Chapter 9

STRUCTURING THE DEAL

INTRODUCTION

Some investors want to get everything, and give nothing. Some owner-entrepreneurs want to take everything and give nothing. Sometimes owners, and to a lesser extent investors are naive about the terms, conditions and fate of transactions made in good faith. Where the entrepreneur may believe "we are all in this together," investors are strictly motivated by return on investment. These differing points of view may contribute to a deal in which the investor demands and gets extraordinary concessions.

This chapter explores private investment deal structure; the variables that influence the bargaining position and relative strengths of the parties; the life cycle of a deal; the Term or Deal Sheet which is an investor's opening offer; ways to value a company and the investor's payoff.

Venture capitalists are focused on high value exit strategies as are other sophisticated investors. Therefore, it is likely they will reserve the right to force an exit in the investment agreement. This chapter also discusses terms that investors might use to acquire control over the company and limit entrepreneurs' control.

The more an entrepreneur knows about venture capital, the stronger his or her bargaining power. The same could be said when dealing with family, friends, angel investors, Small Business Investment Corporations and others. If the entrepreneur knows what to expect, he or she will have

considerably more bargaining power than someone who merely focuses on the amount an investor is willing to invest.

Variables That Affect Deal Structure

Deal structure is driven by five sets of variables. By understanding them, the entrepreneur can shape the terms of the deal. These include:

(i) The relative needs and or bargaining power of the parties.

(ii) How payoff expectations are driven by alternative deals and the deal environment.

(iii) Investor risk minimization

(iv) Exit strategy, and

(v) The relative sophistication of the parties.

Term Sheet or Deal Sheet

The Term Sheet or Deal Sheet provides the highlights of what the investor wants and is a starting point for negotiations. It probably won't appear until the investor is fairly certain they want to invest. That means that an owner/entrepreneur will have had to pitch the investor and provide them with a summary business plan. It also means the investor has done some level of due diligence.

At that point, the investor is interested in maximizing the return and minimizing the risk on the funds they plan to commit. An investor may reserve the right to perform much more thorough due diligence once the deal terms are agreed. If the thorough due diligence is satisfactory, then the actual investment documents will be drawn and executed. A sample deal or term sheet is available from the National Venture Capital Association at their website: www.nvca.org/model_documents/model_docs.html.