# Mind Shaker Meeting
# Team Building

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CAMERA DI COMMERCIO MILANO

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Milano
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# The world of investors

1. Where to raise new funds : who are the investors
2. Different investors for different stages of the company
3. Investing in start up companies : how it happens

# The world of investors

## 1. Where to raise new funds: who are the investors

# Start up and investors

*A - Seed money from family and friends*

*B - Business angels or private investors*

*C - Private equity or Venture Capital funds*

*D - Fresh money from extraordinary deals (m&a) with other companies*

*E - Going public: listing in the stock market*

*… but the early stage company needs more then just money ….*

# Start up and investors

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### *A: Seed money from family and friends*

The entrepreneur inject fresh money in the company helped by his family and friends

*POSITIVE*

- Very easy and fast, with no needs to build business plan or discuss with other investors
- Corporate governance and controlling structure speed up strategic decision

*NEGATIVE*

- Financial resource extremely limited
- Extremely high exposure of the entrepreneur on his business activity
- lack of new competences and expertise
- risk of slow down in growth due to the limited financial and professional resources

# Start up and investors

## *B: Business angels or private investors*

Selling minorities stake of the company to new partners

*POSITIVE*

- Fresh money and new expertise in the company
- New professionals easy to integrate within the management team of the company
- Looking at history, investors with entrepreneurial experience succeed on investing in start up/early stage company also thanks to their support in the developing of the business
- Flexibility and speed in the investment decision by the new partner

*NEGATIVE*

- New corporate governance and new controlling structure in the company
- Rather limited capital injection

# Start up and investors

## *C: Private equity or Venture Capital funds*

- Institutional firms with money mainly coming from institutional investors
- They invest in risk assets mostly not listed in the stock market

*POSITIVE*

- Fresh money
- Improves the corporate governance
- Financial help also thanks to relationship with banks
- Getting ready for going public

*NEGATIVE*

- Due diligence very complex and long
- Very limited help in the managing of the company
- Excess use of financial leverage

# Start up and investors

### *D: Fresh money from extraordinary deals (m&a) with other companies*

Merger with companies with strong balance sheet or that can help the developing of the business trough synergies both on revenues and costs

*POSITIVE*

- Synergies on the cost side: reducing the breakeven
- Enhance the value of the assets in case of merger
- New competences and professional expertise
- Increase the reference markets and improves the economy of scale

*NEGATIVE*

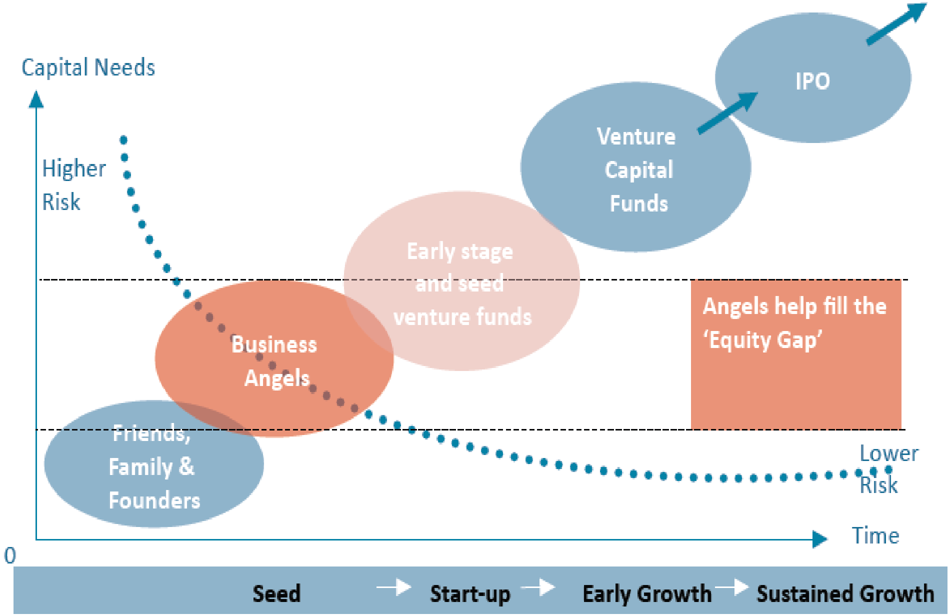
- Complex corporate governance
- Reduction in costs is hard to achieve for start up companies
- Mergers “do not exists”, they always hide an acquisition

# The world of investors

## 2. Different investors for different stages of the company

# Start up and investors

Business Angels fill the Equity Gap



# Different investors for different stages of the company

**New funds from new partners : different amounts during the different stages of the life cycle of the company**

- **Seed**
  - In the early stage focus is on product and market analysis and Incubators can help the company in the very early stage.
  - Money comes from private investors

- **Start up**
  - After the start up focus moves on time to market, commercial and marketing strategy.
  - Money comes from group of investors or professional investors.

- **Early growth and sustained growth**
  - During the expansion focus is on revenues, commercial development and new markets (and don't forget innovation).
  - Venture Capital or Private Equity funds first and IPO later can support the expansion stage of the company.

# Different investors for different stages of the company

- **Friends & Family – € 20k / 50k – "Seed Capital"**
  - Very early stage
  - Investors close to the entrepreneur
  - Incubators

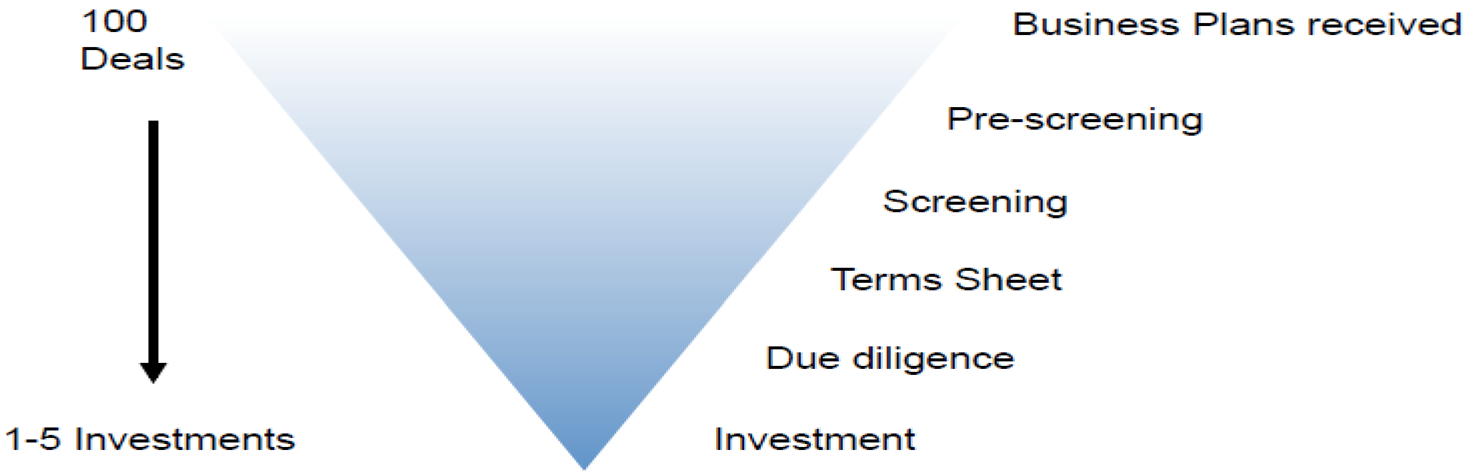
- **Business Angels / Private investors – € 50k / 1.000 k for single investment– "Startup Capital" and early stage "Expansion Capital"**
  - semi-professional (mainly former entrepreneur, manager, financial or business consultants) investors driven by the quality of the idea or the management team
  - Group of business angels operating as part of syndicates.

- **Venture Capital – € 1.000k / 5.000 k per single investment – "Expansion Capital":**
  - Funds (VC or PE) focusing on innovative and growth companies
  - Backed by institutional investors or banks

# The world of investors

## 3. Investing in start up companies : how it happens

# Start up and investors




Source: EBAN Research Committee

# Start up and investors

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## Business angel network and professional investors : how they invest in start up company

1. Pre-screening

   An internal team analyze and makes a pre-selection of the deals…

2. Screening

   The business angels / partners select the best ideas and collect the investment propositions…

3. Term sheet and corporate governance

   Business angels play an important role in writing a new corporate governance; focus on valuation and exit strategy.

4. Due diligence

   Business angels and consultants make in depth analysis of the company and of the product/ markets

5. Execution of the investment

   after the *due diligence* the partners of the network collect and invest their money in the company through a dedicated vehicle (closing of the deal )

# Start up and investors

Investment analysis in early stage company : **PRE- SCREENING**

Reading of the Executive summary, focusing on :

- is the idea really innovative ?
- is the market really growing / has strong growth potential ?
- is the business model scalable ?
- is the company / product in line with own investment philosophy?
- Categories of investors :
  a) growth investors
  b) technology/innovative investors
  c) value investors
  d) turn around investors
  e) sector theme investors (digital, alternative energy, ....)

# Start up and investors

Investment analysis in early stage company : **SCREENING**

- Very careful Reading of the Business plan
- Meeting with the management
- Analysis of the business idea with the help of sector experts
- Analysis of the management team, its background and its commitment
- Sensitivity analysis of the future prospects
- What if analysis, assuming different assumptions on market growth, volumes and revenues focusing on cash burn
- Weakness and potential action to improve the company's structure and mgmt team
- Corporate governance and Exit strategy :  first considerations

# Start up and investors

Investment analysis in early stage company : **TERM SHEET AND CORPORATE GOVERNANCE**

- Focus on valuation methodology, work/experience already brought in the company by the management , goodwill
- Focus on the structure of the deal
- Focus on legal issues related to the deal
- Focus on valuation and exit strategy
- Focus on shareholder structure after the deal
- (stake for mgmt. team vs. stake for financial investors)
- Corporate Governance : focus on control and power pertaining to financial investors
- Focus on costs related to the mgmt team: wages, incentives and lock up agreements

# Start up and investors

Investment analysis in early stage company : **DUE DILIGENCE**

- Several Meetings with all the management team and other partners
- Meeting (together with the mgmt. ) with potential / actual supplier and clients
- In depth analysis of the annual financial reports or the start up program (focusing on legal company, stated book value, financial position , other asset)
- In depth analysis of the product/services , the technology innovation and the intellectual property
- In depth analysis of the reference market and the customers needs
- In depth analysis of the competitors
- In depth analysis of the cost structure
- In depth analysis of the economics and future prospects
- In depth analysis of cash flow and financial needs

# Start up and investors

Investment analysis in early stage company : **EXECUTION OF THE INVESTMENT DEAL**

- Cash to be invested , valuation of the company ---> stake sold to investors
- Corporate governance : legal shareholders agreement
- Execution of the deal with the help of legal experts
- Exit strategy

- …. and now we go , keeping in mind what investors want!!!
  - Stake in the company : from 20 to 49%
  - Corporate Governance : a seat in the BOD with some veto power
  - Return from investment : at least 30% per year
  - Valuation : Correlation between goodwill and founders wages
  - Exit strategy : clear finish line before starting

# Corporate governance

# Start up and corporate governance

Corporate governance, contracts and documents:

- By laws

  ….or the official document of the company

- Shareholders agreement

  ….or the corporate governance

- The purchase agreement

  …or the deal's contract with counterparts

# Start up and corporate governance

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**Corporate governance, key issues:**

- Board of Directors
  - Representatives
  - Veto power
- Founders
  - Incentives/wages
  - Lock up
- Shares’ transfer or Liquidity mechanisms
  - Pre-emption rights
  - TAG along
  - Drag along
  - Put and call
- Exit strategy or Way out

**The Shareholders Agreement**

- What is it:
  It is a contract between the shareholders (both founders and financial investors) of a company

- Why it's so important:
  It includes all obligations, protections and rights of the shareholders. Very important for minority shareholders

- What are the main issues :
  Issues related to founders, corporate governance, shares and exit strategy…or the corporate governance of the company

- What is the main purpose:
  To Structure the relationship between shareholders of one company

- When is usually needed :
  For possible problems between shareholders with predefined solutions

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## shareholders agreement : Board of Directors

- **Board representation** : Usually BOD has at least 1 financial investor…

  …investors want to seat just near by the driving seat and control where the car is going
- **Veto power** : investors want to have power on few, but important issues such as :
  - approving budget
  - new investments
  - incurring new debt
  - board and founders remuneration
  - Hiring and firing of directors
  - Costs above certain amounts ;
  - Divided policy

# Start up and corporate governance

**shareholders agreement : Founders**

- Non competitive agreements
- wages
- Incentives : benefits related to goals achieved, not necessarily profits
- Change of the mgmt

if targets are not reached for clear mistakes related to mgmt behavior

- Lock up

Lock-up Period (usually the lock up period last 4-5 years)

The period of time that certain stockholders have agreed to waive their right to sell their shares. The shareholders that are subject to lockup usually include the founders of the company. If a shareholder attempts to sell shares that are subject to lockup during the lockup period, the transfer agent will not permit the sale to be completed

## shareholders agreement : Shares' transfer

- **Pre-emption right** : if founders/other shareholder sells its stake I have the right (if I want) to BUY it
- **Stock option** or other "Exit driven" bonus: Typically for founders and managers when certain goals are reached
- **Liquidation preference:** Privilege to typically financial shareholders In case of liquidation of the company
- **Puts and calls**

A **put option** allows a particular shareholder (usually minority holders) to require another shareholder to buy its shares for a predetermined price or for a price determined on the basis of a predetermined formula within a given time period

A **call option** allows a shareholder (usually majority shareholder) to buy a particular shareholder's shares for a predetermined price or for a price determined on the basis of a predetermined formula

## shareholders agreement : Shares' transfer

- **Tag along**

The right assures that if the majority shareholder (or founders) sells his stake, minority holders have the right to join the deal and sell their stake at the same terms and conditions as would apply to the majority shareholder

or….: if founders/other relevant shareholder sells its stake I have the right (if I want) to SELL also my stake (proportionally) to the buyer

- **Drag along**

The right assures that if the majority shareholder, or a specific percentage, wants to sell his stake to a third party, then have the right to require that other shareholders sell their shares to the third party

Or….: A majority shareholders' right, obligating shareholders whose shares are bound into the shareholders' agreement to sell their shares into an offer the majority wishes to execute.

## Exit strategy

What investors want? clear finish line before starting

- Investment period :
  - usually 5-10 years for professional investors;
  - private investors could decide to stay for longer…

- The most likely solutions are :

  1) buy back : management buyout
  2) Trade sale: New financial investors buying the financial investors' stake
  3) Trade sale: disposal of the entire company to industrial group

## Exit strategy

1) **Buy back or Mgmt buyout: the founders buy back the financial investor stake after 3-5 years**

**Positive** :

- best solution for the company with the mgmt. controlling the entire capital;
- easy execution because does not involve third parties

**Negative** :

- no guarantee that the mgmt. will be able (financially speaking) to buy the stake owned by financial investors;
- valuation methodology to be decided before starting, but valuation is generally low because it hardly includes the value of goodwill

# Exit strategy

**2) Disposal of the financial investors minority stakes to new financial investors (…from BA to VC or Private Equity or IPO)**

**Positive** :

- best solution for the financial investors as they can maximize their investment;
- New shareholder gets in the company typically bringing fresh money and stronger push on growth potential

**Negative** :

- in Italy it is hard to find VC funds while in US (silicon valley in particular) is the most frequent exit strategy

# Exit strategy

### 3) Trade Sale: Disposal of the entire company to industrial group

**Positive** :

- best solution for all shareholders in terms of investment return (thanks to control stake premium);
- very likely in particular for company with clear competitive advantage

**Negative** :

- The mgmt. and founders are forced to sell their stakes and to leave the company in the hands of new shareholders

# Shareholders agreement

## Case study

# Corporate governance : case study

## Corporate governance and shareholders agreement

- Shareholders : 3 founders and a group of financial investors (business angels)
- Shareholder structure : founders = 60%; financial investors =40%

Corporate governance and shareholders agreement :

1. Shareholders meeting : quorum
2. Board of Directors , structure and veto power
3. Founders : constraints and duties
4. Pre-emptive rights constraints and duties for the disposal of minority stakes
5. Constraints and duties in selling the entire company
6. Exit strategy for the financial investors

# Corporate governance : case study

## Shareholders meeting : quorum

Shareholders meeting : Quorum increased from 50% to 75% for the following resolutions :

1. capital increase
2. changes in the charter and status of the company or major changes in the shareholders rights;
3. dividend policy;
4. acquisition or disposal of stakes in other companies;
5. disposal of company's business units;
6. Merger or acquisition deals;
7. issue of financial debt instruments.
8. acquisition or disposal of real estates properties;
9. Medium/long term financing for amounts above a predefined level;
10. Board of directors remuneration;
11. founders remuneration and incentive schemes;

## Board of Directors , structure and veto power

- Structure : the shareholders agreement will vote for the board of directors with the following structure : 3 directors, out or which 2 appointed by the founders and 1 appointed by the financial investors
- Directors will vote and make resolutions with the absolute majority
- Board of Directors will make resolution with the full approval of the directors on the following issues (or each director has a veto power):

  a) annual budget and Business Plan, that will be discuss during the shareholders meetings;

  b) financing with debt or other financial instruments for amounts above predefined level;

  c) signing contracts that could require cash payment above a predefined level;

# Corporate governance : case study

## Founders : constraints and duties

- The stakes owned by the founders cannot be sold within a period of at least 5 years.
- The founders are obliged for the entire period of the shareholders agreement to do not develop directly /indirectly an activity in Italy or abroad that could be in competition with the company.
- There is no incentive schemes or predefined level of wages for the founders

# Corporate governance : case study

## Pre-emptive rights constraints and duties for the disposal of minority stakes

- The shareholder that wants to sell its stake to a external buyer party must inform all other shareholders. The other shareholders can decide to buy the stake sold at the same price **(pre-emption right)** ;

- If **one of the founders** sell its stake to external buyers, the other shareholders can decide to buy the stake sold at the same price or …
- …other shareholders can decide to sell part of their stakes to the buyer at the same price **(Tag along)**

- Assuming the buyer do not want to increase the shares to buy, all the shareholders that have decided to sell their stake will sell to the buyer a portion of their stakes. This is a minority-shareholder protection affording the right to include their shares in any sale of control and at the offered price.

# Corporate governance : case study

## Constraints and duties in selling majority stakes

- **Assuming that at least 75% of the capital** will receive from a third buyer an offer for the acquisition of the entire company,  they will have to possibility to accept the offer and to obliged all other shareholders  to sell their stakes (assuming they will no decide to buy the stake sold according the pre-empty right). **Drag along**

- In case of exercise of the drag along, the other shareholders will be forced to sell their stakes at the same conditions and price

- **Call option**: there is no right to buy shares by the founders (or other shareholders) from  the financial investors (or other shareholders) at a given price within a given time period.

- **Put option**: there is no right to sell  shares by financial investors (or other shareholders) to the founders (or other shareholders) at a given price within a given time period.

# Corporate governance : case study

## Exit strategy for the financial investors

- **Starting from the fifth year**, in case of more then 51% of the financial investors ask for it, all the shareholders will work on the best solution for the exit strategy and in particular they will work on a possible disposal of the financial investors stake or of the entire company.

- All the shareholders will work on a possible disposal of the stakes owned by financial shareholders (or other shareholders) to the founders (or other shareholders).

- In case no concrete solutions will be found, **within 2 months the way out through the disposal of the entire company will take place**.

- The shareholders will give mandate to a primary investment bank to find the buyer for the entire company.

- In case the offer price will be consider fair by at least one 51% of the financial investors , the **disposal of the company will take place** and therefore all shareholders will obliged to sell their stakes.