

15.391 Early Stage Capital F10

Framework II: Venture Capitalist Simulation Rounds

I. Overview

Armed with keen and trenchant insight from your lawyer round, your team will now formulate its negotiating strategy for reaching the best deal with your VC, and meet for a round of negotiation with a venture capitalist.

II. Mechanics

- Most of the general process of the VC round is the same as for the lawyer round. You will be in the same roles for the same MIT/FIT Corp.-based startup, relying on the same Fact Packet background you used in your lawyer round. You (and your VC) will be using the same Firm Profile and filled-in term sheet you previously prepared.
- As an option, please provide a copy of your real resume. We will include those with the other documents we send to your VC. As you know, ESC is all about building informal networks, and this is an easy way to build a connection that will last after your simulation round is long done.
- The format is the same as the lawyer rounds. The simulation will last approximately 60 minutes. This session is then immediately followed by 30 minutes of unstructured feedback and Q&A with the VC.
- The VC rounds will run between Lec #7 and Lec #11, typically in the evenings.
- The primary difference in the work product for this round is the 2 forms of agenda you must prepare. These are discussed in detail below. The **Strategic Internal Agenda is the critical deliverable** in this course and requires considerable preparation. Please take it seriously.
- You must provide James Luong with the 2 forms of agenda 24 hours before your scheduled round. Provide him with a hard copy of each agenda as well as electronic versions.
- James will forward your firm profile, filled-in term sheet and the *external* agenda (only) directly to the VC as soon as received, for the VC's review prior to the round.
- It is your responsibility to manage scheduling conflicts among team members and to schedule sufficient time between your lawyer and VC rounds to allow adequate preparation.
- The meetings will take place at the VCs' offices. You must coordinate transportation with your team members.

- Most of the VCs' offices are located in Waltham and can be tricky to find the first time. You are responsible for allowing sufficient time to get to your VC's office before your meeting time.
- We will notify you of any relevant security and building clearance requirements for each firm.
- Many teams wear jacket and tie, to add to the seriousness of the exercise. Attire is at your discretion, however.

III. Work Product

A. Pre-Meeting Work Product

Teams will collectively prepare the following 2 forms of agenda. In addition, James will also forward copies of your previously prepared Firm Profile and filled-in Term Sheet to your VCs. (You do not need to resend these.) **The agendas should be submitted to James Luong at least 48 hours prior to your scheduled round. Please provide one hard copy of each agenda as well as electronic versions.**

1. *External meeting agenda.* This document should be an objective, rather spare outline that prioritizes your issues to be discussed. It should be a product of your lawyer meeting notes together with conclusions from team discussion regarding the priority provisions you want to negotiate with your VC. The agenda should outline 2-4 priority issues you are prepared to negotiate as critical deal points at your VC session. Include *minimal* elaboration in the outline. As well, although you will likely have insufficient time to cover them all, your agenda should also list (in *roughly* descending order) all other issues your team finds objectionable in the term sheet. This is the "issue-spotting" part of the exercise; it is objective and will be graded accordingly. The goal is to demonstrate your ability to identify all potential hot spots lurking in a term sheet.

2. Internal strategic agenda. This document should reflect the team's internal negotiating strategy, and a *candid* analysis of how the team has set its priorities.

The internal strategic agenda should clearly demonstrate the team's understanding and mastery of the material covered in this course:

- basic term sheet provisions
- business and financial implications of relevant legal jargon
- customary market practice and norms for term sheet provisions
- standard alternative proposals and compromise tactics
- comparative advantages of short- and longer-term tradeoffs
- motivating factors, drivers and rationale for deal points, from the VC's perspective ("know your investor")

When properly drafted, the internal agenda will make a persuasive case for why and how the team has chosen to balance and trade off relative priorities. A sample internal strategic agenda will be posted in the “Simulation Materials” folder on Stellar. **Important:** The internal strategic agenda will **NOT** be provided to the VC.

The internal strategic agenda represents the major deliverable of this course, and will be graded as such in lieu of a final in-class exam.

B. Post-Meeting Work Product

Meeting summary. A collective appraisal of the simulation. For purposes of the final VC Round-Up class session, please summarize the bottom line of your deal, detailing the major substantive provisions that were agreed to, as well as listing any “standards” or “firm philosophies” that the VC holds to. (For example, “At Greylock, we don’t believe in participating preferred.”) Also highlight any inconsistencies between lawyer’s advice and VC’s position. Include your team name and members’ names. Provide to James within 48 hours after your meeting (or sooner, if your round is near the last day of class).

C. End-of-Course Work Product

Peer evaluation. Individual confidential appraisals of the constructive participation (or otherwise) of the other members of your team. This will take place at the end of the course and cover all aspects of team work. These will be done by email and be reviewed by me only.

IV. Simulation Round Mechanics

A. Valuation

- For purposes of this meeting, assume that valuation discussions are ongoing. You value your company pre-money at \$6 million; you are shopping for a \$4 million investment (resulting in a \$10 million post-money valuation and giving up 40% of the company). The current offer values the company at \$4 million pre-money, with a \$4 million investment for 50% of the company, resulting in an \$8 million post-money valuation. Although you are not ready to accept these numbers, you feel comfortable that you are making progress and that you will resolve the valuation question satisfactorily.
- You have agreed, however, to table discussions on “pure” valuation at this meeting, and take up the other points your team has flagged in the term sheet. ***That is, valuation is deemed an excluded provision from the negotiations.*** This is done in large part to force you to focus on the relative values of the “non-monetary” provisions that will form an important part of your deal, your control and your ownership.

B. Substantive technology

- The technology described in this exercise is deliberately vague. This is done 1) to keep the exercise focused properly on the investment negotiation process, and 2) to marginalize the background material our professional participants (and you) need to be familiar with.
- Substantive technological expertise is irrelevant to the goals of the negotiation. All teams (and professionals) have been provided with the same packet of substantive information. All negotiations should be based solely on the information provided.

V. Approach and Performance Guidelines

- You should assume that you are working with only one VC. This will be the second meeting on the term sheet. You believe you have established a positive, non-adversarial working relationship and a good rapport.
- As in real life, you will meet your VC without your lawyer.
- While the VC values your first-mover advantage and the mammoth size of your potential market, they (and you) do stay awake at night worrying about maintaining your lead time and staying ahead of the competition. Your team, while very committed and experienced, is unseasoned in a startup context. You are not a slam-dunk.
- The VC firm is a respected, experienced group, although not particularly active in this sector. The tone of the meeting is not initially tense or confrontational; you shouldn't enter with a sense that you are negotiating "deal-breaker" provisions. Rather, these are priority provisions that your team has agreed are important to MIT/FIT Corp. and to your vision of what you want the firm to become.
- This is a negotiation involving a great deal of money and the loss of some control of your company, and it is essential that you make every effort to persuade the VC of your views where they differ materially from his or hers. Never lose sight of the fact, however, that at the end of this negotiation, you'll have to live with this new partner. Banging the table with your shoe is not a good way to start.
- Also, bear in mind that the VC will be doing other kinds of due diligence during the negotiation—looking at character, integrity, leadership, management skills and teamwork. Those intangibles are critical in how he evaluates the potential of the venture. *Foster some trust*; help her lower her risk assessment of your team—you'll probably get a better deal as well.

- **Points that bear repeating**

- Teams determine the roles and responsibilities of the members in the meeting. For example, each team member may speak for 15 minutes about a particular issue or concern, or one member may act as an obsessive CEO and do all the talking. This decision should be reflected in the agendas.
- Come to the office “in character.” Introduce yourselves as founders of your firm, not MIT students. (Receptionists will know only that you are from a new portfolio company. Act the part.) This all enhances the value of the simulation, and makes it much easier to get the meeting started. (No awkward metamorphoses before the VC’s eyes.)
- On the other hand, any simulation must balance the value of role-playing and verisimilitude against the goal of education. As this is not a course on negotiation, the role-playing should yield to opportunities to learn more, even if it takes you “out of character.”
- The feedback period, after the simulation, is not structured. The VCs will give their impressions, and then allow for team members to ask questions. You should not be playing any roles. This is the time to exchange your real MIT business cards with your VC.

VI. Resources

We will likely be working with a mix of the following VC firms:

- Battery Ventures, www.battery.com
 - CommonAngels, www.commonangels.com
 - Commonwealth Capital Ventures, www.commonwealthvc.com
 - Flybridge Ventures, www.flybridge.com
 - General Catalyst Partners, www.generalcatalyst.com
 - Globespan Capital Partners, www.globespancapital.com
 - Highland Capital Partners, www.hcp.com
 - Kepha Partners, www.kephapartners.com
 - Next View Ventures, www.nextviewventures.com
 - Northbridge Venture Partners, www.nbvp.com
 - Polaris Ventures, www.polarisventures.com
- Familiarize yourself with your VC’s history of investment, sector focus, operating history, and general philosophy of investing. Most firms have extensive websites. Educate yourself and know your investor.
 - In most cases, we will be able to tell you prior to your round the name of the specific individual whom you will be meeting with.

VII. Power of Informal Networks, Release 3.0

While the VCs participating in these exercises are busy professionals, they have a vested interest in making connections at MIT. To the extent you can engage your VC in some part of the spectrum of MIT and Sloan activities, do so. Some of the participating firms are very active here, others less so. Some are very high profile; some are younger or less well-known. It's up to you to understand your VC and to determine how and in what way you can build your links. Can you foster more interaction? Invite your VC to a conference or club event in which you are active? Look for *natural* ways to build your informal networks, for the benefit of yourself and Sloan, *and* your VC.

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15.391 Early Stage Capital
Fall 2010

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