



Where capital and opportunity meet

## **ISSUES TO CONSIDER IN DUE DILIGENCE**

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### CORPORATE STRUCTURE AND GOVERNANCE

(REVIEW DOCUMENTS AND INTERVIEW MANAGEMENT, BOARD, AND ADVISORS)

- What is the company's corporate structure? C corp., S corp., LLC or LP? Does this model allow for a liquidity event and or return on investment?
- Is there an exit strategy?
- Is the corporate structure overly complicated? If so, why, and might it be simplified?
- How many existing shareholders? Too numerous, and, if so, why?
- Does the corporate structure fit with the business model?
- Does the corporate structure allow for growth?
- What is the founder share allocation? Do they have a large enough stake to have the incentive to succeed, but not so large as to ignore board and other advisors? Is the founders' stock vested over time?
- Who is on the board of directors? Do they have the right background for the company? Is there a sufficient number of outside directors? How are board members compensated?
- Does the company have a board of advisors and, if so, who is on the board? Do the advisors actively participate in the company's development? How are advisors compensated?
- Has the company been involved in any litigation or been threatened with litigation?
- Does the company have all required permits and licenses?

### FINANCIAL ASSUMPTIONS AND REVENUE SOURCES

(REVIEW ALL FINANCIAL DOCUMENTS)

- Has the company completed one-, three- and five-year financial projections
- Have the financial documents been properly developed according to applicable accounting rules?
- Has the company used an outside, independent accounting firm to compile, review or audit financials?
- How good are the assumptions? (rate of growth, acceptance rate, pricing, multiple revenue streams, costs)
- Are revenues realistic?
- When does the company reach cash flow positive, and what cash requirements will it take to get there?
- Has the company already received funding, and, if so, how much? What are pre-money valuation and terms?
- What are the follow-on funding requirements and sources? Has the company properly anticipated future needs, and is it already working on those?
- Have all tax returns been properly filed?
- What is the company's debt carry? What are the ratios?
- Is the company's current valuation aligned with its current stage of development and market potential?

### MARKET ASSESSMENT

(DO INDEPENDENT MARKET ANALYSIS AND REQUIRE CUSTOMER REFERENCES IF APPLICABLE)

- Does the company's product or service address a new or existing market?
- Is the product or service platform-based, with the opportunity for additional products or services? Or is this potentially a one-trick pony?
- Does the company have a well-thought-out sales and marketing plan?
- Does the company have key relationships in place, or is it working on the same, with marketing and/or sales partners?
- Does the company have or need key joint venture relationships?
- Is the company focused on the appropriate market development, or are they trying to do too much at one time?

- Have they chosen the right first market?
- Does their product or service represent a market push or pull?
- What is the potential market size?
- Have they conducted thorough market research to support their financial assumptions, revenue model and valuation?
- What is their stage of development? Concept, alpha, beta or shipping?
- If the company has already introduced its product or service into the market, what is the number of current and potential customers?
- What is the length of its sales cycle?
- What are the channels of distribution?
- Does the company's product or service have a seasonal aspect?
- Is this a stable market and are COGS stable?

## COMPETITIVE ARENA

(DO INDEPENDENT COMPETITIVE ANALYSIS )

- Who are the company's competitors?
- Has the company realistically assessed its competitors?
- What is the company's market differentiator? Is this enough to make them superior to competition from the customer's perspective?
- Is this a market or product consolidation?
- How entrenched are the competitors?
- What is the financial stability of competitors?
- What does the market share look like?
- How will this company win?
- Has the company done a detailed feature-by-feature analysis?

## MANAGEMENT TEAM

(INTERVIEW ALL TEAM MEMBERS AND KEY EMPLOYEE REFERENCES)

- What is the caliber/pedigree of the team?
- What is the team's overall track record?
- Do they have the combined requisite skills and experience?
- Do they recognize limitations in management, and are they seeking candidates?
- Is the management open to discussion and suggestions on improvement to their business model?
- Has the management team been previously funded?
- How are management and all other employees being compensated?
- Does the company have an option plan, and have options been granted to all employees? What percentage do the founders have as compared to other key management?

## TECHNOLOGY ASSESSMENT

(MAY NEED EXPERT OR PROFESSIONAL ASSISTANCE IN TECHNOLOGY ASSESSMENT)

- Do they have market requirements and functional specifications?
- At what stage is development? Concept, alpha, beta, shipping?
- Does the company have any usability studies?
- Does the company have adequate intellectual-property protection? Does it need it?
- Is the company relying on being first to market, rather than on any IP position, for competitive advantage, and is this realistic?



- What is product quality assurance like?
- Is it proprietary architecture or open-source code?
- Do they have adequate systems in place to identify and protect IP?
- Who in the company is focused on these issues?
- Has the company properly set up relationships and documentation to ensure ownership of all intellectual property?
- Does the company own all necessary intellectual property through internal development or licenses?
- Do any other companies have potential claims to the IP resulting from previous employment relationships or for any other reason?

## OPERATIONS

- Does the company have an operating plan or outline of the same if early stage?
- Has the company considered all aspects of operation to successfully launch a product or service?
- Does the operating plan anticipate growth? Is anticipated growth realistic?
- Has the company received any citations or notices of violation?
- For more mature companies, does each division of the company have an operating plan, and are they compatible?
- Does management meet regularly to ensure compliance with plan or make needed adjustments?
- Has the company been able to stay on plan?
- Does the plan take into consideration all cash needs and anticipated cash flow?
- Does the company have an alternative plan if assumptions do not hold, such as for product rollout, cash needs or market response?

## COMPARABLES

- Recent IPOs (10Ks, annual reports)
- Recent companies funded in this space
- Third-party (including government) databases, reports, publications and market analysis
- Comparable financial models

## WHAT TO WATCH OUT FOR:

- Unrealistic valuation (or revenue model)
  - Affects percentage ownership
  - Affects possible subsequent rounds
  - May end up with “down-round” on next financing
- Complicated investment terms
  - Preferred fine, but be careful of other complicated features such as rights of first refusal; onerous liquidation preferences; registration rights; no lock-ups; co-sale
- Heavy debt
  - New investment dollars should be used for advancing the company, not for paying old obligations
- Missing key assumptions about market or financial model
- One-trick pony (one-product or one-service company)
- No board per se
- Inexperienced management
- Poor advisors