Meilinda Huang, Dayne Katz, Jennifer Plasencia, Ari Zandman-Zeman
MGMT 295A
2/1/2013
NanoGene Technologies, Inc.

1. Evaluate the founders' decisions regarding the split of equity and compensation level. As a potential venture investor in the company, would these decisions concern you?

The founders of NanoGene decided to split the equity of the company evenly among the five members and draw $120,000 in salary each year. As potential venture investors, this decision would concern us, but from the perspective of the founders we can understand the decision for equitable share.

<u>Benefits of an equal split</u>

1.) All co-founders feel the equal split was fair and consistent; slicing and dicing the equity and compensation would complicate relationships and upset people.

2.) Each co-founder put in an equal amount ($1000) to incorporate the company and get things going. This would have been more complicated had there not been equal shares for each co-founder.

3.) Co-founders will all be motivated to work hard to pull their weight equally for the company.

4.) It's easy and quick, reducing time needed and rationale behind a more complex split.

5.) Other than splitting equity by potential role in the new entity, it was difficult to credit contribution to different people in the beginning.

<u>Benefits of a non equal split</u>

1.) Each co-founder had varied length of experience, title, and salary at AMSL and each had a different opportunity cost for quitting their full-time jobs to pursue NanoGene exclusively. For instance, Masterson had the most to lose because he made the most salary and had worked his way up to a being a senior scientist in the biophysics group at AMSL whereas Gary had the least to lose because he made the lowest salary.

2.) According to Masterson, the team "determined that Will would take the CEO role by universal acclamation. He just exuded natural leadership and he already had contacts with VCs and with a law firm and had already learned much more...about what it took to start a company." If Tompkins was unanimously voted in as the CEO and leader for NanoGene, he needed to take on all the many responsibilities of being a CEO and accept a higher salary and equity split in return.

3.) It will be difficult to make decisions and understand who has more say than who without a differentiated split structure.

Reason for investor's concern

1.) Tompkins' split of equity and compensation level was below market rates (compared to other VC deals) whereas the VP-level founders' compensations were above market rates.

2.) There needs to be a clear distinction of who the leader is in a founding team otherwise there is a risk of important decisions getting stalled when there is not a unanimous vote and inefficiency in meeting goals and deadlines.

3.) VC investors have already planted a seed in Tompkins' mind that he is being compensated under market rate compared to other start-up CEOs. Therefore, as the company matures and Tompkins sees how much work he is putting in raising capital and getting a lab ready for his co-founders, he may feel that he deserves more compensation and he may feel resentment later.

4.) The co-founders' decision to split equity evenly among themselves may signal their inexperience with working in a start-up. This inexperience with starting a company (they are all academic scientists) is a concern because it may hinder them from succeeding in the business.

2. Evaluate the size and the composition of the founding team. What is the difference between being a "founder" and an early employee?

The team is initially comprised of five founding members:

1.) Will Tompkins is a 41 year-old Biochemist Ph.D who is migrating over from his job at Eastern Institute of Technology's Advanced Materials Sciences Lab (AMSL). In his previous position, Tompkins earned $80,000 per year as a scientist, in contrast at NanoGene, he will be the founding CEO.

2.) Mark Masterson is a senior scientist in biophysics who previously earned $90,000 a year.

3.) Ravi Rhoota is a senior scientist in the biology group who earns $65,000 per year.

4.) Gary Garfield is a post-doctoral fellow in biology who earns $55,000 per year and is planning to seek outside employment soon if he can't earn enough to support his family.

5.) Don Ruper is a Director at AMSL who is interested in joining the founding team in a limited capacity working one day a week but has a reputation and resume that can attract additional investment capital.

In addition to the five founding members, below are others (e.g. investors) involved with NanoGene:

6.) Angel investors: One of Tompkins contacts who was a previously a CEO of a biotech company agreed to invest $600,000 at a $2.25M post-money valuation. After his initial investment during the Angel Found on 6/02 he held 26.49% of the company but would be diluted to 5.68% ownership after an assumed Series A round was raised.

7.) Option pool (13.35% after Series A Round)

8.) Venture capital investors will own 61.52% of the company

9.) Paige Miller, a Harvard Business School MBA, has six years of operational experience in biotech and has been consulting with NanoGene. There is a discrepancy between the amount Miller believe she should earn and what the team feels is fair. Miller believes she should be paid her market value of $175,000 in addition to her equity stake of 3% if she was to join as the VP of Operations.

At the date of company inception on 12/01, each of the five founders splits ownership equally and retains 20% equity in the company. As additional capital is received, ownership will decrease accordingly. Assuming there is a Series A Round of funding, each of the five founders is slated to own 3.15% ownership in the company in addition to taking a $120,000 salary. This has made investors skeptical as they have stressed that each position requires a different skillset and compensation structure should reflect the value they individually bring to the firm.

Each of the three founding senior scientist, with the exception of Rupert, would be appointed one scientist and two research assistants, and would report directly to Tompkins. Research assistants would earn $45,000 in addition to 40,000 options and junior level scientists would be paid $72,000 per year and receive 60,000 options.

The company founders are the members who take initiative on an idea and organize the early foundation and framework for the business. They normally assume the highest amount of financial risk and opportunity cost for their actions. Since they are the ones who create the business entity they own 100% of the equity and are able to decide how to allocate it. Early employees are the first hired staff to join the team and take on the roles that the founders need filled. While early employees do assume varying degrees of risk associated with the company's financial well being, they normally have a guaranteed compensation plan, which is often times subsidized by equity and does not entitle them to equal ownership or authority in the company.

3. Evaluate Paige Miller as an addition to the team, and assess her compensation demands. Would you hire her on the terms she seeks?

Paige Miller has valuable experience the founders don’t have, however, she isn’t the ideal fit for their current needs.

<u>Benefits As An Addition</u>

1.) Manufacturing experience: worked in every kind of job in manufacturing with some exposure to marketing and finance; was responsible for all aspects of manufacturing.

2.) General management experience: her experience working in a fast growing pre-IPO biotech company in a variety of roles shows versatility for plugging uncertain needs during growth; integrated international operations; managed corporate information systems; directed activities of 85 people.

3.) Miller fills knowledge gaps in the founding team: she can assist with designing HR policies, company culture and compensation policies, although that is not her area of expertise nor does it relate to her accomplishments. Her story taking over a Tennis Clubs operations supports her ability to handle personnel and uncertain people management issues.

4.) She can create a performance-oriented culture: VCs are concerned about the academic culture and wanted a performance-oriented one, although this wasn't the biggest area of concern.

Drawbacks As An Addition

1.) Lack of very early stage experience: she joined Biomolecular Technologies when there were 120 employees.

2.) Lack of specific fit: she was not in charge of company culture or HR policies, although she can probably figure it out. Hiring scientist candidates for likeability is different to anything she has ever done nor does it make sense entirely.

3.) Her role in commercialization and growth is unclear: it is unclear what her role was in her prior company's growth and success. The implication from the facts is that she was good at doing her job, but was not the secret sauce to her firm's success.

4.) Cost: she is expensive and her deal will create tension with the founder's equity %s and compensation. Further, she will not leave much equity for future hires which can create difficulty filling future senior positions.

5.) She doesn't solve the major concerns VCs have with the firm: namely the founder's equity splits and salaries. There was no critical VC concern with the lack of management experience. The additional concern with the founding team was the relative inexperience with commercialization and it's unclear if Paige is strong in this area.

6.) She is perhaps overqualified to do the necessary work needed for her role at this point: HR policies, access to appropriate facilities, manage vendor relationships, deal with the landlord and do the bookkeeping.

7.) Misaligned focus: seems singularly focused on compensation in her negotiation and not on her commitment or interest in the concept. Seems like the wrong mix of motivation.

Compensation Demands

It is foolish to hire Miller on the terms she seeks without interviewing other candidates and an investigation of fair market value. Miller is interested in a base of $160-$180k and 2.75-3% of the equity. Miller cites this offer as the market rate based on other offers she has received. Perhaps the equity she was promised would be diluted more at other companies based on their future funding needs.

As a given amount regardless of performance it seems high, although it might be justified. The CEO, Tompkins, is currently projecting a salary for himself of $120k. Given feedback from VCs it will likely be closer to $200k ("certainly less than $250k based on his experience."). Further, Miller's reference point early stage firms are unclear in terms of reasonability as comparisons.

Perhaps other firms she interviewed with had a greater need for her at the present moment in terms of her skillset from Biomolecular Technologies. This is unclear. Also, why is she still shopping around for offers?

I would recommend not hiring Miller on the terms she seeks at the present time. Tompkins has not evaluated any alternative candidates who might be good fits. Further, the co-founders are not sold on her value. Tompkins knows what to look for in terms of a person who has experience growing early stage biotech companies and is comfortable doing multiple functions, including HR, vendor relationships and bookkeeping up-front. Miller does have skills of interest and might be the best available candidate. In order to keep her around while looking for other candidates, it is wise to give her a consulting arrangement. It may be wiser to also consult out the various needs at this time relating to HR and bookkeeping and let Paige focus on her true strengths such as vendor relationships and facilities.

In a short period after you agree to work with her you need to interview other candidates and figure out where she fits in terms of strengths. Can you find a similarly strong candidate who will settle for higher compensation and lower equity or vice versa? Once the possible talent on the market is vetted then it's time to decide whether to make a deal with Miller and under what terms.

4. Assess the company's progress on each of the specific issues discussed in the last section of the case; the hiring process; a compensation policy; the company's culture. Specifically, in each of these areas, what should the company do?

<u>The Hiring Process</u>

The co-founders agreed on an initial organizational structure that would require three of the founders (the one's other than Tompkins and Rupert) to take on senior scientist positions. They agreed that each scientist would have a scientist and two research assistants (RAs) reporting into him. It is not discussed how they came to this agreement. In addition, Tompkins projected that they would expand to 25 employees by the end of the year.

As the company got closer to funding, the co-founders were encouraged to begin recruiting scientists and RA's. Miller was concerned that they had not made much progress in developing a formal hiring process. In addition, based on discussions with the team, she realized that none of them had hiring experience, yet the team had informally agreed that the person who the new hire would report to would do the hiring.

As a start-up, it is important to be agile, however it is also important that there be formal hiring processes in place when it's time to expand and build out the team. Not only does it ensure that the new hires are joining the team understanding the vision and having the proper qualifications, it also positions the company as a more credible establishment that they can trust.

Nanogene should regroup and develop a vision for a more formal hiring process, keeping in mind that it is still in the start-up phase and may not need a super blown out plan. Perhaps it initially consists of outlining the vision of the type of talent it would like to attract, how many people would do the interviewing and who would make the ultimate decision. The founding team should establish a framework for the hiring process ahead of time.

Compensation Policy

Tompkins asked Miller to join Nanogene to do some initial consulting work while they began to have more serious conversations about joining as Vice President. She had begun to define the standard salary and option grant for each position level and proposed that RA's be paid $45,000 and receive 40,000 options, scientists would be paid $72,000 and would receive 60,000 options. However, not all the founders were on board and they pushed back stating that they needed more flexibility in order to attract the best talent to the business.

The founders wanted to hire 2 scientists, one that wanted to get paid less (90% of the standard) in exchange for more vacation days and the other that wanted to be paid less in exchange for more options. Miller, however, felt that they should stick their compensation policies. In addition, Miller was concerned that they were not going to be able to continue to give each employee the same level of options. She felt it was fair to reduce the number of options with each month they were in business since the progress would reduce the level risk each new employee would take on.

Nanogene should develop a formal compensation policy, a framework to work from. However, in order to attract the best talent they need to determine what they are willing to negotiate on a case-by-case basis. I agree in Miller's thoughts to reduce the number of options with each month the company is in business since this does reduce the amount of risk each new employee is faced with.

Company Culture

Tompkins and Miller had agreed to have a discussion in regards to the company culture, however, there hadn't been much progress to date. Tompkins stated that the VCs were concerned that the academic lab culture was not the right one for a start-up that should be focused on performance and measured by KPIs (key performance indicators).

Miller echoed this same concern. She felt that the concept of goals was a foreign concept for academic scientists whom were focused and distracted by discovery.

The VCs and Miller have very valid concerns. Tompkins should develop a company culture that breeds creativity and innovations, yet is measured by results. This in turn should be communicated to the greater team and shared throughout the interview process. It may be difficult for new hires that have only worked in academia to switch gears after working within certain culture their entire career.