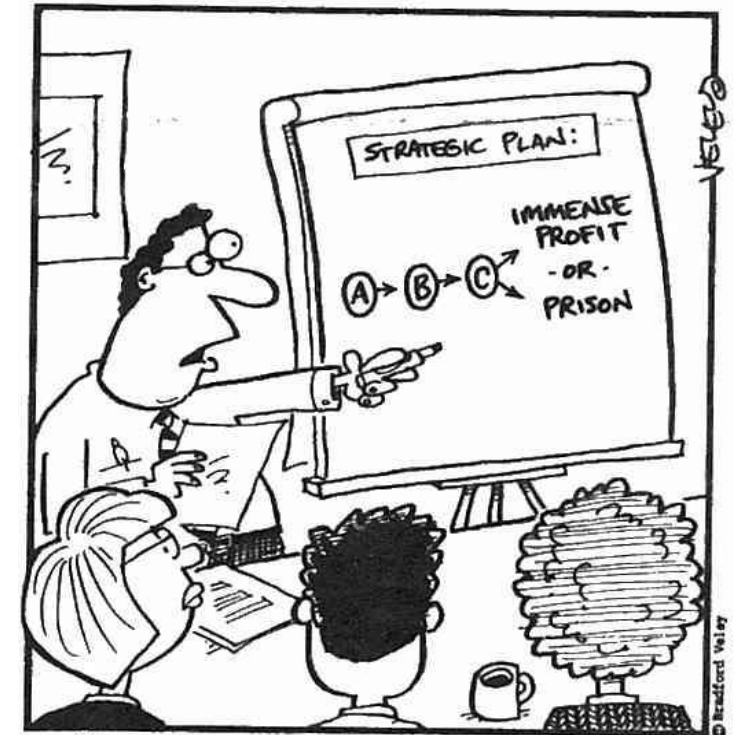
- 1) Name of Target and Relevant Unit
- 2) Current **Customer Base**
- 3) Target's **Reason for Interest**
- 4) **Prior Acquisition(s)** of Technology from the Outside
- 5) **Criteria** Likely to be Used to Evaluate Your Technology
- 6) Likely **Information Desired**
- 7) Likely Preferred Legal Structure for Deal
- 8) At What **Stage in Maturity** does the Target Prefer to Obtain Technology
- 9) Will Target **Participate in Concurrent Engineering** or Test & Evaluation?
- 10) Who is the Ultimate **Decision-Maker(s)**



# Analyze for Strategic Fit

- 1) Return on Investment (Their Market Share → Our Market Access)
- 2) Your Mission Statement Goals
- 3) Management Capabilities; Their Intentions;
- 4) Corporate Culture; History of Partnerships
- 5) Business History, Financial Background
- 6) Partnership Strategic Direction

See: Lorraine Segil, Intelligent Business Alliances  
(1996: Times Business, Random House)



"Stay with me now, people, because in step C, things get a bit delicate."

# Examine Closely Before Entering Into An Agreement

<b>RISK</b>	High	<b>I</b>	<b>III</b>
	Low	<b>II</b>	<b>IV</b>
		Low	High

**COST/BENEFIT**

- Financial Situation
- Operations
- Market Presence
- Quality of Product or Service
- Views on Customers and Service
- Marketing
- Desire

<http://www.va-interactive.com/inbusiness/editorial/bizdev/ibt/alliance.html>



# Check List

**1) Financial Situation**

**2) Annual Revenue**

**3) Annual Growth**

**4) Organization  
Structure**

**5) Management  
Experience &  
Background**

**6) Market Presence**

**7) Prospect Markets**

**8) Growth  
Opportunities**

**9) Quality Standards**

**10) Customer Feedback**

**11) How Are Complaints  
Handled**

**12) Marketing**

**13) Cash & Personnel**

**14) Desire, Enthusiasm**

# **How To Approach a Prospect**

**The Deal That You Are Proposing Should be Equally  
As Beneficial To Them As It Is For You**

**\* Handle Similarly to an I-Corps Value Proposition**

# **Checklist to Formally Discuss with a Potential Partner**

- 1) The Business Opportunity at Hand**
- 2) Respective Financial Resources and Responsibilities**
- 3) Steps Required to Launch Alliance &/or Develop The Product**
- 4) Who Will Supply Which Personnel**
- 5) Duration of Commitment or Relationship**
- 6) Intellectual Property Ownership; Exit Strategy**

# Licensing – “Wheelbarrow Expressions of Value”

- Lump-Sum License
- Royalty License
- Upfront Payment(s)
- Annual Payments
- Milestone Payments
- Option Payments
- Royalty Adjustments
- IP Rights
- Commitment to Purchase
- Equity



Source: Robert Goldscheider, Editor, Licensing Best Practices (2002: Wiley & Sons)



# **Addendum**

**I – “Crossing the Chasm”**

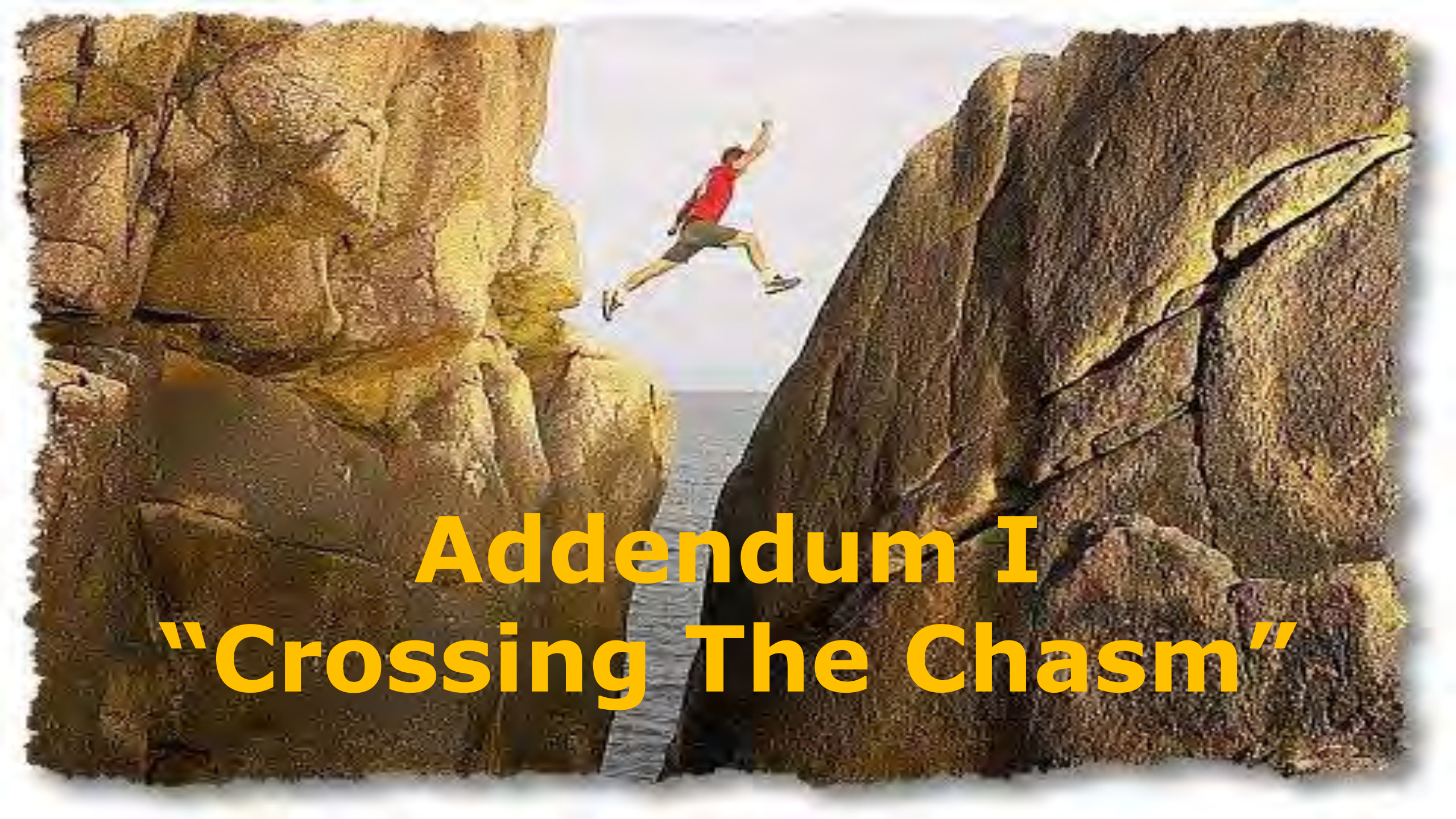
**II – Investor Pitch Academy**

**III – Overviews**

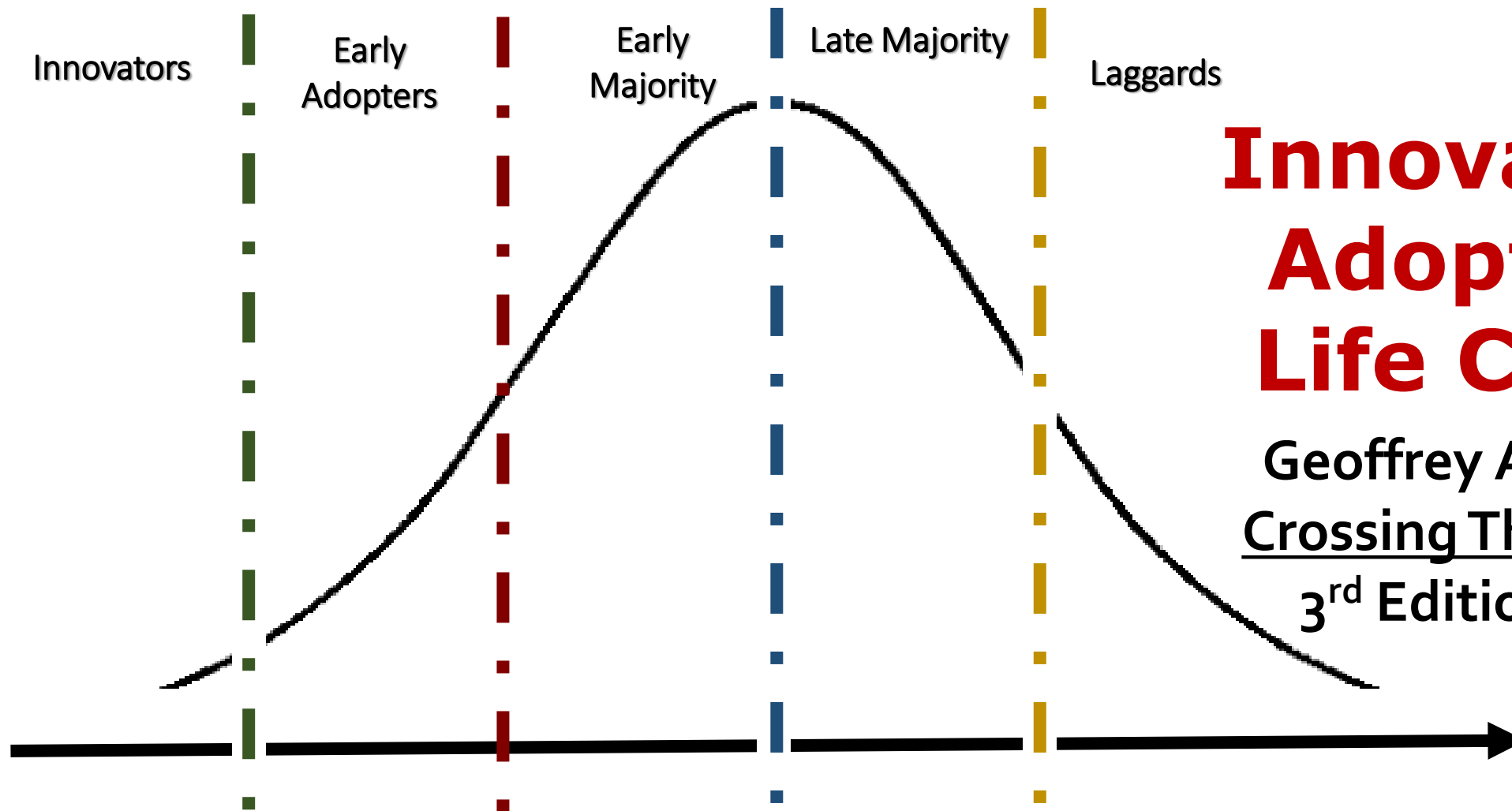
- The Term Sheet: (a) Economic, (b) Control**
- The Capitalization Table**
- Convertible Debt**

**IV – Telling Our Story**



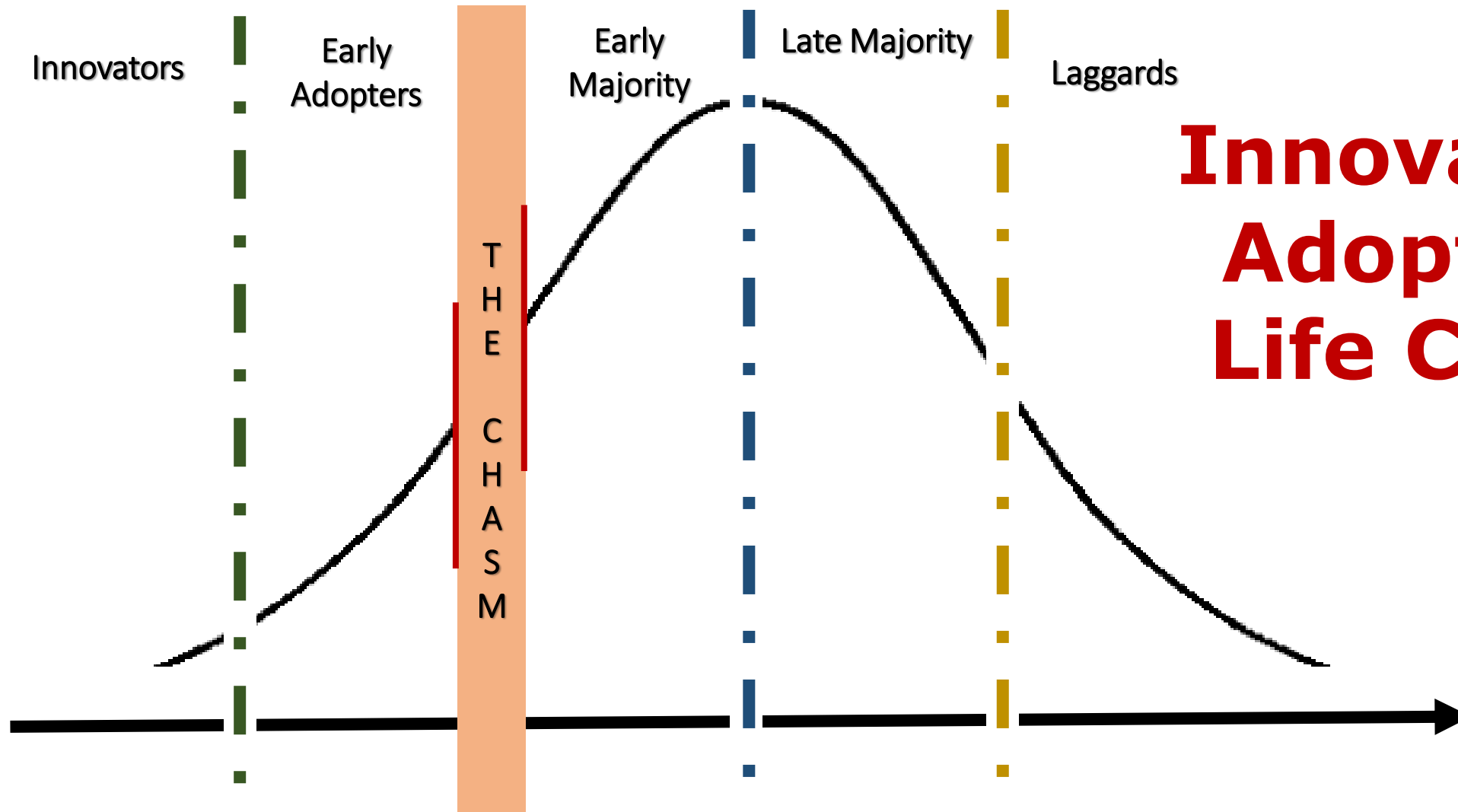


**Addendum I**  
**“Crossing The Chasm”**



# Innovation Adoption Life Cycle

Geoffrey A. Moore,  
Crossing The Chasm,  
3<sup>rd</sup> Edition, 2014



# Innovation Adoption Life Cycle

Innovators

Early Adopters

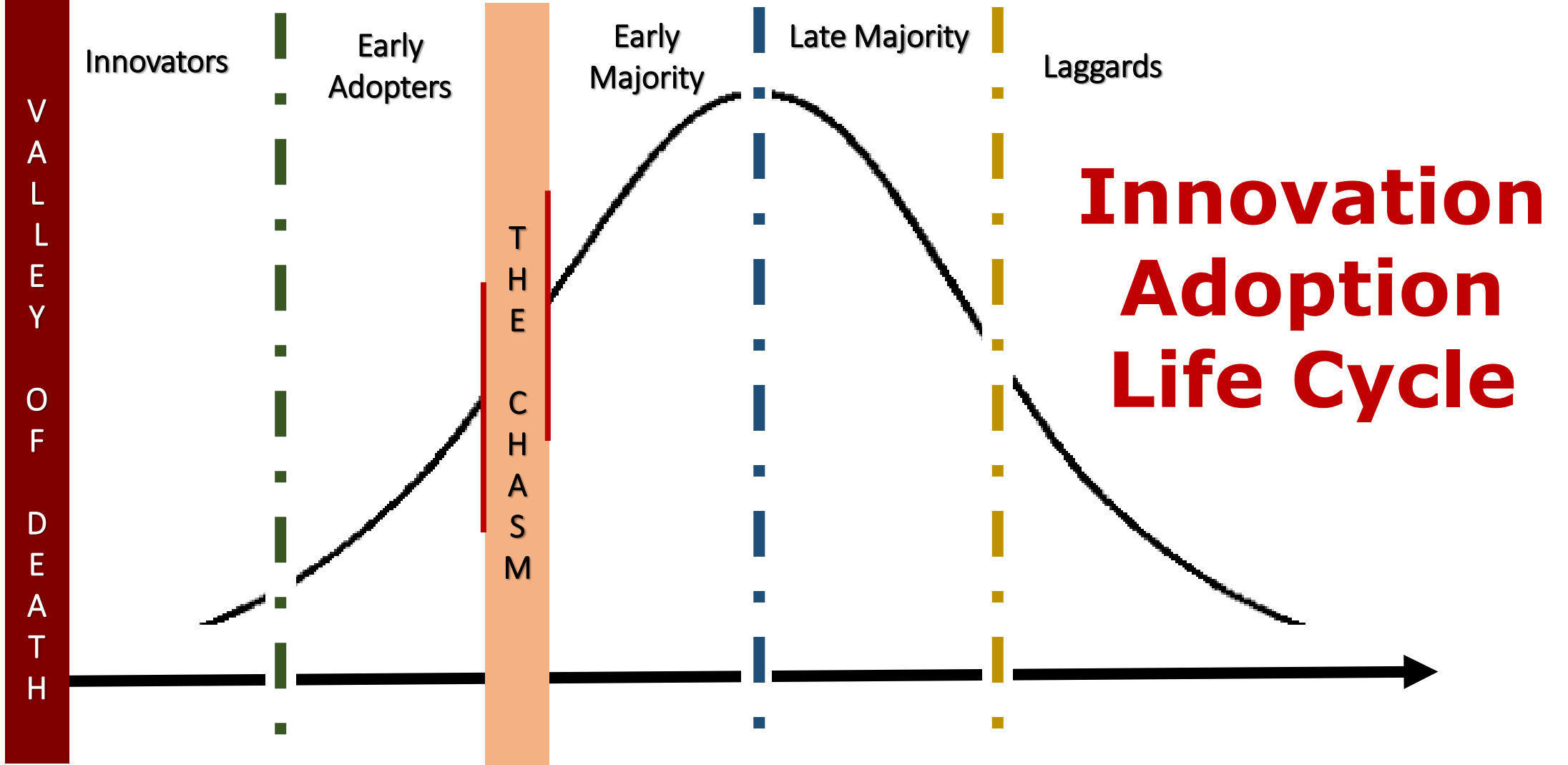
Early Majority

Late Majority

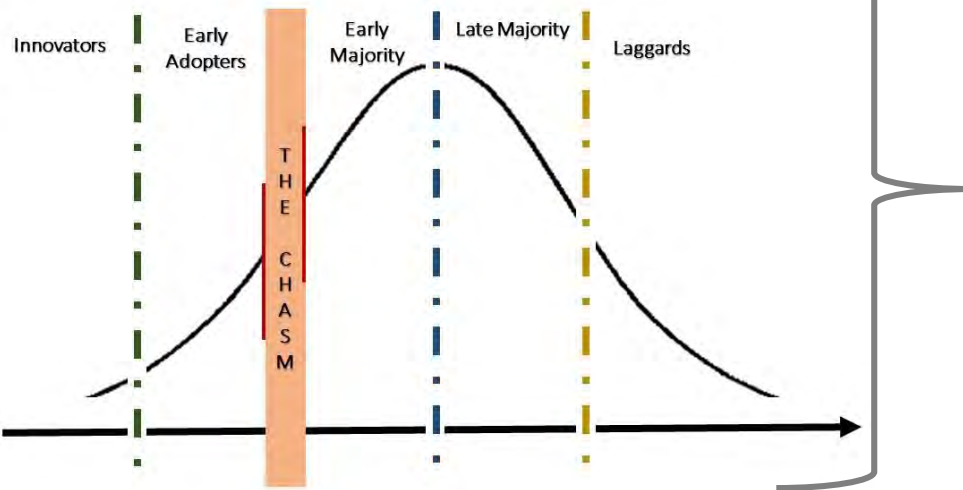
Laggards

T  
H  
E  
  
C  
H  
A  
S  
M





## Innovation Adoption Life Cycle



1. Innovators
2. Early Adopters: Visionaries
3. Early Market: Early Majority
4. Later Market: Later Majority
5. Laggards

## Distinguishable Sets of Prospective Customers

- For a given set of products/services; they present common, intrinsic needs & wants;
- each hears, responds differently to targeted messaging.
- They reference others in THEIR GROUP (not prior one) when buying-in

# Tech Enthusiast (Innovator)



Geoffrey A. Moore, Crossing The Chasm, 3<sup>rd</sup> Edition, 2014

## Notable Characteristics

1. “Into” new tech products
2. Technology is a “central interest”
3. Seek them out - pre-market; don’t need to be fancy (early MVP)
4. Winning them over is key; they’ll help debug
5. Their endorsement reassures other decision makers that the product does in fact work

“Give me the truth: no tricks – techie-to-techie interaction – Give me the new stuff, first . . .  
. . . and I want it cheap”

# Early Adopters (Visionaries)



They can make noise . . .  
. . . music to us

## Notable Characteristics

---

1. **Recent entrants** in executive ranks; motivated; have a dream
2. **Seeking Fundamental Breakthroughs;** New World; “Order of Magnitude ROI
3. **Want to be First;** Champion, Risk-Taker; Change Agent & Be Recognized
4. **Have a Budget;** Not Afraid To Use It
5. Will authorize – and control - Pilot Projects, Phases, Milestones; Measures/Metrics (**Based on Their Needs; Not Yours**)
6. **In a Hurry:** Windows of Opportunities, Deadline Pressures



# Early Market (Early Majority)

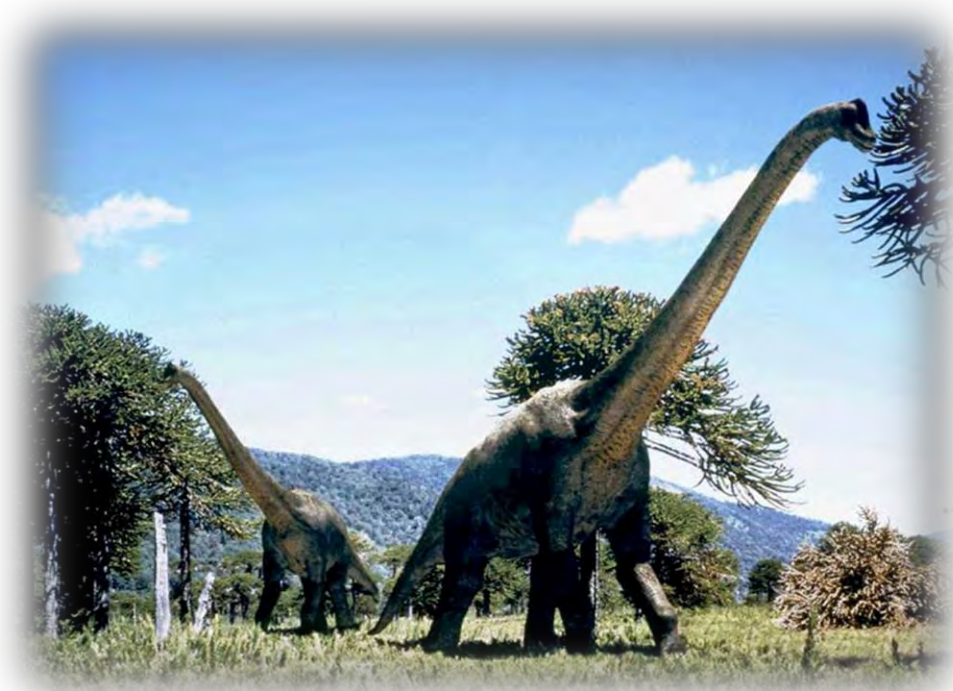


## Notable Characteristics

1. Pragmatist, Prudent, Cautious
2. Not Assertive; Not Pioneering
3. Not the Stars of Show
4. Not Futuristic; Present Day
5. Value Experiences of Their Peers
6. Prefer Percentage Improvements

**Bowling Pin Analogy: One pin knocks over others ▪ Prefer “*Market Pull*” to “*Sales Push*” ▪ Want evidence of installations ▪ Don’t Sell Them Disruption**

# Later Market



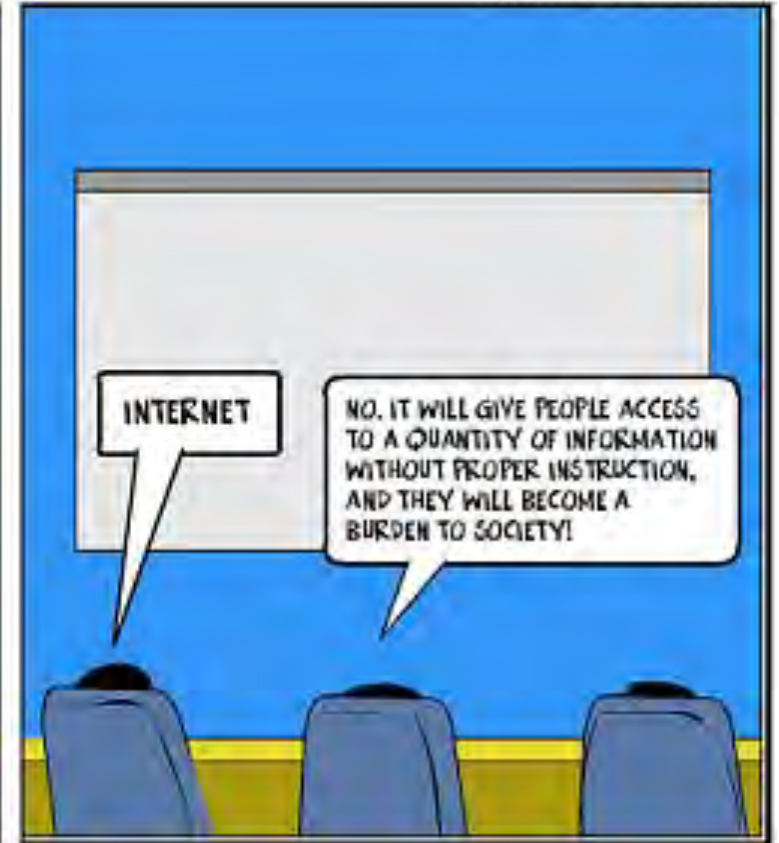
Geoffrey A. Moore, Crossing The Chasm, 3<sup>rd</sup> Edition, 2014

## Notable Characteristics

1. Conservative; Not interesting to Entrepreneurs
2. More Traditional than Pragmatists; not willing to work at the mastering the product
3. Prefer mature products; bugs removed; risks eliminated
4. Convenience, not performance
5. Costco buyers: pricing does not pay for tech support

# Laggards

EVOLUTION OF TEXT - BY H2M1



WWW.TOONDOO.COM

Geoffrey A. Moore, Crossing The Chasm, 3<sup>rd</sup> Edition, 2014



# The Chasm



## Establish a “Bounded” Market Segment

1. Make your initial challenge simple
2. Focus on a very specific, confined niche market
3. Deliver an over-abundance of support
4. Develop your solid list of references, collateral, and internal procedures
5. Concentrate communication

**Don't Try to Expand Too Quickly**

\* Geoffrey A. Moore, Crossing The Chasm, 3<sup>rd</sup> Edition, 2014



# War Analogy: Establish A Beachhead



**Be Market-Driven; not  
Sales-Driven**

1. Objective: Get those References
2. Single very specific niche segment: drive word-of-mouth effect
3. Own that niche, when captured, as your next-niche entry point
4. Avoid the multi-opportunity "Sirens"
5. Pragmatists go for and fortify the market leaders. That's why they delay their decisions

# Addendum II: **Investor Pitch Academy**



# **What Should We Tell Investors?**

- I. “Elevator Drill” – Set The Stage and Establish Expectations; Five (5) “Take-aways”**
- II. What is the problem?**
- III. What is Your Solution?**
- IV. Business Model: Define Your Market; Customer Segment(s) – “Pains”, Needs; Desired Gains**
- V. Value Proposition**

**. . . and**

- VI. Competition – Your Distinguishing Characteristics**
- VII. Market Development (“Get – Keep – Grow”) Plan**
  - **Sales/Distribution; Revenue Stream/Tactics**
- VIII. Your Team**
- IX. Pro Forma Financial Statement**
- X. Corporate Development Timeline**



# **. . . Finally**

**XI. Capital Funds Required – Use of Funds**

**XII. Exit Strategy**

**XIII. The Deal**

**XIV. Final Summary Slide (See Slide I)**

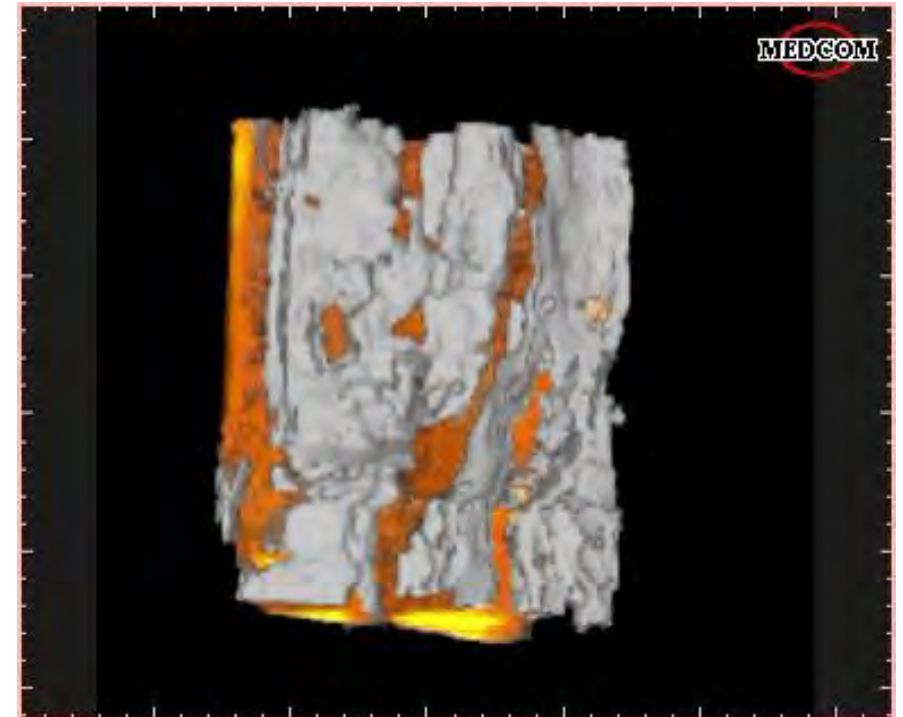
**XV. Back-Up Slides**

# How Many Slides?

- 1) How much time do you have? 3 – 6 – 12 – 18
- 2) Keep it Moving
- 3) Simple is Good
- 4) No Sentences; Few Words
- 5) White Space = Good

# What is (Company)? Too Much

- A recurrent service revenue company, predicated on telemedicine and novel neuroimaging devices
- That transforms existing acute/preventative stroke and TBI diagnosis/treatment paradigms by:
- Delivering neurological diagnosis upon *initial patient contact. ANYWHERE*
- Changing the process and logistics of care
- Reducing service time
- Providing seamless continuum of care from home to hospital
- Fostering earlier and appropriate and warranted therapy and reduced costs
- Improved morbidity and mortality
- Significant Investment return for investors with recurrent revenue based on established CPT codes



# The Issue: Diagnosing Traumatic Brain Injury & Stroke

- Strokes: \$74B cost per year in U.S. \$130B by 2030
- Traumatic Brain Injury (TBI): \$60B cost per year in U.S.

**Blend 6 & 7 into a Pain – Need Slide: Critical Problems that Mandate Resolution: Process, Outcomes, Cost to Patient & Society**

→ Keys to reducing costs:

- ★ Diagnosis and prevention pre-stroke
- ★ Rapid diagnosis and treatment post-stroke and post-TBI
- ★ Reduction in severity of acute stroke and TBI

**Company's system is the unique solution**



**Stroke : Time lost is brain lost**

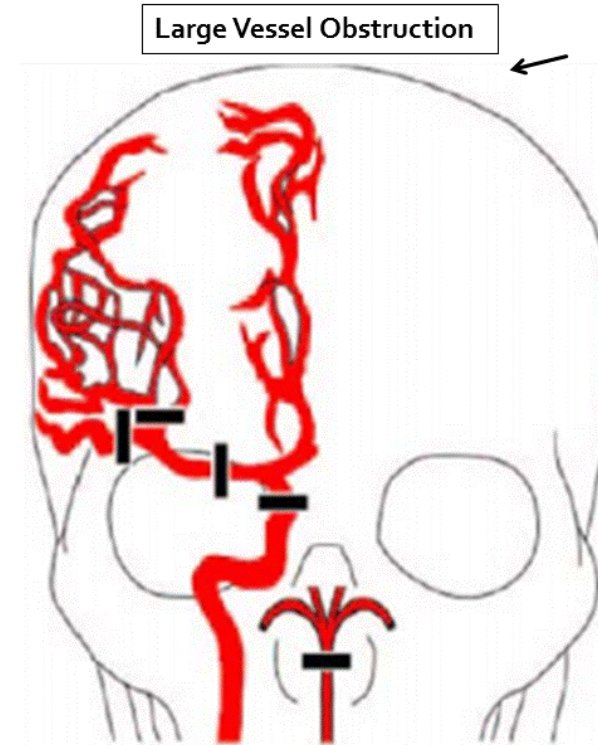


# (Still) Too Crowded



- Stroke: 880,000/Year; US
- \$70B/Year
- \$ 130B (2030)
- \$140,000/episode
- \$300-800,000 if severe
- Traumatic Brain Injuries (TBI): 1.7 M/Year
- > \$100B/Year

**Stroke: Time Lost = Brain Lost**



- 300,000/ Year
  - 60-80% die/severe disability
- Only 10% (27,000) definitive early treatment

Early Diagnosis, Early Treatment

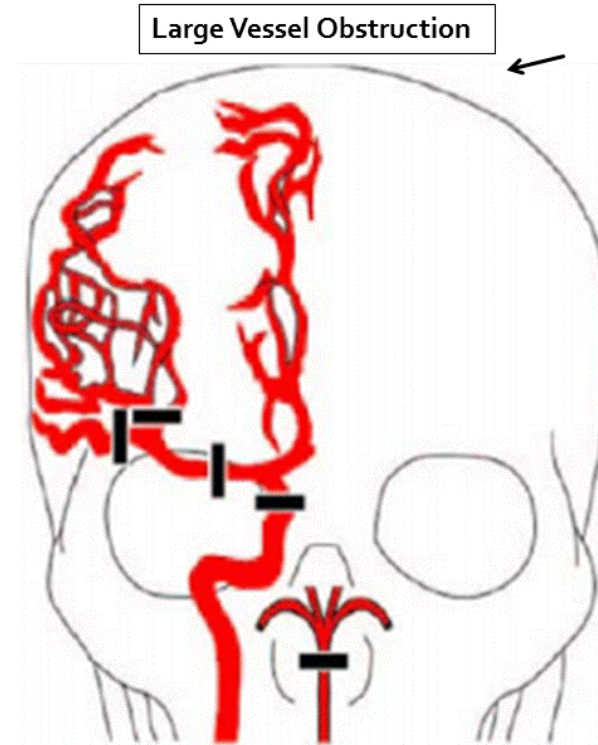
Significant Revenue

# Better



**2 Million  
Neurons per  
Minute**

**Time Lost is Brain Lost**



**880,000**

**\$70 B**

**\$140 - \$800K**

**10%**

# The Elevator Introduction



Who

What

Why

How

# The Problem

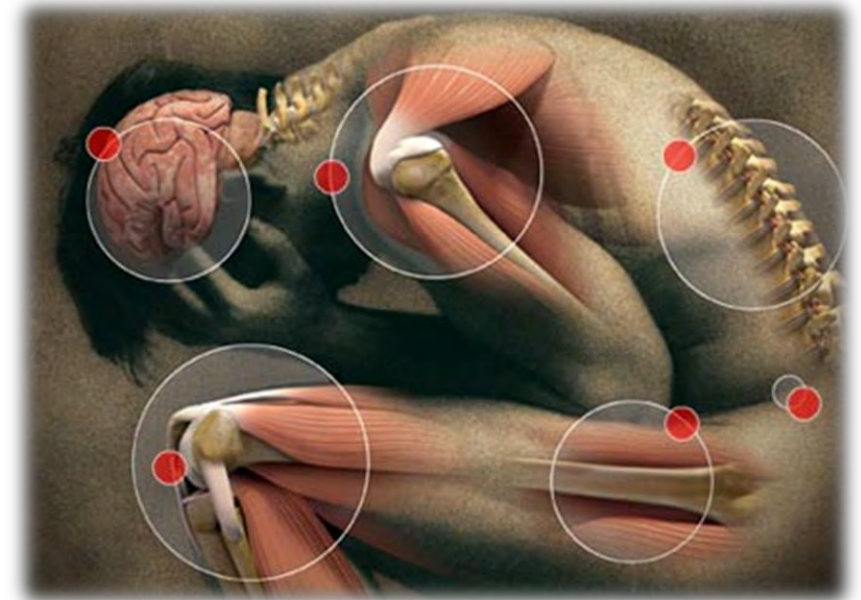
What is it?

Who has it?

How badly do they want it fixed?

What have they tried so far?

Repercussions - Ramifications



## Make Us Care



# Your Solution

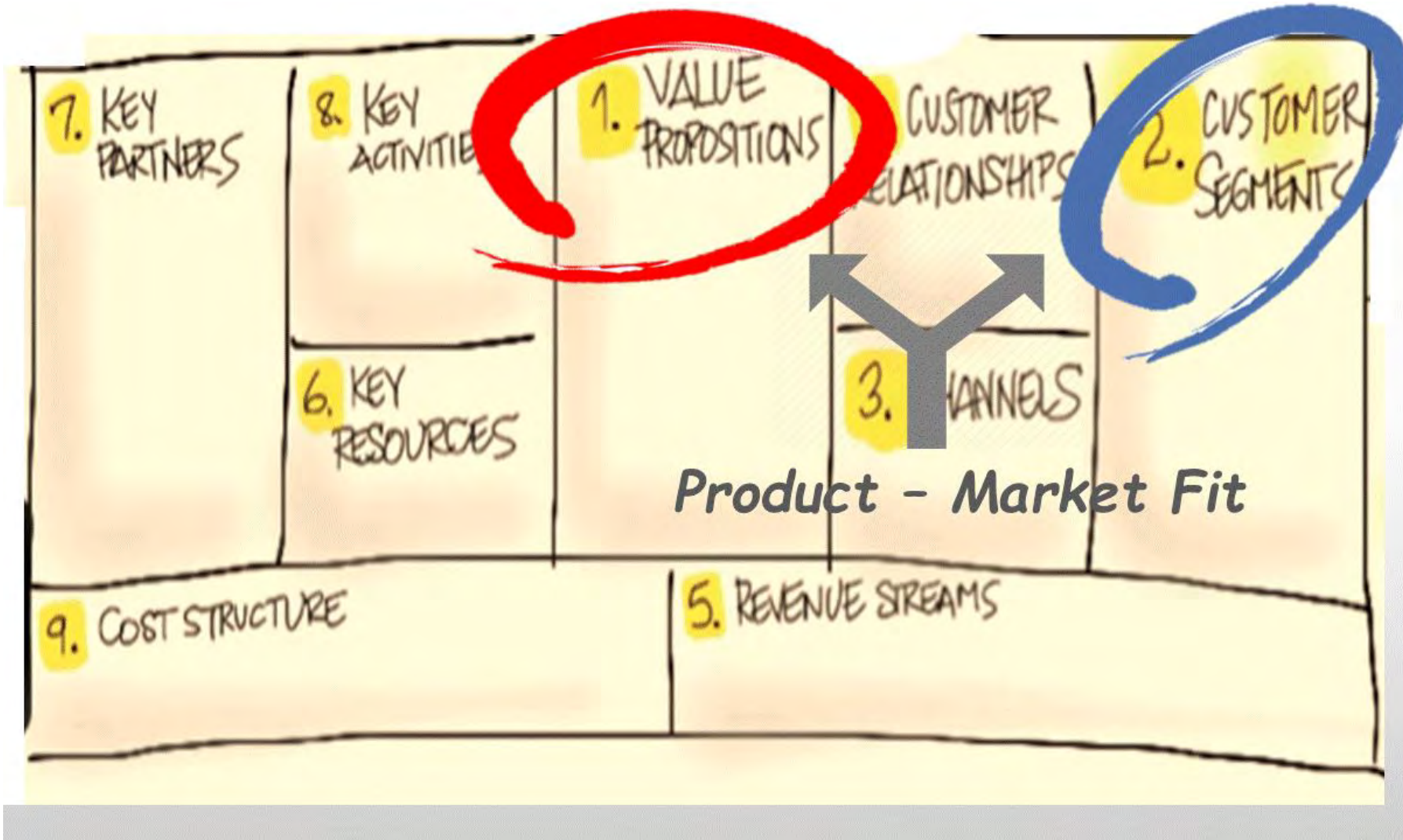
- 1) What is it? Simple, not in Detail
- 2) What it does? NOT how it does.
- 3) What will happen if it is implemented?
- 4) How much will it save?
- 5) What will it allow your customer to do that couldn't be done before?



# For Whom?



# Your Market



How Significant?

How Large?

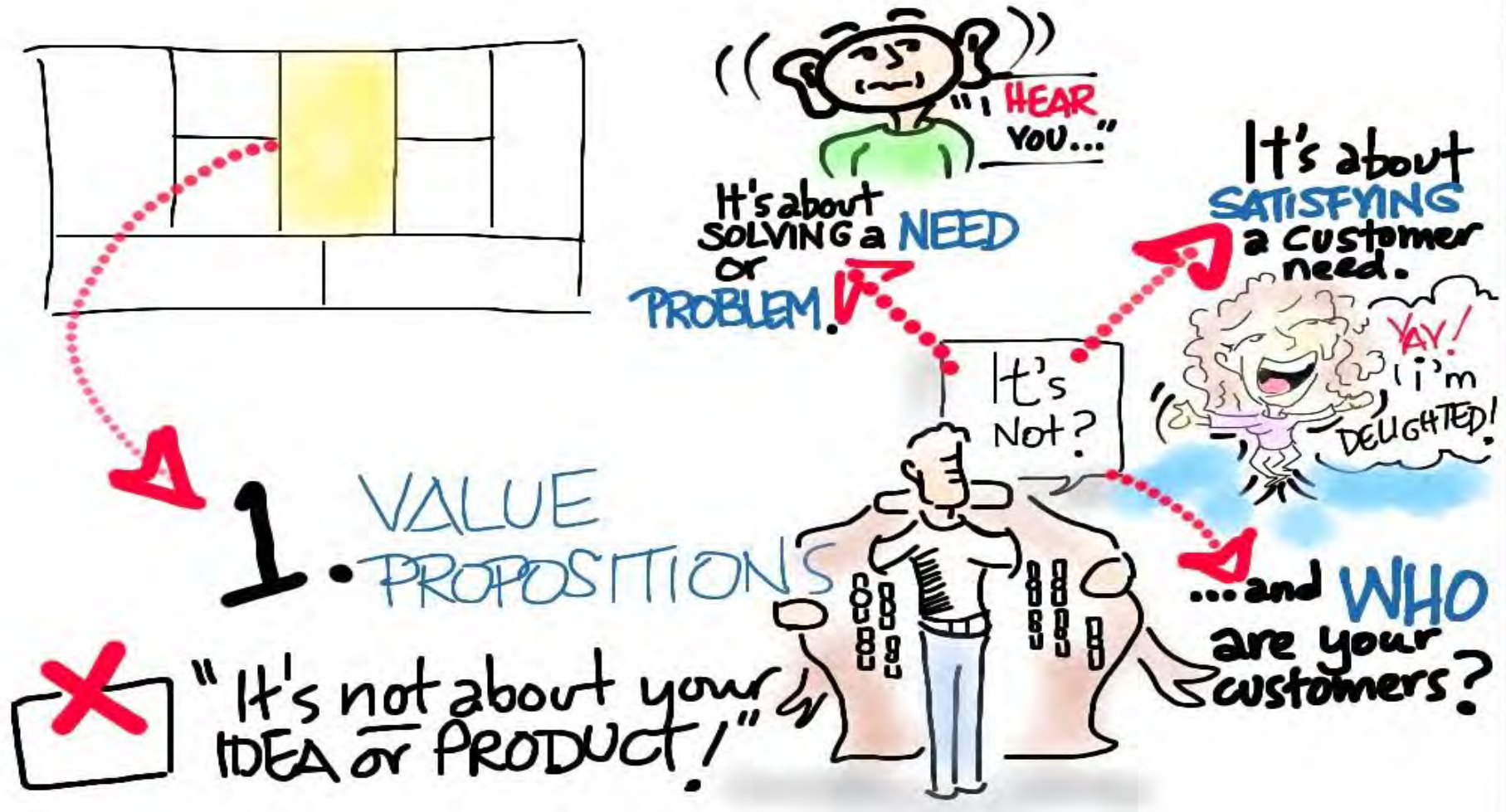
Scalable?

How are you Positioned?

Beachhead?



# Value Proposition

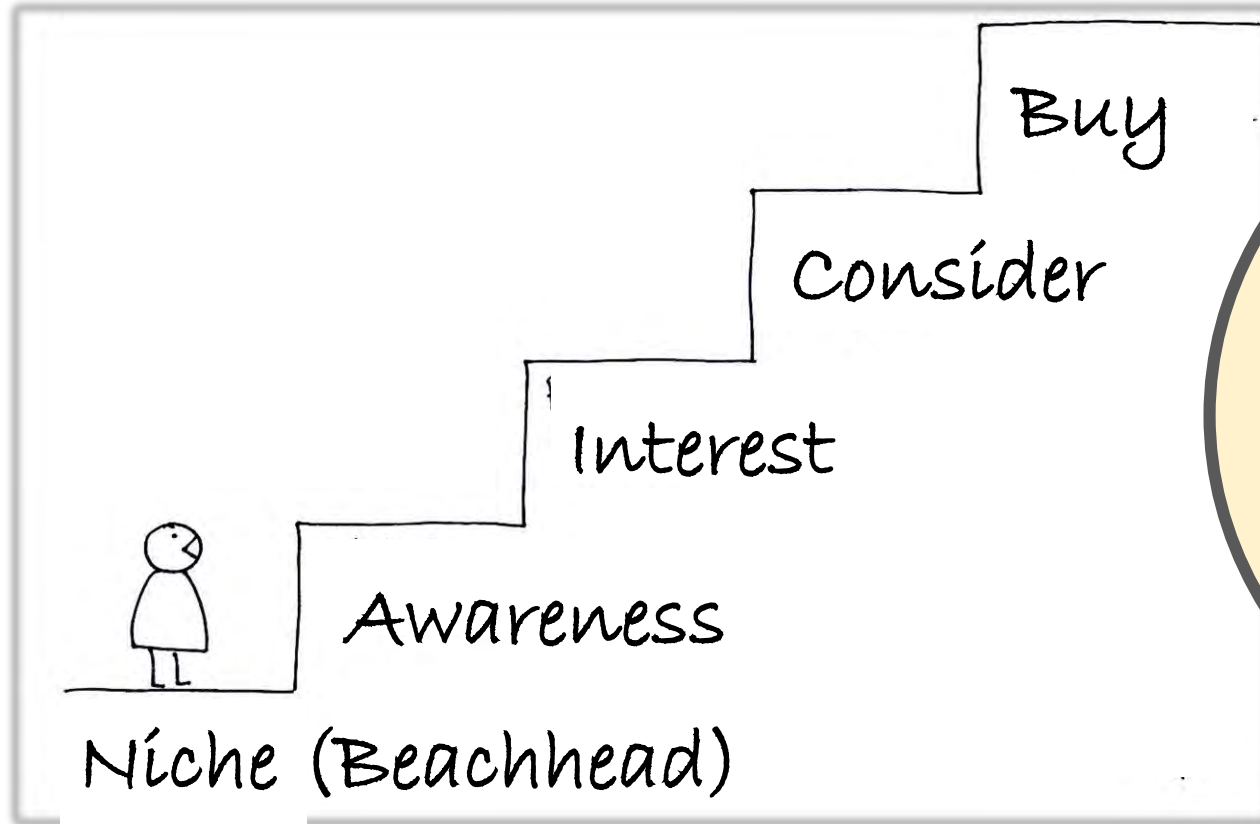




# Competition – Your Advantage

	<b>YOU!</b>	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>
<b>V. P. 1</b>	<input checked="" type="checkbox"/>	✓	✓		
<b>V. P. 2</b>	<input checked="" type="checkbox"/>	✓		✓	
<b>V. P. 3</b>	<input checked="" type="checkbox"/>		✓		
<b>V. P. 4</b>	<input checked="" type="checkbox"/>			✓	
<b>V. P. 5</b>	<input checked="" type="checkbox"/>				✓

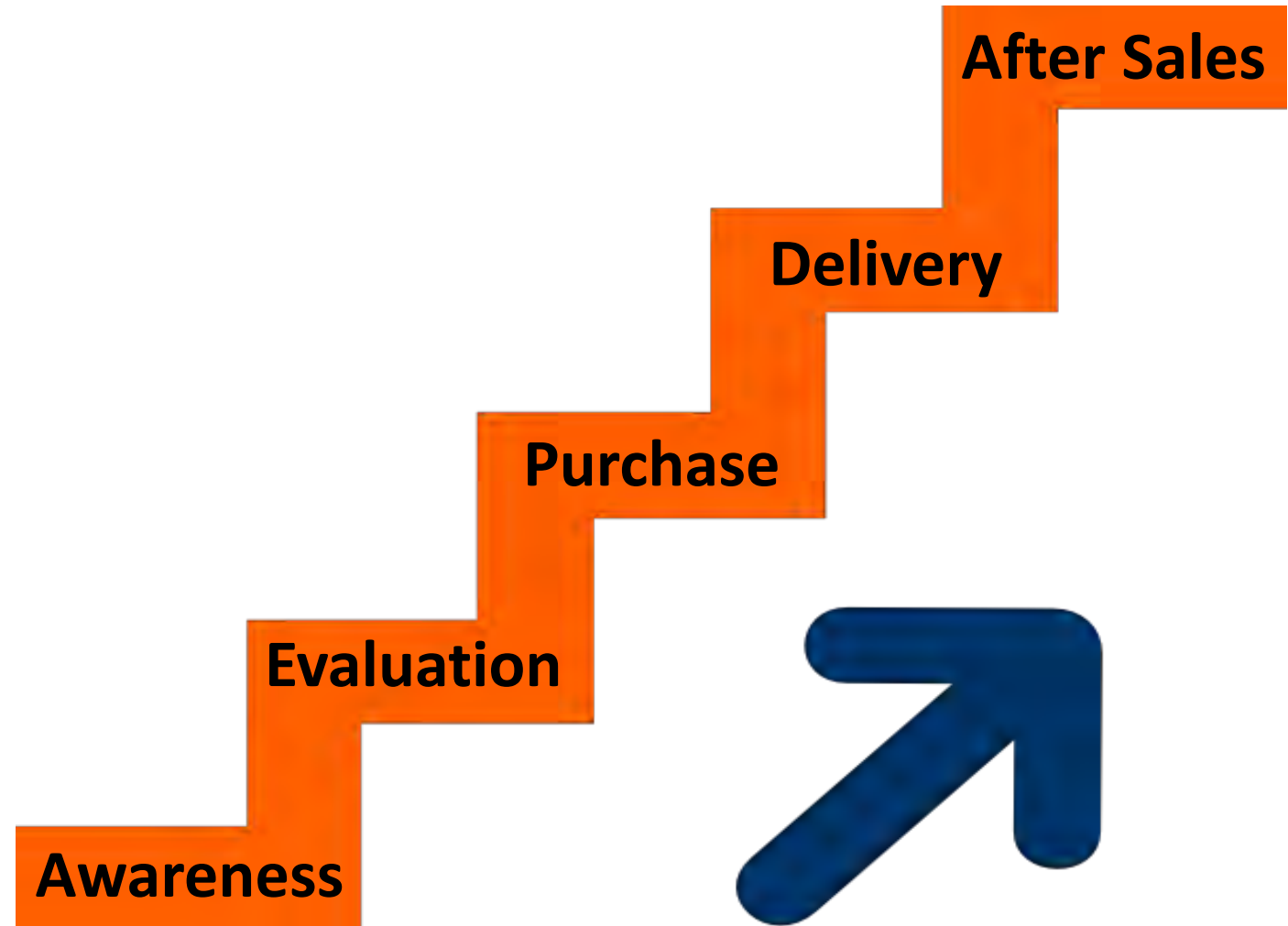
# Market Development: Get, Keep & Grow



**PROCEED CAREFULLY**  
"This is not the time to broadly launch your product to a wide audience or get a ton of press (You'll be under enormous pressure to do so.)"\*

\* Steve Blank/Bob Dorf (2012)

# Sales Channels



# Revenue Stream

<p>Asset Sale Usage Fee Subscription Fees</p>	<p><b>Fixed Menu Pricing</b> List Price Product Feature Dependent Customer Segment Dependent Volume Dependent</p>
<p>Rent, Lease License Brokerage Advertising</p>	<p><b>Dynamic Pricing</b> Negotiation Yield Management Real Time Market Auctions</p>



# Your Team

IMPRESS

US

-

Experience

&

Credentials



**Yiying Lu**  
CEO



**Arash Ferdowsi**  
CTO



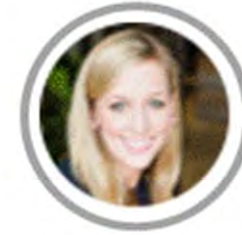
**Joe Gebbia**  
CPO



**Dave Altarescu**  
Director of  
Marketing



**Tobias Van Schneider**  
Art Director



**Paige Brewster**  
Account Manager

---

## Advisors & Investors



**Paul Graham**  
Advisor



**Brian Chesky**  
Creative  
Advisor



**Jason Jones**  
Investor



**Tim Ferriss**  
Investor

# Financial Proforma

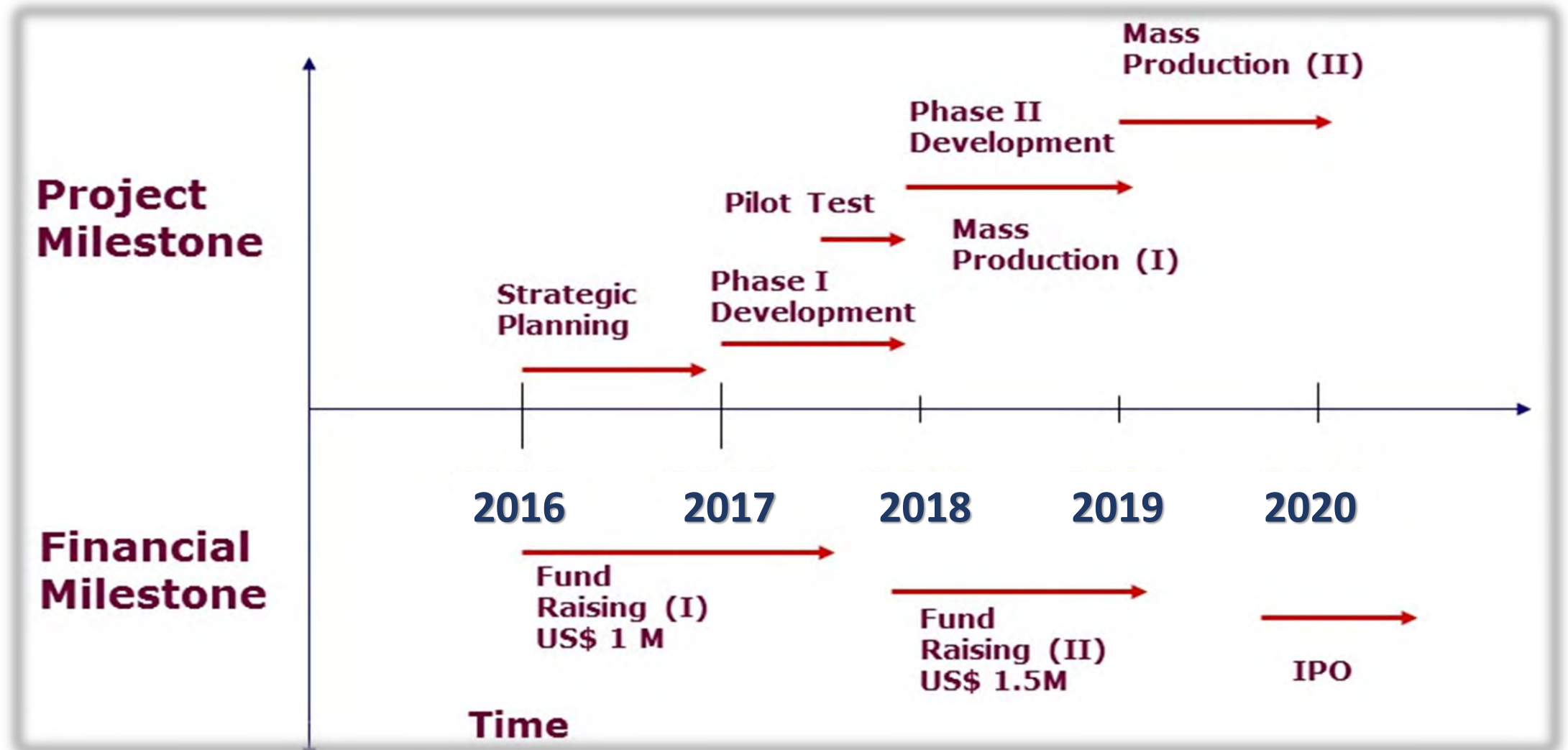
(\$000's)	2016	2017	2018	2019	2020	2021
Revenue	\$43	\$3,032	\$11,900	\$57,245	\$112,881	\$192,721
Units Sold	251	2,458	5,208	16,217	22,939	32,425
Gross Profit	(208)	574	6,692	41,028	89,942	160,296
Gross Margin	(482%)	19%	56%	72%	80%	83%
Sales/Market/Admin	707	2,305	7,609	19,948	34,756	46,877
R & D	-	1,200	1,350	2,050	3,050	5,050
EBITDA	(\$915)	(\$2,930)	(\$2,267)	\$26,030	\$52,135	\$108,368
Capital Funds	\$1,000	\$3,000	\$3,000	-	-	-
Cumm. Net Cash	\$84	\$155	\$887	\$19,917	\$79,053	\$187,421
Customer Events	125	5,500	20,500	98,250	192,750	327,750
Net \$/Event	\$285	\$536	\$566	\$572	\$575	\$577
Venues/Sites	5	50	150	500	700	1,000
Cost/Venue	\$37	\$34	\$28	\$27	\$27	\$27



# Financial Proforma - Simplified

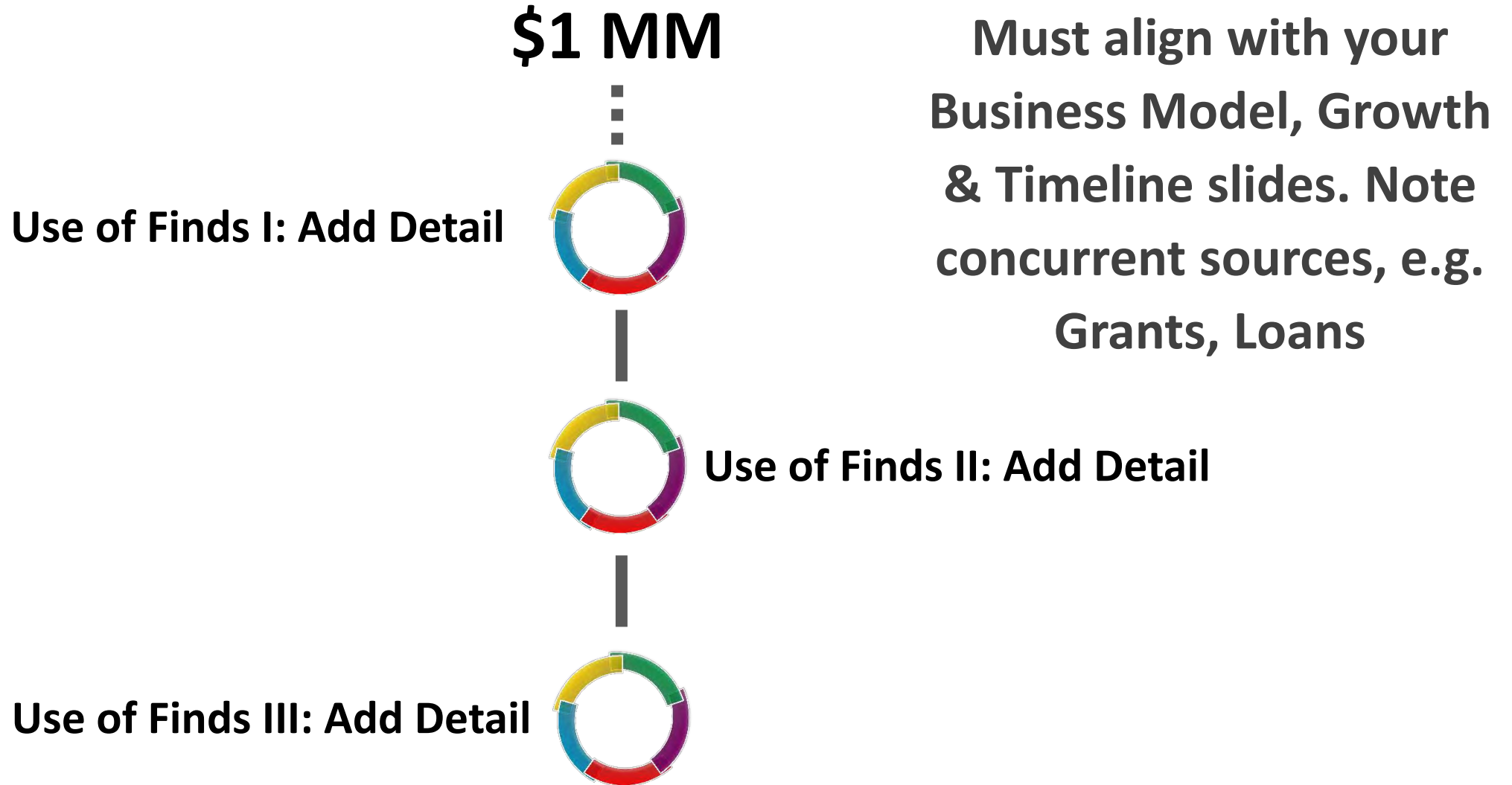
<b>(\$000's)</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>
<b>Revenue</b>	<b>\$43</b>	<b>\$3,032</b>	<b>\$11,900</b>	<b>\$57,245</b>	<b>\$112,881</b>	<b>\$192,721</b>
<b>Units Sold</b>	<b>251</b>	<b>2,458</b>	<b>5,208</b>	<b>16,217</b>	<b>22,939</b>	<b>32,425</b>
<b>EBITDA</b>	<b>(\$915)</b>	<b>(\$2,930)</b>	<b>(\$2,267)</b>	<b>\$26,030</b>	<b>\$52,135</b>	<b>\$108,368</b>
<b>Capital Funds</b>	<b>\$1,000</b>	<b>\$3,000</b>	<b>\$3,000</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Customer Events</b>	<b>125</b>	<b>5,500</b>	<b>20,500</b>	<b>98,250</b>	<b>192,750</b>	<b>327,750</b>
<b>Net \$/Event</b>	<b>\$285</b>	<b>\$536</b>	<b>\$566</b>	<b>\$572</b>	<b>\$575</b>	<b>\$577</b>
<b>Venues/Sites</b>	<b>5</b>	<b>50</b>	<b>150</b>	<b>500</b>	<b>700</b>	<b>1,000</b>

# Corporate Development Timeline





# Funds Required – Use of Funds



# Your Exit Strategy



**Who? Why?**

**Recent Deal History;  
Structure/Value/Multiple**

- 1) Strategic Acquisition
- 2) Competitor Acquisition
- 3) Initial Public Offering (IPO)
- 4) Management Buy-Out
- 5) Investor Buy-Out

# The Deal

## Almost Always Disagreements; be Open-Minded

- 1) Typically: (1) Straight Equity; (2) Convertible Note
- 2) Don't add \$ valuation to the slide . . .  
    . . . prepare to discuss a range
- 1) % Percentage of start-up

# The Close

## Reminder of Key Points

--

## Prompts to ask questions during Q&A

Source: Rockies Venture Club



Dream Team

### Raising \$750k

- For: inventory, a new CMO, and process machinery
- Burn rate: 18 months
- Current valuation \$1.3-1.8M
- After 18 months \$6.8M potential valuation

The Deal



Working prototype and 4 signed pre-orders from corporate lumberjacks

Traction

- Two patents pending (filed 8 months ago)
- six trade marks
- and a trade secret that is really hard to figure out but we know it and the other guys don't

IP or protected barriers to entry

A well known company has met with us to discuss a future acquisition. 4 yrs or \$X in sales = interested.



\$26M potential exit in 4 years

The Exit



Board meetings are on held at our main office on Oahu in Waikiki.

Investor Perk



# Back Pocket/Appendix Slides:

- Included in your deck for AFTER the pitch, during Q&A
- Something not conveyed during pitch
  - OR to support something in more detail
- Examples:
  - *Extended Info on Competition*
  - *Expanded Pro Forma*
  - *Further Explanation/Display of Product or Technology*
  - *“Comps”, Intellectual Property*



**Addendum III:**  
**The Term Sheet**  
**Capitalization Table**

**Two Key Things That Matter  
in Term Sheets:**

**Economics &  
Control**

# How Much Are You Raising?

- 1) Determines who you will speak to
- 2) Complex Financial Models: We know that they are wrong
- 3) Focus more on the length of time for funding to get to meaningful milestones
  - How long to ship your first product?
  - Time to get to a certain # of users or specific \$ amount
  - Monthly spend: burn rate/number of key personnel
  - Think balance sheet; working capital; cushion for reality



# Don't Ask For Too Much Either

1) For example, if you need \$500,000 but are looking for \$1.0 MM . . .

- Q: How much money do you have committed to the round?
- A1: I have \$250,000 raised (of \$1.0 MM sought), or
- A2: I'm at \$400,000 on a \$500,000 raise and we have room for one or two more investors

2) Don't go for a range e.g. \$5 MM to \$7 MM

3) Know what you need the funds for

# Fundraising Materials

- 1) “Fast Facts” (Not the same as the Elevator Pitch)
- 2) Executive Summary
- 3) Presentation (Pitch Deck) – See Addendum I
- 4) *Later Stage: Business Plan*
- 5) *Later Stage: Private Placement Memorandum (PPM)*

While style does count, don't overdesign; substance matters the most  
(Focus on Content)

# **Clear, Concise, Interesting & Easy to Process**

**If you have to talk us through everything or respond to a lot of clarification questions, you have lost the battle before you've started.**

# **“Fast Facts”** – Single Page

<b>Company, Logo, Product Name</b>	
<b>Problem Statement</b>	<b>Leadership</b>
<b>Graphic</b>	<b>Advisors</b>
<b>Opportunity/Solution (Distinguishing Value)</b>	<b>Legal Counsel</b>
<b>Market/Target Audience</b>	<b>Accountant</b>
<b>Founders/Team</b>	<b>Raise (\$), Stage</b>
<b>Financial ProForma Synopsis</b>	<b>Contact Info</b>



# Executive Summary

- 1) One – Three Pages
- 2) Idea, Product, Team, Business
- 3) For Example:

- 
- |  |   |
|--|---|
| <ul style="list-style-type: none"><li>▪ Business Concept</li><li>▪ Market Opportunity/Problem Solved</li><li>▪ Product Offering/Technology (Graphic)</li><li>▪ (Clinical/Regulatory Pathway)</li><li>▪ Intellectual Property Status</li><li>▪ Business Model/Strategy</li><li>▪ Competitive Advantage(s)</li><li>▪ ProForma</li><li>▪ Competition/Market Circumstances</li></ul> | <ul style="list-style-type: none"><li>▪ Founders/Team</li><li>▪ Leading Advisors</li><li>▪ (Legal Counsel)</li><li>▪ (Accounting)</li><li>▪ Timeline &amp;</li><li>▪ Key Milestones</li><li>▪ Financial Offering</li><li>▪ Use of Funds</li></ul> |
|--|---|

# **Your Presentation (Pitch)**

- 1) See Addendum I**
- 2) Customized to Meeting or Event**
- 3) Ten to 20 Slides**
  - PLAN TO GO SLOWLY – 1 Minute +/-Slide\***
  - Same Info as Executive Summary**
  - Focus on Substance (but visually appealing)**
  - Again: Clear, Concise, Interesting, Easy to Process**

# Also

- 1) **Business Plan – Still Useful\***
- 2) **Private Placement Memorandum**
- 3) **Detailed Financial Model**
  - **Expense Side is instructive in re how you think**
  - **Assumptions underlying revenue forecast**
  - **Monthly Burn rate/cash consumption**
  - **Focus on lagging cash spend increase behind planned revenue growth**

**\* Think about the Lean Startup Business Model/Canvas and Discovery/Validation Method**

# **Due Diligence Material\***

- 1) Capitalization Table**
- 2) Contracts**
- 3) Material Agreements**
- 4) Employment Agreements**
- 5) Board Meeting Minutes**

**\*See "Resources at [www.venturedeals.com](http://www.venturedeals.com)**



# **A Few More Notes**

**“If you want money, ask for advice.”**

**“Do your homework. . . If someone insists that we sign an NDA before we review a plan, we know that they did absolutely zero research on our firm or us. At best the submission doesn't rise to the top; at worst it is ignored.”**

# **A Few Thoughts on the Term Sheet**

- 1) Entrepreneur's Perspective: "Think of it as a Blueprint for your Future Relationship with Your Investor."<sup>1</sup>**
- 2) Key Concepts: Economics and Control**
  - Economics – Return from a Liquidity Event**
  - Control – Mechanics allowing affirmative exercise over the business or veto decisions**
  - Important things to pay attention to: "They rule the day."**

# **Economic Terms**

- 1) Price**
- 2) Liquidation Preference**
- 3) Pay-to-Play**
- 4) Vesting**
- 5) Employee Pool**
- 6) Anti-dilution**

# Price

Usually, this - Price: \$ \_\_\_ per share (original purchase price) – fully diluted pre-money valuation of \$ \_\_\_\_\_ million and fully diluted post-money valuation of \_\_\_\_\_ million. . . . .assumes the conversion of all outstanding preferred stock . . .

Or this - Amount of Financing: An aggregate of \$ \_\_\_\_\_ million, representing a \_\_\_\_\_% ownership position on a fully diluted basis

Be certain you know what "*pre-money*" and "*post-money*" mean as well as "*fully diluted*" (referring to *employee or options pool*).



# The Matter of Options

- 1) Size of the pool is taken into account in the valuation of the company
  - VC may want option pool as large as possible. Come armed with a detailed option budget regarding planned hires, next financing date, approximate option grant to land each hire
- 2) Warrants – right purchase a certain number of shares at a pre-determine price.
- 3) Bridge loan – existing investor provides funds at a convertible debt (converts to equity) with a discount on the equity price

# **How do VCs Value Companies**

- 1) Stage of the company**
- 2) Competition with other funding sources**
- 3) Experience of the Entrepreneur**
- 4) Size & Trendiness of the Market**
- 5) VC's natural entry point**
- 6) The numbers**
- 7) Prevailing economic climate**

# Liquidation Preference

- 1) Impacts how the proceeds are shared
- 2) Actual Preference: A certain multiple (generally 1X) of the original investment per share is returned to the investor(holder of Series A Preferred) before the common stock receives consideration
- 3) Participation
  - Full – Receipt of liquidation preference, then share the rest
  - Capped – Receipt, then share up to a certain multiple
  - No – Receipt, but no sharing thereafter

# Examples: Four Scenarios\*

- 1) Preferred Series A, 1X Liquidation Preference, No Participation
- 2) Preferred Series A, 2X Liquidation Preference, No Participation
- 3) Preferred Series A, 1X Liquidation Preference, Full Participation (No Cap)
- 4) Preferred Series A, 1X Liquidation Preference, Participation up to 3X Cap

\* See Brad Feld and Jason Mendelson, Venture Deals (2016), pp. 45 – 53, for a full treatise on this topic with numerous scenarios and mathematics



# Example I

- One round of financing at \$5.0 MM Series A at a \$10 MM pre-money valuation
- So, post-money valuation = \$15 MM; investors own 33.3%
- WHAT IF: Company has a \$15 MM offer?
  - 1) 1X Liquidation Preference (LP), No Participation: 1X LP = \$5.0 MM, but so does converting to common at 33.3% & taking the proceeds that way.

## Example II (Same Offer)

- One round of financing at \$5.0 MM Series A at a \$10 MM pre-money valuation
- So, post-money valuation = \$15 MM; investors own 33.3%
- WHAT IF: Company has a \$15 MM offer?
  - 2) 2X Liquidation Preference (LP), No Participation: 2X LP = \$10.0 MM while converting to common at 33.3% results in \$5.0 MM. So, take the LP.

## Example III (Same Offer)

- One round of financing at \$5.0 MM Series A at a \$10 MM pre-money valuation
- So, post-money valuation = \$15 MM; investors own 33.3%
- WHAT IF: Company has a \$15 MM offer?

3) 1X Liquidation Preference, Full Participation (No Cap):  
1X LP = \$5.0 MM, while participating at 33.3% for the remaining \$10.0 MM (= \$3.3 MM). Total = \$8.3 MM

## Example IV (Same Offer)

- One round of financing at \$5.0 MM Series A at a \$10 MM pre-money valuation
  - So, post-money valuation = \$15 MM; investors own 33.3%
  - WHAT IF: Company has a \$15 MM offer?
- 4) 1X Liquidation Preference, Participation up to 3X Cap: 1X LP = \$5.0 MM, while participating at 33.3% for the remaining \$10.0 MM (= \$3.3 MM). Total = \$8.3 MM, same as Example III.



# Pay-to-Play

- 1) Usually relevant in down round financing
  - Company is struggling & needs another financing
  - In the event of a Qualified Financing, shares of Preferred A held by an investor who does not participate in this round is converted to Common Stock
- 2) Generally considered good for the company and its investors
  - Ensures that all investors agree in advance to the rules of the engagement concerning future financings

# Vesting

- 1) Typically stock & options vest over four years
- 2) Usually 25% at end of Year 1 (the "cliff"); remaining 75% over 36 months
- 3) If you leave before the end of four years, the vesting formula applies & you get only a percentage of your stock
- 4) Founders may get their 25% at close of financing

# The Employee Pool

- 1) Aka the "*Option Pool*"
- 2) Reserved for future issuance
- 3) Clarifies the capital structure & defines allocation %
- 4) Is redundant with the attached capitalization table, but manages possible confusion
- 5) VCs may want to inflate the pool

# Anti-Dilution

- 1) Used to protect investors in the event a company issues equity at a lower valuation than in previous rounds.
  - Ratchet-based, or
  - Weighted average



# **Control Terms**

- 1) Board of Directors**
- 2) Protective Provisions**
- 3) Drag-Along Rights**
- 4) Conversion**

# Board of Directors


Think carefully about proper balance

<p><u>Early Stage (3 Members)</u> Founder/CEO VC/Angel Outside Member (or Other Founder)</p>	<p><u>Early Stage (5 Members)</u> Founder CEO VC/Angel 2<sup>nd</sup> VC/Angel Outside Member</p>
--	---

- More mature board count is 7 – 9
- Outside member compensation: options (0.25% -0.50%, vested 2 – 4 years)
- Outside members invited to invest
- Instead of founder or investor control, protective provisions preferred

# Protective Provisions

Effectively veto rights on certain actions (generally standardized)

- 
- 1) Change terms of stock ownership
  - 2) Authorize creation of more stock
  - 3) Issue stock senior or equal to VC's
  - 4) Buy back common stock
  - 5) Sell the company
  - 6) Change certificate of incorporation or bylaws
  - 7) Change board size
  - 8) Pay or declare a dividend
  - 9) Borrow money
  - 10) Declare bankruptcy
  - 11) License away IP; effectively selling company

# Some Thoughts

- **Materiality Qualifiers** (e.g. changing terms of rights, privileges, preferences of preferred stock; authorized number of shares; certificate of incorporation or bylaws
  - Go for specificity rather than reasonableness (words such as “material” or “materially”); avoid the debate on what “material” means
- **What about provisions for future rounds?**
  - Series B gets its own protective provisions
  - Go along with original investors as a single class\*

\* As long your Cap Table is rational, things should be fine; keep your investors aligned

# Drag-Along Agreement

Generally two types:

- 1) Preferred shareholders “drag-along” the common (often regarding the sale of the company)
  - Small investors may want to go along with majority of common shareholders instead
- 2) Departed founder cannot play “hold-out” on voting matters



# Conversion

Preferred shareholders have the right – at any time - to convert to shares of common stock.

Automatic Conversion (specified applicable conversion price) – in the event of an IPO\*

\* Regardless of thresholds, you should not allow investors to negotiate different automatic conversion terms

# Capitalization Table

COMPANY NAME							
CAPITALIZATION TABLE							
	Number of Shares	Original Issue Date	Price Per Share	Total Purchase Price	% of Class	% of Issued Shares	Fully Diluted % of Ownership
Founder Common Shares:							
Name			\$0.0001	0.00	NA	NA	NA
Name			\$0.0001	0.00	NA	NA	NA
Name			\$0.0001	0.00	NA	NA	NA
Name	-		\$0.0001	0.00	NA	NA	NA
Name	-		\$0.0001	0.00	NA	NA	NA
Name	-		\$0.0001	0.00	NA	NA	NA
Name	-		\$0.0001	0.00	NA	NA	NA
Name	-		\$0.0001	0.00	NA	NA	NA
	Total Common Shares	-	\$0.0001	\$0	0.00%	0.00%	0.00%
Preferred Shares - SEED							
	-		\$0.50	0	NA	NA	NA
	-		\$0.50	0	NA	NA	NA
	-		\$0.50	0	NA	NA	NA
	-		\$0.50	0	NA	NA	NA
	Total Preferred Shares - SEED	-	\$0.50	\$0	0.00%	0.00%	0.00%
Preferred Shares - SERIES A							
	-		\$5.00		NA	NA	NA
	-		\$5.00		NA	NA	NA
	-		\$5.00		NA	NA	NA
	-		\$5.00		NA	NA	NA
	Total Preferred Shares - SERIES A	-	\$5.00		0.00%	0.00%	0.00%
Preferred Shares - SERIES B							
	-		\$0.00	0	NA	NA	NA
	-		\$0.00	0	NA	NA	NA
	-		\$0.00	0	NA	NA	NA
	-		\$0.00	0	NA	NA	NA
	Total Preferred Shares - SERIES B	-	\$0.00	\$0	0.00%	0.00%	0.00%
TOTAL SHARES ISSUED							
	-			\$0		0.00%	0.00%
Convertible Loan Shares - Common/Preferred							
							NA
Optional Reserve Convertible Loan Shares							
							NA
	Total Common	-	\$2.50	\$	-		0.00%
Restricted Common Stock Employees							
							NA
	Total Restricted Stock - Vesting		\$2.50	\$	-		0.00%
Stock Options							
Stock Option Plan Reserved Shares							
							NA
Options Available for Grant							
	0						NA
Total Available Option Pool							
	0						NA
TOTAL CONVERTIBLE SECURITIES							
	-			\$	-		NA
TOTAL FULLY DILUTED EQUITY							
	-						
Shares Authorized by Articles of Incorporation							
Common Stock							
Preferred Stock							

- 1) How does a typical *capitalization table* work?
- 2) Summarize who owns what part of your company before and after financing
- 3) What will I own if someone or an entity invests X% in my company at a Y valuation?

← **Template Available (mkleckner@cox.net)**

# A Simple Example

Class	Shares	Preferred Price	Valuation	Percentage
Founders	2,000,000	-	-	A
Employee Pool	B	-	-	20%
Investors	C	D	\$5.0 MM	33.33%
<b>TOTAL</b>	<b>E</b>	<b>D</b>	<b>\$15.0 MM</b>	<b>100.0%</b>

- 1) 2 million shares held by founders before investment
- 2) \$10 million pre-money valuation; \$5 million invested
- 3) Post-money valuation = ? (\$15,000,000)
- 4) IF new employee option pool = 20% (post money basis; unallocated after investment)
- 5) A = ? What is the Total Shares amount (E)? ( $2,000,000/A = 4,285,408$ )
- 6)  $B = E * 0.20 = 857,081$
- 7)  $C = E * 33.3\% = 1,428,326$
- 8)  $D = \$5,000,000/1,428,326 = \$3.50$  per share

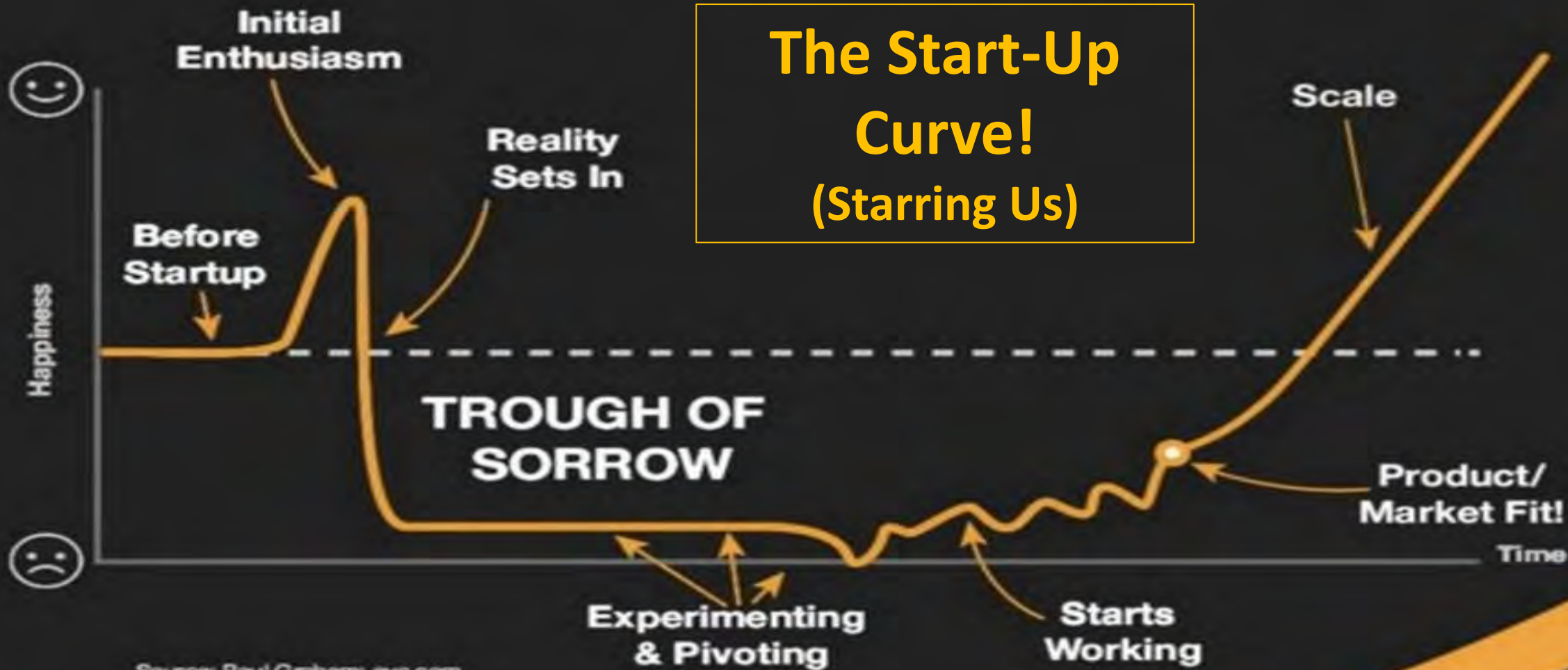
**Addendum IV:**  
**Telling Our Story**

# Your Story: The Hero's Journey





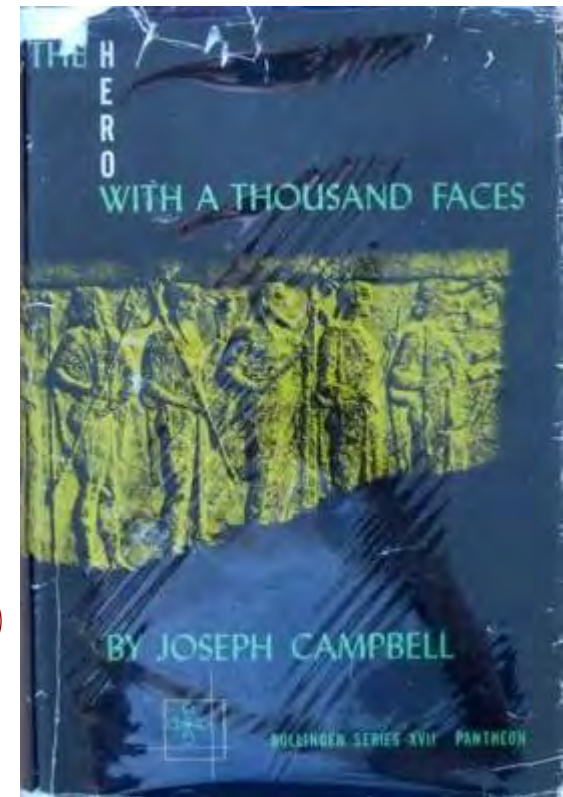
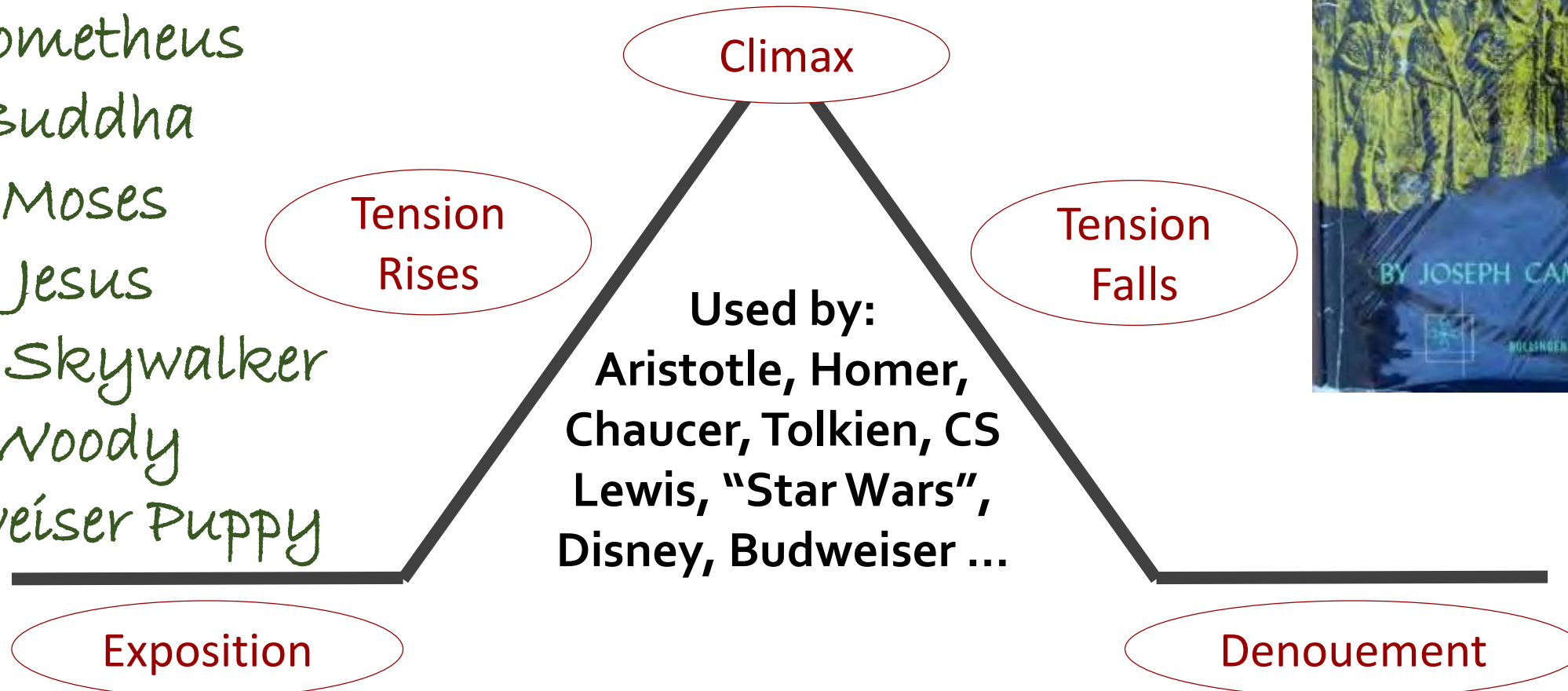
# Behind Every Innovation is a Great Story



Source: Paul Graham; avc.com

# Your Story Matters

Osiris  
Prometheus  
Buddha  
Moses  
Jesus  
Luke Skywalker  
Woody  
Budweiser Puppy



How important are those customer interviews?



A misty forest path with text overlays. The path is covered in snow and leads through a dense forest of bare trees. The atmosphere is soft and ethereal. Three text boxes are overlaid on the image: a yellow box in the top left, a brown box in the middle, and a blue box in the bottom right.

# Why do our Stories Matter?

Brain Science: Insula

Dopamine (Hope/Optimism)

Cortisol (Stress)

Oxytocin (Connection/Empathy)

***"Get Out of the Building!"  
Get Proof/Evidence. Discover and  
Validate!***

***Martin Kleckner III PhD MBA, Advisor  
University of San Diego BRINK SBDC  
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mkleckner@cox.net***

