

Kauffman Fellows Program
Class 17 Session Guide
Module II

Dear Class 17 Kauffman Fellow,

The theme for this module – Investment DNA: Getting Capital Formation Right – is to develop a framework for assessing and addressing the many forces that influence a portfolio company over its life. Particular emphasis will be placed on the front-end of the process. Activities related to sourcing new deals – due diligence, term sheets, and the discussions and negotiations that lead to company formation – will be explored.

The aim is to build up your intuition about the vital importance of these initial steps in affecting the eventual health and success of a new venture. Transparent, constructive, and direct engagement with entrepreneurs will be the order of the day – as always, informed by genuine empathy and a spirit of risk-sharing and collaboration.

This year we have brought the Program to New York City. Our hope is to prompt an ongoing, two-way dialogue with the local eco-system, as well as to better understand how our body of expertise in capital formation can benefit local innovators. In addition, we wish to incorporate the best local expertise into our global community and to reinforce the presence of Society of Kauffman Fellows members in the region.

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Session 1: Good Money After Bad (Due Diligence, Term Sheets)

Speaker: Praveen Sahay (Class 8), WAVE Equity Partners

Session Goals:

This session is designed to assess and understand where the fellows are with regards to the due diligence process, term sheets, and initial company formation.

Materials: HBS Case – Good Money After Bad, March 2007

Questions to Ponder:

- What are the fundamental goals of the due diligence process? The limitations? The tools and techniques?
- What is the primary purpose of the term sheet? In what ways can a term sheet become an obstacle to progress? How does the due diligence process inform a term sheet?
- How important is the initial company formation structure? How much variety is there in the industry?
- What are the common entrepreneur perspectives on due diligence, term sheets, and formation structures? Why do entrepreneurs have these views?
- What are the special challenges that come with down rounds?
- Are divergent incentives inevitable after several rounds of funding? What mitigation or re-alignment techniques are available?
- What is the typical trajectory of founder and employee stock incentives over multiple rounds of financing? What are the common problems and remedies?
- Does Brandon deserve the second Chance? Would the second round definitely be a down round?
- Do you have similar experiences and what was your final decision on similar cases?
- Do you think Brandon shows the type of entrepreneurial spirit you would like to identify with?
- How do you think the emotional link that Harbinson may have towards Brandon and his technology?
- What would be the pros and cons in terms of Scharfstein Weekes' if SW denied the second round investment in Seven Peaks?

Notes:

Session 2: Term Sheet Negotiations

Speakers: Justin Fishner-Wolfson (Class 14), 137 Ventures
Warren Packard, Thuuz

Session Goals:

To understand: the business rationale for various investment deal terms; how to set mutual goals with entrepreneurs in a way that achieves alignment with investors; how to account for what might happen as a portfolio company matures; and how to cope with misalignments that may emerge.

Questions to Ponder:

- How do stakeholders and participants share in the rewards when a young company has a successful outcome? What mechanisms drive these results?
- How should I describe common terms in a way that is understandable and acceptable to the entrepreneur? How do I make these legal terms palatable and still show that I am excited and interested in the company?
- What are typical areas of misalignment between the investor and the portfolio company (at this funding and future ones, including exits) that we can take into account in this term sheet? How accurately do they correlate to the most important points of conflict?
- What protections and accommodations does the term sheet provide for the entrepreneur?
- What is the range of entrepreneur reactions to an initial term sheet?
- What are the common objections? The most onerous terms?
- Which terms rarely get discussed (or invoked) despite their importance?
- When does a term sheet become too investor-friendly or entrepreneur-hostile? Would most entrepreneurs agree with these perceptions?
- What two or three things would I change about the typical term sheet to make it a more effective tool?

Notes:

Session 3: The Burgeoning NYC Ecosystem

Facilitator: Lisa Skeete Tatum (Class 4)

Panelists: Maria Gotsch, New York City Investment Fund
Seth Pinsky, NYCEDC
Danny Schultz (Mentor, Class 16), DFJ Gotham

Session Goals:

New York City has rapidly become one of the most active and robust innovation and entrepreneurship hubs in the world, both in terms of numbers of entrepreneurial start-ups and amount of venture capital invested. With an aggressive private/public partnership forming the new multi-billion dollar university Cornell NYCTech, NYC looks to become the leading 21-century tech powerhouse. Leaders in venture capital, entrepreneurship, academia and government will discuss how this burgeoning innovation ecosystem is being created.

Questions to Ponder:

- What have been the key components of NYC's success?
- What resources were used to achieve their goals?
- What role have 'champions' played in this success?
- What problems/missteps have occurred?
- How can you utilize their experience to build or strengthen your innovation ecosystem?
- If in Silicon Valley, is NYC a competitor or a potential collaborator, and how should you respond?
- What are the threats to the future for NYC in technology, innovation & entrepreneurship and how does this apply to your innovation ecosystem?

Notes:

Session 4: Breakout Panel: How Institutional Investors are Evaluating Smart Connected Capital

Facilitator: Bruce Upbin, Forbes

Panelists: Mel Williams, TrueBridge Capital Partners
Rick Slocum, The Johnson Company
Doug Coyle, The Rockefeller Foundation

Session Goals:

Varying opinions abound on venture capital as an asset class today and in the future. Is venture capital irretrievably broken or is it 'morning for venture capital'? Is it back to the fundamentals or are there new venture capital models that are attracting the interest of limited partners? How are limited partners evaluating emerging markets, emerging funds? This panel of top limited partners will share their views on venture capital as an asset class, discuss how they consider investment opportunities, and provide their view of the future.

Questions to Ponder:

- What are the greatest concerns identified by Limited Partner 'customers' of venture capitalists, that apply to you or your organization?
- How could the opportunities that Limited Partners see now or in the future provide a strategic opening for you or your organization?
- What new models in capital formation could meet the needs of the different strata of limited partner investors
- What are the most important trends surfaced by the panelists?
- How can you impact the future of capital formation in your environment or globally?

Notes:

Session 5: Breakouts: Focusing Innovation Talents Beyond Venture Capital

Facilitator: Jens Eckstein (Class 10), SR One

Panelists: Thomas Darden (Charter Class), School District of Philadelphia

Peter Krawiec (Class 6), Amazon.com

Dan Malven (Class 4), Analyte Health

Winslow Sargeant (Class 11), Small Business Administration

Session Goals:

Kauffman Fellows innovators and investors are focusing their talent beyond the traditional venture capital path with great impact. Panelists discuss their respective career paths within corporate organizations, entrepreneurial ventures, high level government and policy, and within one of the largest public school systems in the world. This session is especially focused for Kauffman Fellows who wish to leverage their background and expertise toward broader innovation opportunities.

Questions to Ponder:

- What are the various ways that you can impact innovation?
- What determinants go into your career decisions now and for the future?
- How do you measure your personal impact

Notes:

Session 6: Fireside Chat with Benno Schmidt, Kauffman Foundation

Speakers: Benno Schmidt, Interim CEO, Kauffman Foundation & Phil Wickham, CEO, Kauffman Fellows

Session Goals:

Benno Schmidt will share his views on entrepreneurship, venture capital, and innovation. In addition, Benno's father was the co-founder of J.H. Whitney & Co, one of the nation's first VC firms, providing an interesting insight into the early years of venture investing to the present.

Notes:

Session 7: Keynote: How Networks are Transforming our Economy & Society (and How We Invest in Them)

Keynote Speaker: Fred Wilson, Union Square Venture Partners

Session Goals:

Fred Wilson, co-founder of Union Square Ventures and one of the leading venture capitalists in NYC, focuses his investments in internet networks that have the capacity to transform the global economy. The firm's investments include Twitter, Tumblr, Foursquare, Lending Club, Zynga, 10gen & Etsy. His blog, A VC, is one of the world's mostly widely read business blogs and features MBA Mondays and Skill Share classes for entrepreneurs. As well, Fred is a thought-leader in social innovation, convening groups to focused on "Hacking Education" and "Hacking Society." Fred will discuss his venture investing practice in internet networks as well as how networks are transforming our economy and society, and what this means for the future of innovation, regulation, advocacy, and politics.

Questions to Ponder:

- How does Fred's investment thesis impact your view of investment and/or innovation opportunities?
- Fred is consistently defined as an entrepreneur's VC. What practices does he utilize with entrepreneurs that you can adapt in your investing/innovation practices?
- Where do you agree/disagree with Fred's view of the transformative nature of networks?
- How will we use networks to enhance and transform society?

Notes:

Session 8: Influence Without Authority

Facilitator: Bill Tobin, Strayer Consulting Group

Session Goals:

As we move from highly structured and codified environments of school and established business and governmental systems to those that are more chaotic and unstructured in the innovation ecosystem, we need to also evolve our thinking and modify our (previously successful) behavioral practices toward a leadership style that provides a vision that others will want to follow, instills their trust and faith in us, and motivates the discretionary effort that will help us be successful. This session will help the class understand why influence matters and how it plays a role in long-term individual and firm successes. In addition, we will identify situations (on boards, in portfolio companies, etc.) where influence significantly impacts your results. You will experience how to apply influence principles and strategies to improve intended outcomes.

Questions to Ponder:

- How have I been successful to date using my own two hands? How about being able to direct others' work (command and control)? How have I started to use influence rather than directing others or doing it myself?
- How well do I craft compelling narratives for the future?
- Do I see others as potential allies or enemies?
- How much empathy and compassion do I have for others in my daily activities?
- Am I good at understanding and exercising reciprocity with others?
- Am I developing a powerful network that will drive my future business ecosystem?
- Where and how do I lose influence?

Notes:

Session 9: Lunch Keynote: Building Entrepreneurial Ecosystems

Speaker: Brad Feld, Foundry Group

Session Goals:

To gain familiarity with the frameworks of investor, entrepreneur, and author, Brad Feld, and to test his theories against the New York dynamic, as well as your own. The thesis of Brad's new book, *Startup Communities*, is that entrepreneurs lead a startup community while everyone else feeds that community. Feeders include the government, universities, investors, mentors, service providers and large companies. He will discuss the characteristics of regional entrepreneurial leaders, the engagement catalyst provided continuous, local activities and events and the appropriate roles that incubators, accelerators, universities, and government can (and should) play. Lastly, he will lead a conversation on how a strong community culture can help define and sustain entrepreneurial communities.

Notes:

Session 10: Due Diligence and the Essence of Great Investing

Speaker: Gene Hill, SV Life Sciences

Session Goals:

To share and discuss best practices for conducting due diligence. To consider how the diligence process varies – by firm, by individual, by sector, stage, geography, and circumstance – and how it can be an effective tool for making superior investments. Through the use of scenarios, focus on issues of leadership, emotional awareness, and social awareness in the due diligence process.

Questions to Ponder

- How does the diligence process evolve as a company progresses from Series A through subsequent financings.
- As an existing investor, what are your disclosure obligations to prospective investors?
- As a prospective investor, how should you weigh and interpret the input and endorsements you receive from existing investors?
- How should you balance qualitative and quantitative inputs? Facts versus opinions? Contradictory inputs? Confirmation bias? Not-invested-here expert bias?
- How thorough and consistent is your firm's diligence process?
- How well does it facilitate decision consensus?
- How often (in retrospect) does it tend to generate false positives and false negatives?
- What happens when diligence work is accelerated in the face of competitive pressure?
- Should you share your findings outside your firm? With the company? When unfavorable?
- Should you have a model for due diligence?
- Can your model be different from that of another great investor and still be successful?
- What are the two or three most common questions investors ask that add very little value to the investment process?
- What are the two or three most valuable questions that investors fail to ask?
- Does the way in which you conduct due diligence have post-investment impact?
- Do leadership, emotional awareness, and social awareness have a role in the due diligence process?

Notes:

Session 11: Wax On/Wax Off: Let's Make a Deal

Facilitator: Brendan O'Leary (Class 8), Prism VentureWorks

Session Goals:

This session will focus on a key litmus test every venture capital investor faces on multiple occasions: doing your "first" new deal. You may be an associate-level professional trying to make your first lead investment. Later in your career as a seasoned investor, you may be debating which deal to do first in a new fund or after joining a new partnership. You may be a government official attempting to fund the first new deal from an economic development vehicle. No matter the situation, you will have to choose your "first" new deal wisely and then win support from initially skeptical or cautious stakeholders in authority. Once you have sourced the right deal and won the necessary support to pursue it, you must execute a due diligence plan efficiently yet thoroughly. Assuming the deal has survived those checkpoints, you must determine the best structure for a financing and attempt to win the deal as close to those terms as possible.

In this session, we will navigate through the lifecycle of a first, new deal using a case study as an informative backdrop. This will be an interactive and lightly-structured session where we will integrate the lessons learned from other module components and your own experiences.

As preparation for the class, please read the Due Diligence Summary for Fusion Pharmaceutical Corporation. Obviously, you won't be quizzed about the technical details associated with Fusion's technology and drugs; however, you will hopefully gain an appreciation of the particular challenges and opportunities in front of this early stage company. You will be broken into groups to discuss differences between how a typical biotech investment is handled versus other sectors. At the end of our session, you will be asked to craft a high-level term sheet for Fusion's Series B financing using the provided material and any insights gained during the course of the session.

Questions to Ponder:

For the first set of questions, please think of how you would (or did) answer each at various stages/positions in your career:

- How do you know when you're ready to lead your first deal?
- How do you win internal support to do your deal? Find the "perfect" deal to catalyze the process? Other strategies? Do different situations require different strategies and tactics?
- Should your first deal have a certain profile? Should it pass any special tests or expectations that you wouldn't impose on your subsequent deals?
- In your experience, what are the best ways to source a new deal? For your first new deal, are certain source strategies better than others?
- Assuming a deal passes initial inspection, what due diligence areas do you explore before bringing the deal to your full team? Before doing a term sheet? After a term sheet? Would you do anything special with the first deal?

As part of our term sheet exercise at the end of the session, you will need to quickly assemble a rough set of terms for Fusion. Giving serious thought to the following questions ahead of time will help us expedite the last part of the session:

- What do you think are the most important overall themes or goals behind a term sheet?
- If you had to choose a handful of terms as most important, which would you pick?
- What is the best way to negotiate a term sheet? Start with best & final offer? "Low ball" offer? In between?
- How do you know when to walk away and what is the best way to do it?

Notes:

Session 12: Entrepreneur's Perspective

Speaker: Jeff Bussgang, Flybridge Capital Partners

Session Goals:

A primer and reminder about viewing every element of the venture investing process from the perspective of the entrepreneur; to explore the role of empathy and how it is reflected in each firm's structures and style of engagement; to consider the impact of the initial deal structure and conditions on the entire lifecycle, and eventual exit, of a new enterprise.

Questions to Ponder:

- How do entrepreneurs view VCs? What do they see that is good? What do they see that is bad?
- How well do entrepreneurs evaluate competing venture firms? How transparent is the process for them?
- How does a venture firm's empathy manifest itself in the deal flow, screening, diligence, and term-sheet processes? In a new company's structure and timeline and exit expectations?
- What do entrepreneurs fear most about their investors?
- What do entrepreneurs crave most from their investors?
- What are the two or three things that would surprise the typical entrepreneur most about the venture model?
- How burdensome is the due diligence process for a young management team?
- Do most entrepreneurs want to become rich? Or famous? Both? Something else?
- How to achieve the ever-elusive goal of alignment between VC and entrepreneur? Where are they not aligned and how does a VC handle it?

Notes: