CREATING COMPELLING OFFERS

Module 4

Module 4: Creating Compelling Offers

Introduction

Lesson 1

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Introduction

Creating compelling offers by employing:

Design thinking

Investor-centric design methodologies:

- “Fish where the fish are.”
- “To get the fish you want to bite, present the food they prefer to eat.”

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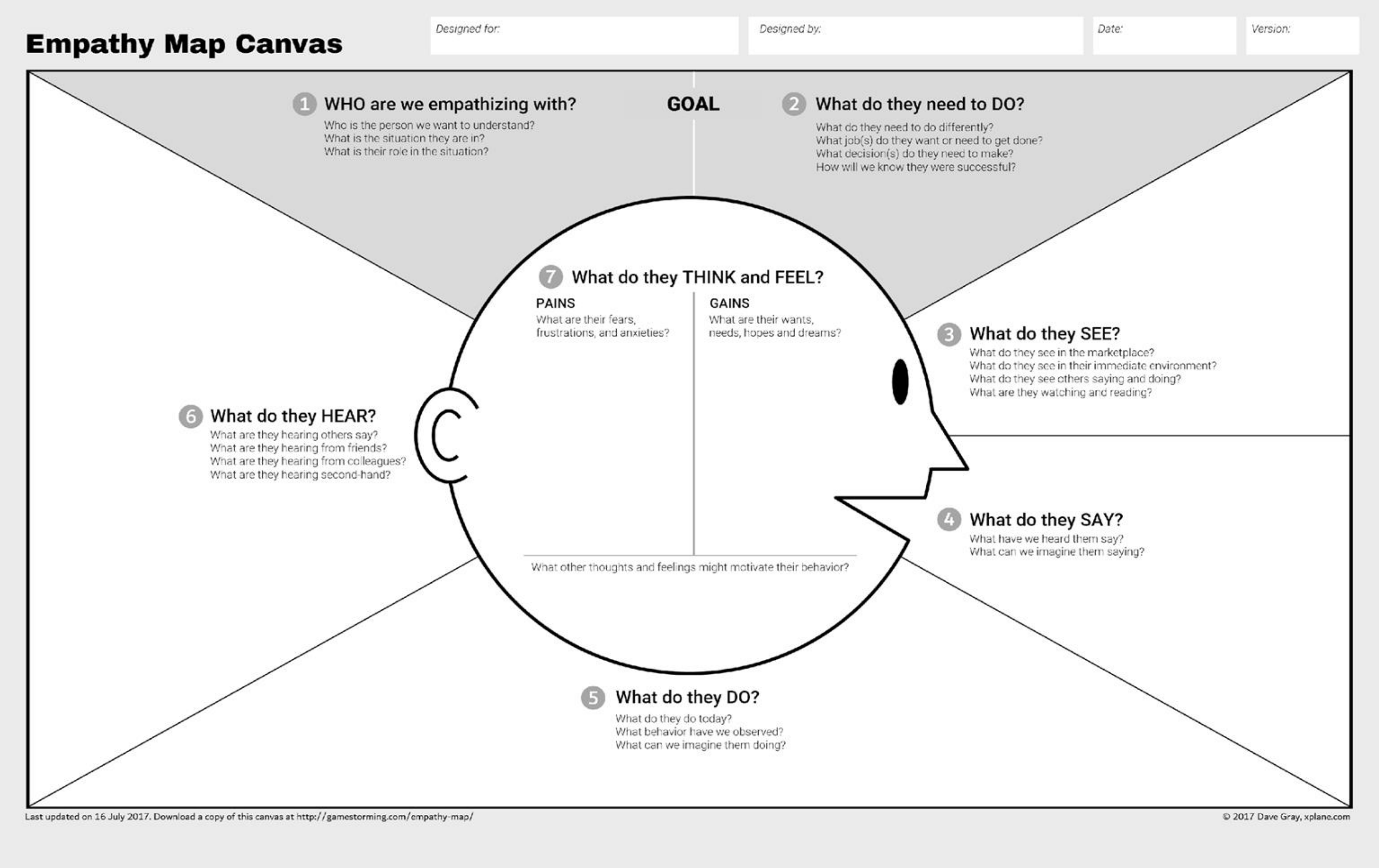
Investor Personas and Empathy Maps

Lesson 2

Investor Personas and Empathy Maps



You can download this map or text version of empathy map exercise in your Venture Finance Module 4 Lesson 2 downloadable files area.

Source: https://medium.com/the-xplane-collection/updated-empathy-map-canvas-46df22df3c8a

Investor Personas and Empathy Maps

If you want to see things from an investor's perspective, then you need to do the work, using the Empathy Map Canvas (invest 30-60 mins):

1. Who are you empathizing with? **Who** first, then **what**.
2. What do they need to DO?
3. What do they SEE?
4. What do they SAY?
5. What do they DO?
6. What do they HEAR?
7. What do they THINK and FEEL (pains and gains)?

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Ten Investor Profiles

Lesson 3

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Ten Investor Profiles

1. Friends, family and fools (FFF).
2. Crowdfunding (4 basic types).
3. Business incubators.
4. Business accelerators.
5. Angels/super angels.
6. Micro VC's.
7. Traditional VC's
8. Corporate venture capital and corporate innovation groups.
9. Venture debt/venture leasing.
10. ICO (Initial Coin Offering) and STO (Security Token Offerings).

Friends, Family and Fools

Lesson 4

Friends, Family and Fools

- The most frequent source of capital to start businesses.
- Tend to be based on “personal relationships,” subjective feelings.
- Although this source of capital is probably most generous (not always – depends on family), best practice is to treat them like you would a professional angel:
  - Common stock
  - Convertible debt
  - Debt with warrants (upside on top of return of capital + interest)
- “Personal guarantees” – be careful, they can come back to bite you.
- Typical investment from $20-300K.
- Valuation methodologies vary – concept and pre-revenue stage hard.
- Valuation “averages” vary – industry and geography matter a lot.

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Crowdfunding

Lesson 5

Crowdfunding

Four basic types:

- **Rewards-based crowdfunding:** backers give a small amount of money in exchange for a reward.
- **Donation-based crowdfunding:** donors give a small amount of money in exchange for gratitude and the feeling of supporting a cause they believe in.
- **Equity crowdfunding:** investors put large amounts of money into a company in exchange for a small piece of equity in the company.
- **Debt crowdfunding:** lenders make a loan with the expectation of making back their principal plus interest.

Crowdfunding

Benefits:

- Market validation
- Consumer feedback
- Legitimacy and exposure
- Funds

Crowdfunding

Drawbacks:

- It is a LOT of work.
- You pay out at least 8-12% of proceeds.
- Most campaigns fail.
- Funds frequently do not support future growth.
- For equity crowdfunding, you could also end up with a massive shareholder base that is difficult to manage (make sure you have a vehicle to act as shareholder representative for the “crowd” to manage shareholder communications and voting).

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Crowdfunding

- Links to additional resources:
- https://blog.feedspot.com/crowdfunding_blogs/
- http://crowdfundinghacks.com/best-of-crowdfunding-hacks/
- https://www.bigcommerce.com/blog/benefits-and-drawbacks-of-crowdfunding/
- https://www.smartcompany.com.au/startupsmart/advice/crowdfunding-pitfalls-the-legal-risks-startups-need-to-know-before-running-a-crowdfunding-campaign/
- https://www.strictlybusinesslawblog.com/2018/01/31/legal-pitfalls-rewards-based-crowdfunding-campaigns/

Business Accelerators

Lesson 6

Business Accelerator

- The purpose of a business accelerator program is to help very early stage ventures (sometimes pre-incorporation) do more, faster by nourishing the founders/early employees with support, connections, knowledge, training and seed capital. There are many different types of accelerators, including traditional and corporate sponsored (and hybrids thereof)
- The process and deal:
  - Application period (open for ~60-90 days).
  - Narrow candidates down to 2x cohort size (e.g. ~20-30 applicants).
  - Accelerator invites shortlisted candidates for meet and greet, and makes final selection (e.g., ~10-15 teams).
  - 90-120-day program, culminating in a demo day.
  - Funding (cash): varies from $20K to $150K, plus the “in-kind“ value of program.

Business Incubators

Lesson 7

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Business Incubators

- Various models/frameworks: sometimes they work for-profit, sometimes supported by a government, or non-profit association, or corporate sponsor.
- Different from accelerators – generally no defined period.
- Similar to co-working space, but with some "shared services," such as legal, accounting, marketing.
- Sometimes funding (equity and non-equity) available.
- Government support/resources – frequently able to access and leverage through business incubator connections.

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Angel Investors

Lesson 8

Angel Investors

- An angel is an individual (not a institutional investor) who invests personal capital in an early-stage company.
- Angels are generally motivated by both financial returns (e.g., looking for internal rates of return of 25%) and social give-back.
- Generally curious + prior track record of entrepreneurial success.
- Law of large numbers: portfolio theory of angel investing, with average ticket size of about $20,000 to $50,000 per deal.
- Usually stay within personal knowledge, passions and networks.
- You can approach angels via:
  - Online platforms
  - Angel networks
  - LinkedIn

Angel Investors

- How angels and founders find one another:

  - Personal connections (including through LinkedIn and other social networks, and through professional advisors).
  - Angel groups (local, regional, national and global).
  - Startup conferences and trade shows.
  - Accelerator "demo days."
  - Online platforms (be careful, as securities laws in different countries may have "accredited investor" and/or "general solicitation" limitations).

Angel Investors

- Deal structures: Angel investment is typically the first outside money after founders (and perhaps friends, family and fools). The most common form of securities issued are:
  - Convertible notes (sometimes with a a valuation cap, discount to next round price, and/or warrants).
  - SAFE/KISS (which generally include a valuation cap).
  - Series Seed.
  - Convertible Preferred Stock

Note: Common Stock is sometimes used, but not favored by experienced angels or companies issuing equity compensation to motivate employees.

Super Angels

Lesson 9

Super Angels

- "Super angels" are just like other angels (e.g., individuals, not institutional investors, investing their own capital), except:
  - They can <u>and</u> do invest more money per deal than regular angels (e.g., average ticket size of $100,000-$500,000).
  - They have the competence and willingness to act as "lead investor," negotiating term sheets, conducting due diligence and providing ongoing corporate governance at board level (observer or director).
  - They have greater influence and "social proof" among larger startup and emerging growth company ecosystems (e.g., other prospective investors and advisors, customers, channel partners and future hires).

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Micro VC’s

Lesson 10

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Micro VC's

These are "institutional investors," managing funds invested by third parties (i.e., high-net-worth individuals, family offices, corporations, university endowments, pension funds, etc.), usually organized with:

- General partners who actively manage the fund and get paid through management fees (2-2.5% of AUM/annually and carried interest (20-25% of profits after return of capital to LPs).
- Limited partners (passive investors).
- 10 Year fund life (no new portfolio bets after 5 years, except follow-ons in existing portfolio).
- Note: Micro-VCs may deviate from the model above, especially first time funds.

Micro VC's

- Fund size – less than $100M, typically in the $5-$50M range.
- Unique selling proposition: these funds are typically focused on an underserved geographic region and/or specific industry, and are frequently quite "creative" in articulating their unique selling proposition (USP).
- Ecosystem value-add – provide access to post-angel financing, and can be the bridge and "boots on the ground" for national or global VCs.

Traditional VC's

Lesson 11

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Traditional VC’s

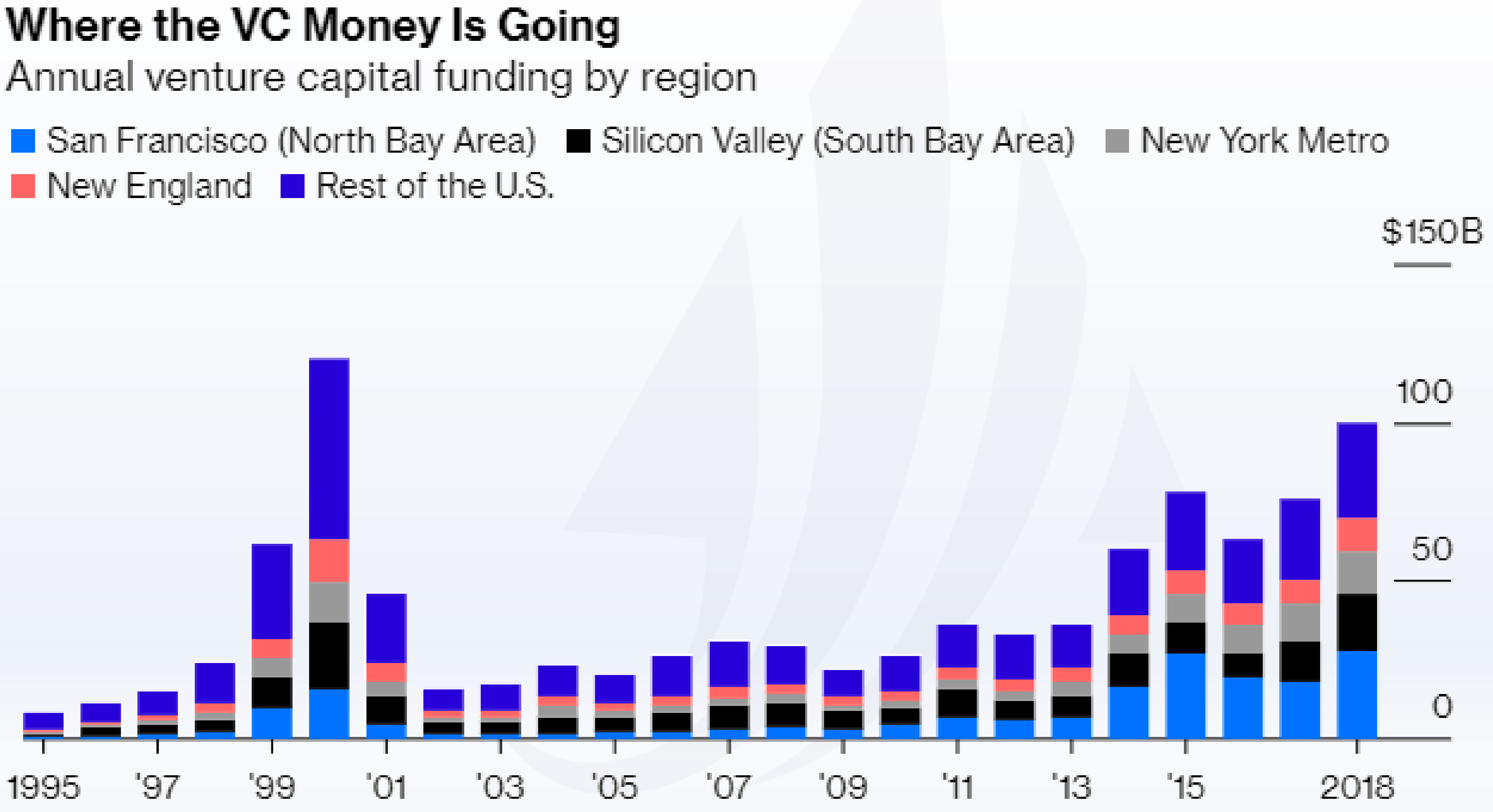
- Structured same/similar to micro VC‘s (e.g., “institutional” money raised from third-party limited partners, with general partners earning management fees (2-2.5% of AUM) and carried interest (20-25% of profits after return of capital to LPs), 10-year fund life, and no new portfolio bets after 5 years, except follow-ons).
- Fund size – more than $100M (and up to $Billions)
- Unique selling proposition (USP): reputation, track record (internal rate of return), longevity, team, process, knowledge and insight, network, industry focus, geographic focus.

Traditional VC's

- Top VC Funds – 2019 rankings by one reputable source.
- These firms have the most partners featured in their ranking of the top 100 venture capitalists:
  - Accel
  - Andreessen Horowitz
  - Benchmark
  - Index Ventures
  - Sequoia Capital
  - Bessemer Venture Partners
  - Founders Fund
  - GGV Capital
  - IVP

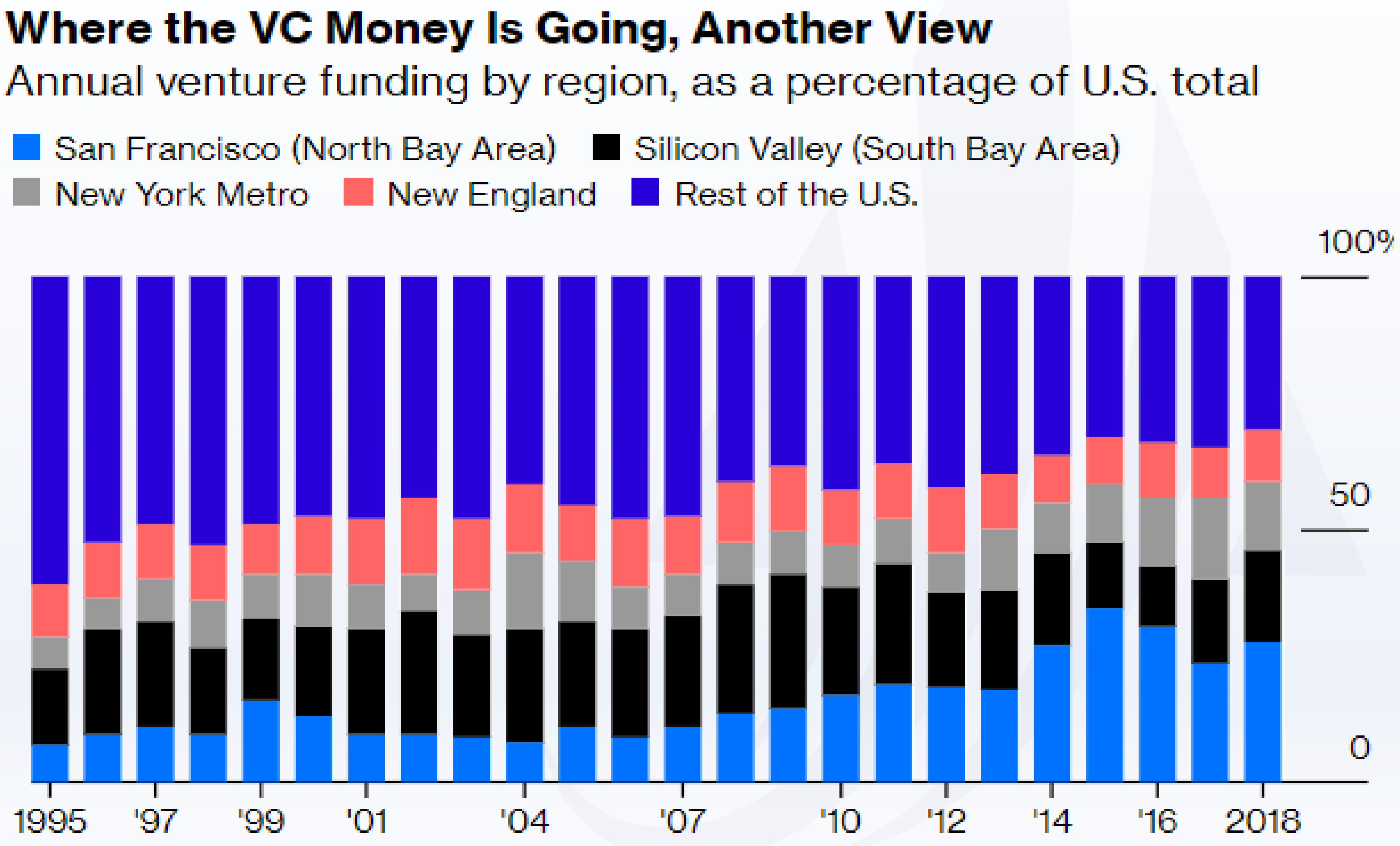
- https://www.cbinsights.com/research/top-venture-capital-partners/

Traditional VC



Source: https://www.bloomberg.com/opinion/articles/2019-01-08/venture-capital-still-flowing-to-silicon-valley-and-bay-area

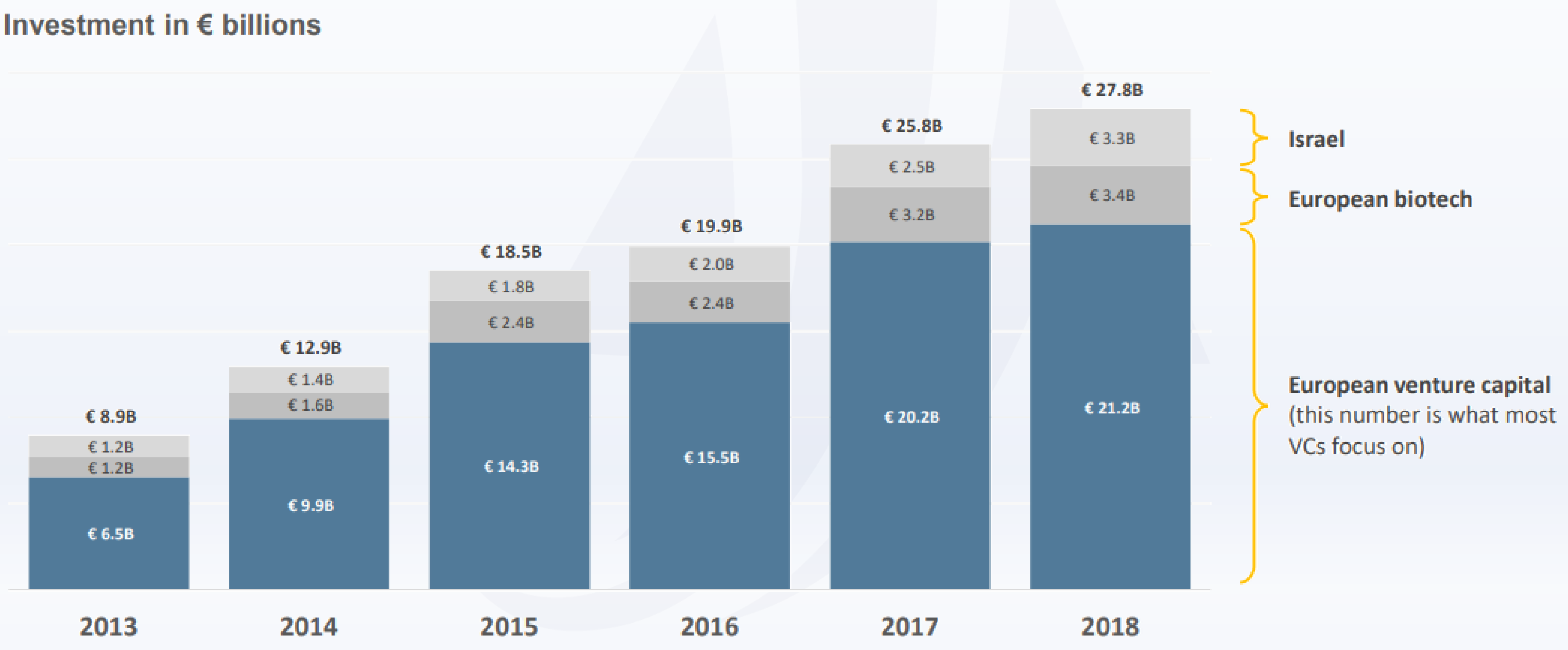
Traditional VC



Source: https://www.bloomberg.com/opinion/articles/2019-01-08/venture-capital-still-flowing-to-silicon-valley-and-bay-area

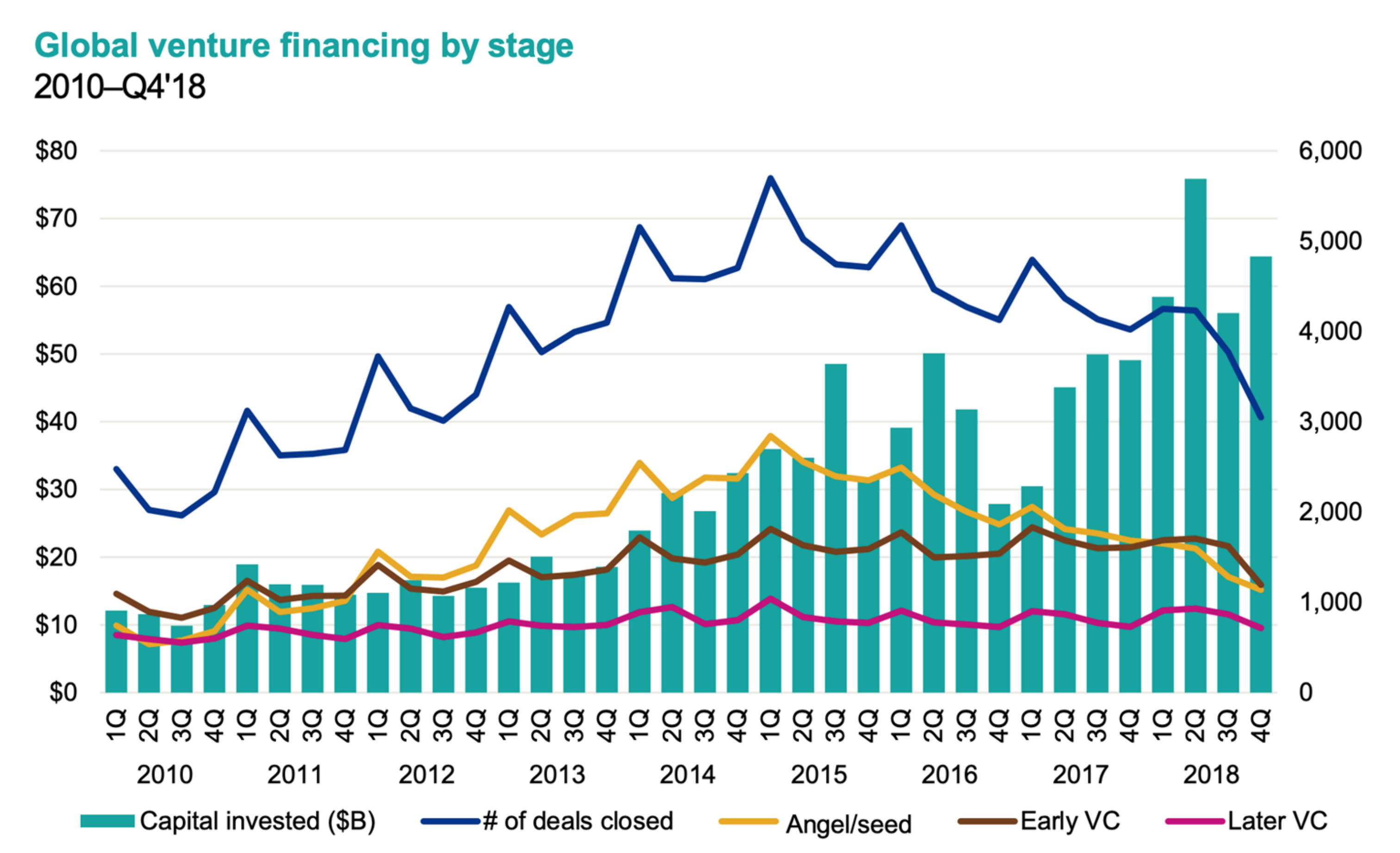
Traditional VC

In 2018, a record €28 billion invested in European and Israeli startups (€21 billion excluding Israel & Biotech)



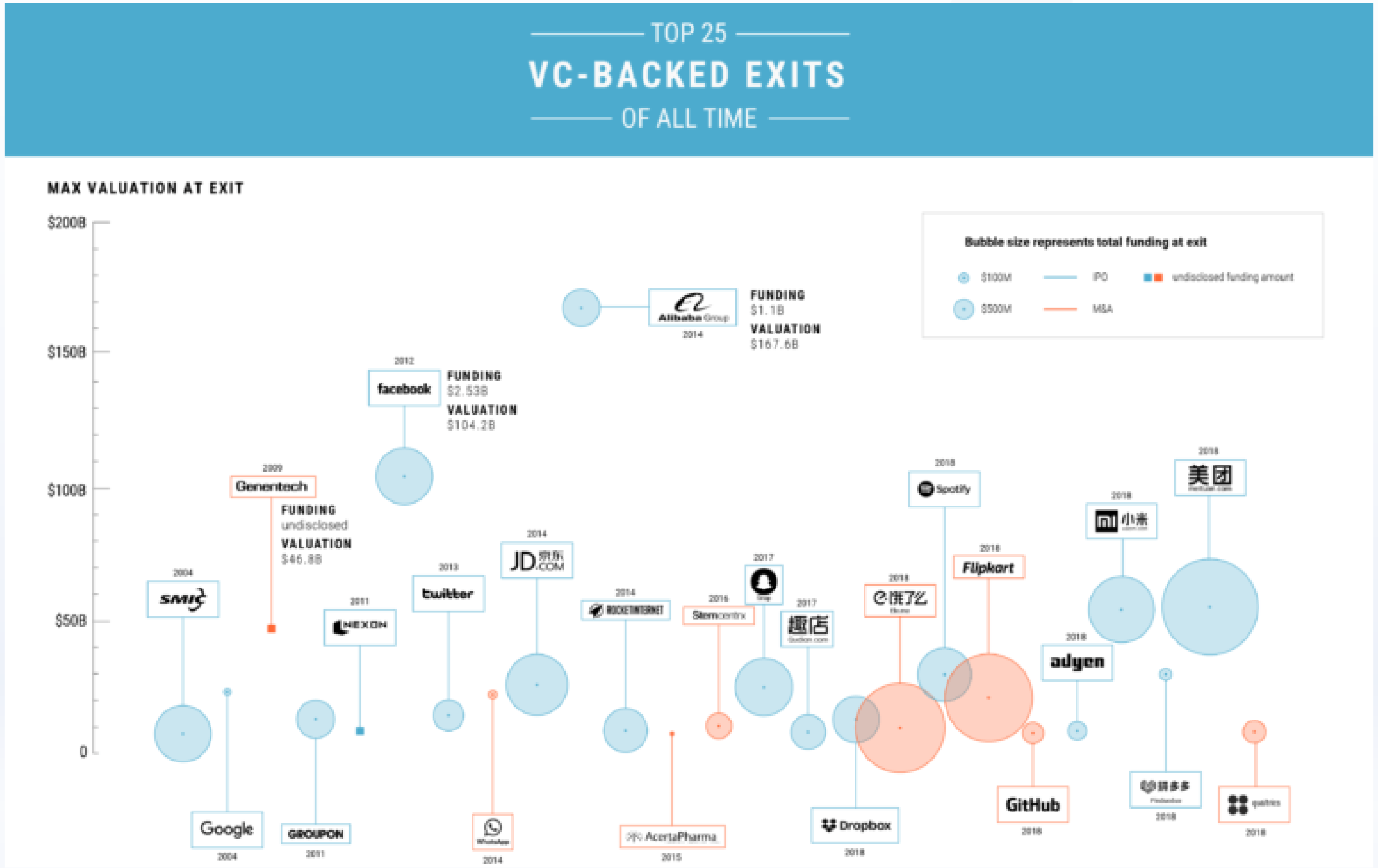
Source: https://blog.dealroom.co/wp-content/uploads/2019/02/Dealroom-2018-vFINAL.pdf

Traditional VC



Source: https://www.nexitventures.com/blog/the-hottest-vc-trends-of-2019/

Traditional VC



Source: https://www.cbinsights.com/research/best-venture-capital-investments/

Module 4: Creating Compelling Offers

Corporate Innovation Groups and Corporate VC's

Lesson 12

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Corporate Innovation Groups and Corporate VC’s

Corporate Venture Capital (CVC) is unique from traditional VC because it strives to advance both strategic and financial objectives.

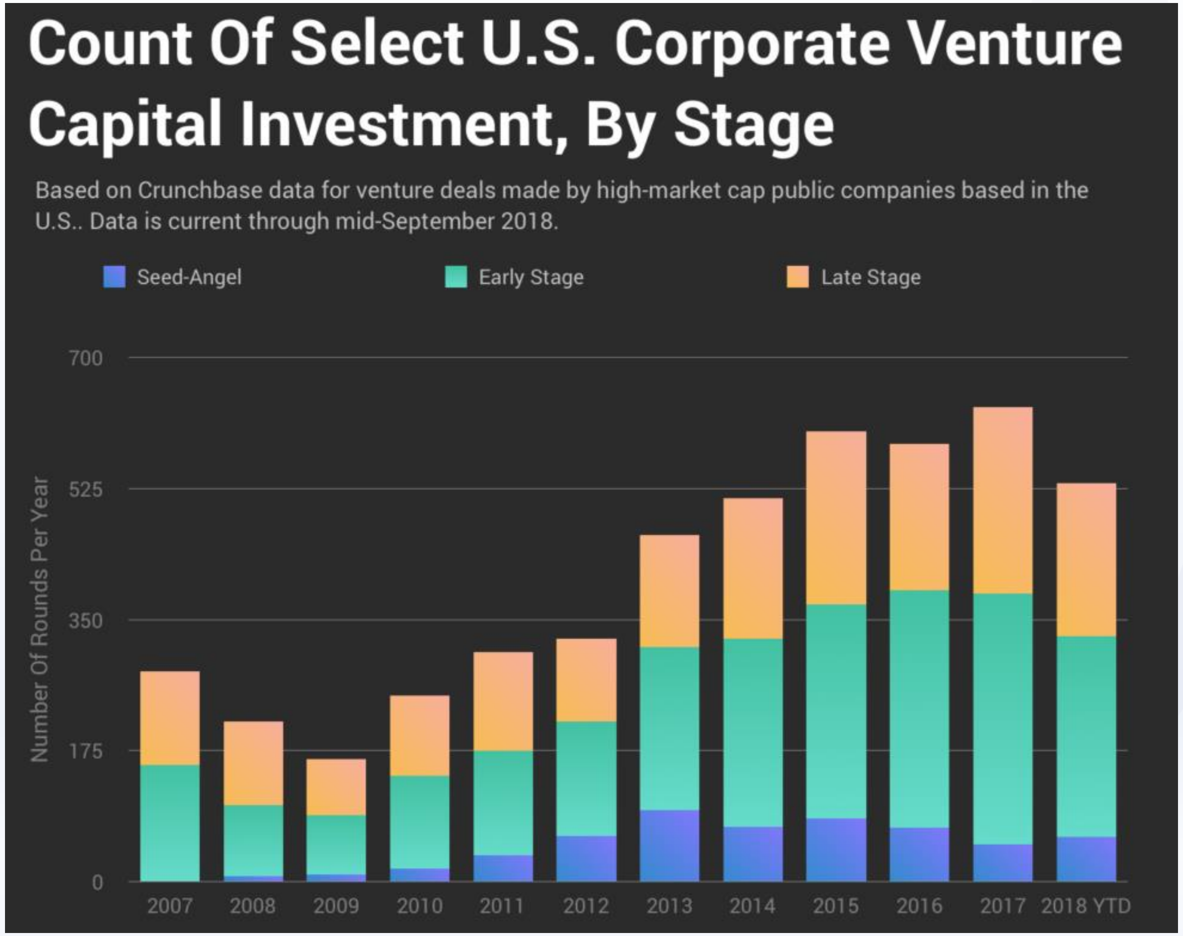
- Strategic objectives: increase, directly or indirectly, sales and profits of incumbent‘s business (e.g., window on new technologies, new markets, acquisition targets, and new resources).
- Financial objectives: leverage traditional returns, but keep the VC efforts “in house.”

Corporate Innovation Groups and Corporate VC's

Corporate innovation groups: like CVC, motivation is to advance both strategic and financial objectives, but here method and commitment usually tilted towards the strategic:

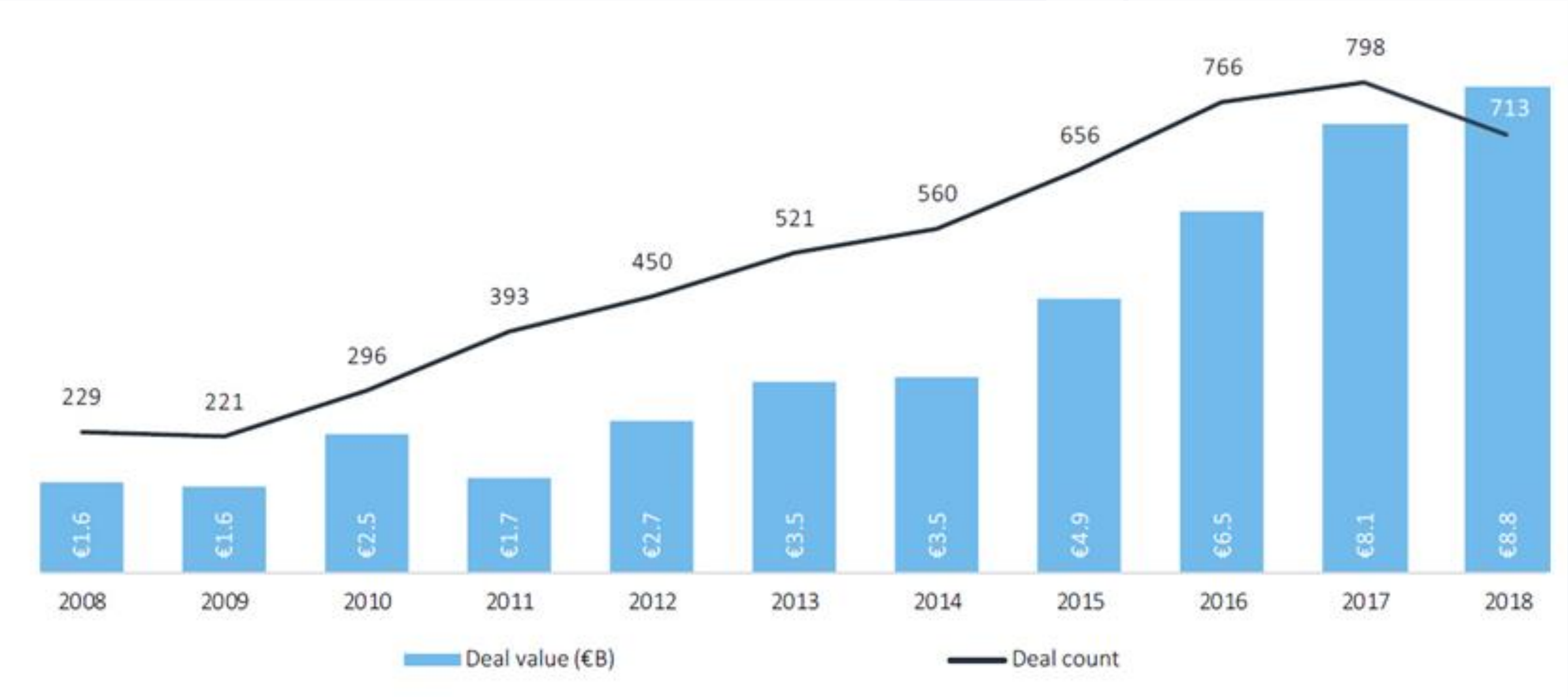
- Strategy.
- Co-creation.
- Collaboration with industry/academia/government.
- Fresh ideas/talent/innovation/acquisition targets.
- Business development/corporate development.
- Branding (i.e., reputation for supporting innovation + entrepreneurship).
- Caveat: be wary of "innovation theatre" and "drive by commitments"

Corporate Innovation Groups and Corporate VC's



Source: https://techcrunch.com/2018/09/22/corporate-venture-investment-climbs-higher-throughout-2018/

Corporate Innovation Groups and Corporate VC's



Source: https://pitchbook.com/news/articles/european-vc-trends-in-9-charts

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Venture Debt or Venture Leasing

Lesson 13

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Venture Debt or Venture Leasing

- This type of venture financing is provided by specialized banks or non-bank lenders to fund working capital or capital expenses (e.g., purchasing equipment).
- Unlike traditional bank lending, it is available to startups and growth companies that do not have positive cash flows or significant assets to use as collateral.
- Venture debt and venture leasing providers combine their loans with equity kickers, such as warrants, to compensate for the higher risk of default.
- Venture debt providers typically look to piggyback on the credibility and reputation of the equity investors (e.g., “social proof” and the belief that they will get their money out before the equity holders allow the ship to go down).
- Smart source of growth capital to “extend the runway” of startups and emerging growth companies looking to achieve the next milestone while minimizing equity dilution to existing equity holders.

Module 4: Creating Compelling Offers

ICO’s and STO’s

Lesson 14

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ICO’s and STO’s

WHAT IS AN INITIAL COIN OFFERING OR ICO?

It is the cryptocurrency space's rough equivalent to what in the mainstream world would be considered an ”initial public offering” or IPO.

- Investors buy in to the offering, either with fiat currency or with preexisting digital tokens.
- In exchange for their support, investors receive a new cryptocurrency token or coin specific to the ICO.
- Investors hope that the token or coin will perform exceptionally well into the future, providing them with a stellar return on investment. The company holding the ICO uses the investor funds as a means of furthering its goals, launching its product, or starting its digital currency.
- ICOs have been used by startups to bypass the rigorous and regulated capital-raising process required by securities laws, regulations and regulators.
- The era of the ICO “Wild West” enabled blockchain entrepreneurs to raise almost $20B in venture finance through 2018, but since then the market for ICO’s has largely dried up

ICO's and STO's

WHAT IS A SECURITIES TOKEN OFFERING OR STO?

- Similar to an ICO, an investor is issued with a crypto coin or token representing their investment. But unlike an ICO, a security token represents an investment contract into an underlying investment asset, such as stocks, bonds, funds, art, real estate and real estate investment trusts (REIT).
- A security can be defined as a "fungible, negotiable financial instrument that holds some type of monetary value," i.e., an investment product that is backed by a real-world asset such as a company or property.
- A security token represents the ownership information of the investment product, recorded on a blockchain. When you invest in traditional stocks, for example, ownership information is written on a document and issued as an analog or digital certificate. For STOs, it's the same process, but recorded on a blockchain and issued as a token (or coin).
- STOs can also be seen as a hybrid approach between an ICO and the more traditional IPO because of its overlap with both of these methods of venture finance fundraising.

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ICO’s and STO’s

WHAT IS THE DIFFERENCE BETWEEN AN ICO AND AND STO?

It is the same process, but the token characteristics are different.

- STOs are asset-backed and comply with traditional securities regulations. Most ICOs, on the other hand, attempt to position their coins as a utility token that give users access to the native platform or decentralized applications (Dapps), the principal purpose of which is for usage and not for investment. As a result, ICO platforms have argued, increasingly unsuccessfully in most jurisdictions, that they may circumvent certain legal frameworks and do not have to register or comply with traditional securities regulators or laws.
- It is much more difficult to launch an STO, as the intention is to offer an investment contract under traditional securities laws and regulations.
- For STO issuers, the reality is this: “meet the new boss, same as the old boss,” with much of the same players and costs and headaches as traditional IPOs. The STO represents real innovation in venture finance, but…

ICO's and STO's

HOW IS AN STO DIFFERENT FROM AN IPO?

Again, it's the same process, but STOs issue tokens on a blockchain while IPOs issue share certificates on traditional markets.

- Although both are regulated offerings, IPOs are only used to enable previously "private" companies to register their shares for sale and resale on a "public" market. Through the IPO process, they raise funds by issuing new shares to investors, and agree to financial reporting obligations to ensure investors continue to have access to material information to enable efficient secondary market trading in those shares.
- With STOs, tokens that represent a share of an underlying asset are issued on the blockchain to investors. These can be shares of a company but, because of tokenization, can actually be of any asset that is expected to turn a profit, including a share in the ownership of a property, fine art, real estate, investment funds, etc.
- Many have argued that STO will be more cost-effective than IPOs. IPO issuers typically pay high brokerage and investment banking fees to get access to a deeper investor base. STO issuers will still need to pay lawyers and advisors, but, it is argued, they offer more direct access to the investment market and, therefore, avoid paying large fees to investment banks or brokerages. On the other hand, there may be other intermediaries that step into the shoes of investment banks or brokerages. The post-offering administration for STOs may also be less cumbersome and cheaper than with traditional IPOs. TBD

ICO’s and STO’s

HOW ARE STOs DEFINED AND REGULATED AROUND THE WORLD?

This will very much depend on the individual jurisdictions.

USA - Securities Exchange Commission (SEC)

- (DOA Report, July 2017) Definition of “security“ same as it ever was...

The Howey Test: An investment contract is (1) an investment of money (2) in a common enterprise (3) with a reasonable expectation of profits (4) to be derived from the entrepreneurial or managerial efforts of others.”

- Statement on “Framework for ‘Investment Contract’ Analysis of Digital Assets (April 2019)”

https://www.sec.gov/news/public-statement/statement-framework-investment-contract-analysis-digital-assets

ICO's and STO's

HOW ARE STOs DEFINED AND REGULATED AROUND THE WORLD?

This will very much depend on the individual jurisdictions.

UK – Financial Conduct Authority (FCA) (Guidance on Cryptoassets, Jan 2019)

- **Exchange tokens** - "These are not issued or backed by any central authority and are intended and designed to be used as a means of exchange." They fall outside the regulator's governing perimeter.
- **Utility tokens** - "These tokens grant holders access to a current or prospective product or service but do not grant holders rights that are the same as those granted by Specified Investments." They may be within perimeter if they meet the definition of "e-money."
- **Security tokens** - "These are tokens with specific characteristics that mean they meet the definition of a specified Investment like a share or a debt instrument." They are fully under the scope of the FCA's regulations, if they meet the definition of a "Specified Investment."

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ICO’s and STO’s

HOW ARE STOs DEFINED AND REGULATED AROUND THE WORLD?

This will very much depend on the individual jurisdictions.

Switzerland – Financial Market Supervisory Authority (FINMA) (ICO Guidelines, February 2018)

- **Payment tokens** - “Tokens may in some cases only develop the necessary functionality and become accepted as a means of payment over a period of time.” FINMA will not treat such tokens as securities but will require compliance with anti-money laundering (AML) regulations.
- **Utility tokens** - “Intended to provide digital access to an application or service.” These tokens do not qualify as securities if their sole purpose is only to confer digital access rights to an application or service, and if the utility token can already be used in this way at the point of issue.
- **Asset tokens** - “Represent assets such as participations in real physical underlyings, companies, or earnings streams, or an entitlement to dividends or interest payments.” FINMA regards asset tokens as securities, which means that there are securities law requirements for trading in such tokens.

ICO’s and STO’s

HOW ARE STOs DEFINED AND REGULATED AROUND THE WORLD?

This will very much depend on the individual jurisdictions.

Regulatory “competition“ (aka “regulatory arbitrage“?) around the world to attract innovators and financiers to create “the next Silicon Valley“. Some of the first mover jurisdictions to provide regulatory certainty include:

- Singapore
- Liechtenstein
- Estonia
- Gibraltar
- Malta

Module 4: Creating Compelling Offers

Summary

Lesson 15

Summary

If you want the investment, you must create compelling offer(s)

- Show empathy for the investor: **Who** first, then **what.**

- Not all money is green. Not all money is equal.
  - Some money comes with value added.
  - Some money comes with strings attached.

Summary

Ask yourself these questions:

- Who do you want to be your financial partner(s)?
- What do you want these individuals or firms to bring to your table?

Employ design thinking and "investor-centric design:"

- If you were in the shoes of your ideal investor, what would you want?
- "Fish where the fish are."
- "To get the fish you want to bite, present the food they prefer to eat."
- Design your offer(s) to "fit like a glove."

Summary

Don‘t be shy. You miss 100% of the shots you don‘t take.

Be creative, and ask for help.

- Valuable support and introductions, like good ideas, can come from anywhere.
- In many places, economic development/government support, credits and financing might surprise you.

Raising venture finance requires a scientific mindset – you must have a rational hypothesis to “test” specific offer(s) with to specific pools of investors, and a desire also way to capture valuable feedback and an open mind to tweak or pivot your strategy and tactics, based on qualitative and quantitative data.