Evaluation techniques for start ups prior to meeting the investors

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Valuation Challenges

- Start-ups: The challenge of valuating a business before revenue creation and market positioning
- Mature companies: Never straight forward job even for mature companies, where several parameters like brand value, IP, changing markets could also challenge multiples

Valuation Truths

Valuations are:

- More art than science, or a mix
- What the market says your company is worth
- What a disinterested investor is willing to pay
  - Not: What you think you worth, what a family member or existing equity holder would pay

The Challenge Continued

- In start-up/early-stage, valuation exercise more art than science, with heavy dose of negotiation driven by the investment source (VC's, angels, etc.)
- Valuation may be used for both negotiated as well as for "price" for equity investment purposes, Founder/ Partner buy-out scenarios (more common than you think), marital dissolutions, and third-party acquisitions
- Absence of historic, or (often) accurate means to predict future revenues and cash flow, makes it practically impossible to use traditional models like DCF – used frequently by investment analysts, practically for start-up evaluations

Startup Valuation Truths Continued

- Investment decisions are driven only by projected returns on the investor's investment
- Negotiation happens between investor and entrepreneur with no correct answer/ as far as two ends meet
- Other terms matter too (option pool, preferences, voting rights, etc.)

Approaches to Valuation

1. The market approach – comparative – suitable when there is an available value of another similar sector company.
2. The income approach – recognizes future earnings by calculating the present value of projected cash flows at a reasonable present value discount rate.
3. And the asset-based approach – results in the lowest valuation based on expenditure for developing companies assets

Valuation Terminology (1/2)

1. Financing Round: Seed, First, Second, Third, Mezzanine and IPO
2. Step-Up in Value: increase in pre-money valuation between two financing rounds e.g. $1m EUR/$200K= x5
3. Return on Capitalization (ROC): annualized change, or growth, in pre-money market capitalization between two rounds.

   eg. Premoney: 200K EUR, Capitalization after 5 years: 1m EUR

   (1000-200)/(200x5) = 800/1000 = 40%

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Valuation Terminology (2/2)

- Valuation: value of equity interests
  - Fully diluted: include all shares that could be issued, but not all authorized
- Pre-money: value of equity before financing
  - Fully diluted shares x price per share

    10.000 shares x 20euro/share = 200.000 euro
- Post-money: value of equity after financing
  - Fully diluted shares x price per share

    50.000 shares x 20euro/share = 1.000.000 euro
- Post-money- Pre-money = amount raised

  1.000.000euro - 200.000euro = 800.000 euro

Valuation Dilemma

- Economic Profit = Invested Capital x (ROI of Capital – Opportunity Cost of Capital)
- How do you forecast ROIC when a startup has no revenue, next to nil physical assets, good will as premium on valuation and IP?
- Partial answer: Verification and Validation milestones

How Much Do You Need to Raise?

- How much money do you need in order to show significant growth and achieve next value-enhancing milestone
- How much of the company do you SELL (not give) to the investor?

Rule of Thumb: Raise to Value Enhancing Milestone+

- Early stage investors are looking for rapid growth
  - E.g., 10X growth in 18 months
- Valuation is responsive to milestone achievement
  - Prototype completion
  - Product launch
  - First 1M users
  - Etc.
- Things always take longer and cost more than anticipated
- Budget past milestones for runway to raise next round

Investor's Perspective

- Where and when is the exit?
- How much can this company sell for?
- How much total money will it take to grow the company to the point that someone will buy it for….let's say, 10 million EUR?
- What percentage will the investor need to get the return (ROI) desired? 10x? 20x? 50x?
- Desired IRR? (Internal Rate of Return) >25% (per annum).

Market Considerations

- Entrepreneur Valuation Expectations*

IRR:

  - Too Low 9%
  - Appropriate 22%
  - Too High 69%

- All markets are affected by national trends – (US values multiply for EU values for same business!)
- Follow-on investors are not always local
- Entrepreneurs have limited experience of valuation

*According to Angel Resources Institute

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Typical Expected Rates of Return

STAGE	IRR	5 Year ROI
Seed/Start-up	82%+	20x
Early Stage	60%	10x
Growth	40%	5x
Later Stage	25%	3x

VALUE ESTIMATION METHODS USED BY VCs and BAS

- Comparable Transactions
- Venture Capital Method
- Scorecard Method on Comparable Companies
- Scorecard by Applying Risk Factors Method

Comparable Transactions

- Theory: compare valuation to similarly situated companies raising capital at similar stages
- Reality
  - Real data hard to come by
  - Anecdotes hard to defend
  - Investors can easily find distinguishing features
  - It's a lot about intelligence and several times inside information (colleagues, banks, accountants, etc)
  - Rarely star cases reach to the press and set benchmarks

Comparable Companies

- Theory: compare valuations of similar companies when they were at similar stage of development
- Reality:
  - More data may be available (recently public companies report 3-5 years of historical results)
  - Perceived selection bias (not everyone will be next Google)
  - Prepare to defend assumptions regarding growth

Comparables

- Accurate, reasonable approach to valuation, in the absence of, or willingness, to apply other valuation methods
- Simply research valuations, of similar companies who have raised equity capital, at same stage, in same region
- Regional "pricing" applies. Valuations in USA are NOT the same as in Europe or Greece
- In US, we use Dow Jones "VentureSource" and "PitchBook" to research comparable valuations as reported in VC deals.
- In Europe we use EMAT data base of evaluation multiples.
- In Greece, we use press and insiders!

Venture Capital Method

Post-Money Valuation (valuation at Investment or Pre-money plus investment) = **Terminal Value** (valuation at Exit) / **Expected Return on Investment (ROI)**

where: **Terminal Value = Earnings x P/E Ratio** (absolute figure in EUR or Revenue x Earnings %)

Assuming no dilution

Estimating Terminal Value - Example 1

Investment	$5 million
Exit year	5th year
Revenues	$20 million
Earnings (Net Profit)	10% ($2 million)
P/E	25x
Terminal Value	$50 million

Reminder: Terminal Value = Earnings x P/E Ratio

Venture Capital Method approach for estimating Pre-money evaluation – Example 1

- Determine the potential value of company at exit ("terminal value"): i.e., EUR 50M
- Determine the ROI required: i.e., 20X
- Calculate Post-Money: EUR 50M/20 = EUR 2.5M
- Determine size of investment: EUR 1M
- Calculate Pre-Money: EUR 2.5M - 1M = EUR 1.5M

Venture Capital Method – Example 2

	Company A M&A	Company B IPO
Revenue	$1,000,000	$800,000
Net Income	$150,000	$90,000
IPO/M&A Multiple		15X Net Income
SaaS metric	6X EBIT	
Terminal Value	$900,000	$1,350,000

Venture Capital Method - Example 2

	Company A	Company B
Terminal Value	$900,000	$1,350,000
Post Money = Terminal Value/30 (ROI)	$30,000	$45,000
Subtract Investment	$10,000	$10,000
Pre-Money	$20,000	$35,000

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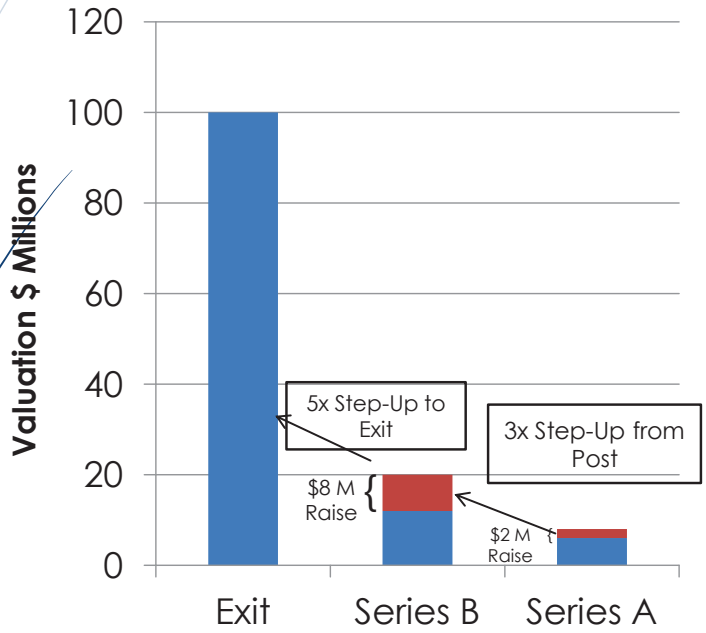
Venture Capital Method – Working Backwards From Exit

- Estimate terminal value
- Project all financing rounds to exit
- Build in valuation step-ups for each round
- Work backward to determine initial pre-money
- If we know the value of something in the future and we know what kind of ROI we need to induce us to make as investment, then we figure out it's "present value" to us.
- Present value = valuation
- Incorporates some elements of DCF insomuch that we apply risk premium (expressed as return/discount/hurdle rate), and are determining PV, but it is based on future terminal value rather than cash flows.
- No time/value of money considered

Bill Sahlman, Harvard

Venture Capital Method – Working Backwards From Exit, example 3



Assume: $100M exit and $10M capital raise, with $2M Series A and $8M Series B

$8M Series B – 5x Return to Exit

- Post-Money = $20M
- Pre-Money = $12M

$2M Series A – 3x Step-Up from

A -> B

- Post-Money = $4M
- Pre-Money = $2M

Venture Capital Method

1. Forecast future results ("success") vs current situation (more optimistic).
2. Determine likely value at that point (e.g. P/E ratio for comparable).
3. Determine likely dilution from: (a) equity capital issuance and (b) employee stock option grants.
4. Determine share of value "pie" demanded given required rates of return.
5. Convert future values to present to derive share prices, ownership percentages.

Terminal (exit) value / post-money valuation – return on investment

or,

Post-money valuation = terminal value / anticipated ROI

Effect of Venture Capital Math on Shareholdership

- $1 million at a $3 million Pre-Money Valuation leading to a $4 million Post-Money Valuation.
- The math works out that the investor owns 25% of the company Post-Deal ($1 million invested / $4 million Valuation) and assuming 1 million shares, each share would be valued at $3 / share ($3,000,000 Pre-Money / 1 million shares = $3/share).
- Investors own 25%, the founders own 75%.
- But…… ESOP complicates it, and impacts price/share. (Options Pool)
- Assuming a 15% option pool post funding, then you need a 20% option pool pre-funding (because the pool gets diluted by 25% also when the VC invests their money). So your 100% of the company is down to 80% even before VC funding.
- The VC's $1 million still buys them 25% of your company – it's you who has diluted the 60% ownership rather than 75%.
- The price / share is actually $2.41 (not $3.00), which is $3,000,000 Pre-Money / 1,250,000 shares (because you had to create the 250,000 share options). Thus, "true" Pre-Money is only $2.4 million (and not $3 million) because $2.40 per share is 1 million Pre-Money outstanding shares = $2.4 million

Scorecard Method on Comparable Companies

- Not really a "valuation method" in itself.
- Ranks various factors consider predictors of entrepreneurial success.
- Somewhat subjective but balanced on the whole.
- Best for comparing a number of companies against each other, by type, or by region.

Scorecard Method

- Determine median value for pre-revenue companies in your space in your region (recent deals).
- Assign % weighting on each critical issue.
- Calculate the weighted average of each issue.
- Multiply median value by weighted average.

Scorecard Method Valuation Factors

Management	30%
Size of Opportunity	25%
Products / Services	5%
Marketing / Sales	10%
Competition	10%

Scorecard Method Calculate Weighted Average Multiple (example 1)

FACTOR	ANALYSIS	WEIGHT	RESULT	INPUT
Management	On board except sales	30%	120%	36%
Opportunity	Large	25%	130%	33%
Product	Disruptive	15%	130%	20%
Sales	No channels	10%	50%	5%
Competition	No big layers	10%	110%	11%
Other	Need partners	10%	80%	8%
	Weighted Average			112%

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Scorecard Method (example 2)

Comparison Factor	Range	Company	Factor
Team Management	25% max	150%	0.375
Product/Technology	15% max	100%	0.150
Competition	10% max	75%	0.075
Sales Partnerships	10% max	80%	0.080
Additional Investment	5% max	100%	0.050
Other Factors	5% max	100%	0.050
SUM	100%		1.075

Scorecard Method Calculate Pre-Money Valuation

Median Value	$2.0 million
Weighted Multiple	1.12
Pre-Money Valuation	$2.3 million

Scorecard by applying Risk Factor Method

- Determine a starting valuation point
- Consider and assess risk
- Assign positive or negative values to each
- Pre-Money valuation = Sum

Risk Types

- Management
- Stage of Business
- Legislative/Political Risk
- Manufacturing Risk
- Sales & Marketing Risk
- Funding/Raising Capital Risk
- Competition
- Technology Risks
- Litigation Risks
- International Risk
- Reputational Risk
- Potential Lucrative Exit

Assign Values to Each Risk

- Maximum/Minimum = +3/ -3
- i.e., "Stage of Business Risk"
  - 0 for pre-revenue
  - +1 for beta
  - +3 for paying customers
- +1 = 5% added to Pre-Money valuation
- -3 = -15% subtracted from Pre-Money

Example

Management	+2
Stage of Business	+1
Legislative/Political Risk	0
Manufacturing Risk	-1
Sales & Marketing Risk	-2
Funding/Raising Capital Risk	-1
Competition	+1
Technology Risks	-1
Litigation Risks	0
International Risk	+1
Reputational Risk	0
Potential Lucrative Exit	+3
TOTAL	**+3**

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Risk Factor Summary Example

Base Valuation	2,000,000

Pre-Money Valuation = 2,000,000 + (3 x 5% x 2,000,000)
= 2,300,000

Negotiation Method

- Used more often than not.
- Follows traditional, age-old premise of "value": "what a willing seller and a willing buyer agree upon".
- Can be considered a reasonable foundation value (starting point), on which to apply future/next valuation exercises.
- Probably hard to argue against, retroactively, in legal/court-related testimony of valuation unless one can prove duress.

First Chicago Method

- First Chicago approach simply does three different projections: Best, Worst and Survival scenarios & assigns probability estimates to each.
- i.e. Success – 30% chance; Failure – 20% chance; and Survival – 50% chance.
- When utilized, the First Chicago method results in a separate valuation for each of the three potential outcomes.
- These are then added and the valuation and pricing is determined.

First Chicago Method

Calculations	Success	Sideways Survival	Failure
Revenue Growth Rate (From Base of 1st year)	1.2	0.5	0.05
Revenue Level After 3 Years	4.79	1.52	0.52
Revenue Level After 5 Years	23.19	3.42	0.57
Net Income at Liquidity	4.64	0.24	0.00
Value of Company At Liquidity	69.57	1.67	1.00
Expected PV Of The Company Under Each Separate Scenario	5.62	0.23	0.05
Expected PV Of The Company	5.62 x 0.3 + 0.23 x 0.5 + 0.2 x 0.05 = 1.811		

Valuating Growing and Established Companies Valuation Methods

- Transaction multiples: P/E Multiples (earnings), P/S Multiples (sales)
- Book Value
  - Depreciated value of assets minus outstanding liabilities
- Liquidation Value
  - Amount that would be raised if all assets were sold independently
- Market Value (P)
  - Value according to market price of outstanding stock
- Intrinsic Value (V)
  - NPV of future cash flows (discounted at investors' required rate of return

Relative to Earnings multiples

- Price/ Earnings Ratio (PE)
- Trailing Price/ Earnings Ratio (trailing PE)
  - A trailing PE is a price-earnings ratio based on the most recent 12 months' results of published companies report quarterly, so a trailing PE is computed based on the most recent four quarters.
- Forward Price/ Earnings Ratio (forward PE)
  - Also called estimated PE. Forward PE divides a stock's current price by it's estimated future earnings per share. Forward PE is often used to compare a company's current earnings to it's estimated future earnings.

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Valuation: P/E multiple

- If valuation is being done for an IPO or a takeover.
  - Value of firm = Average Transaction P/E multiple x EPS (Earnings per share by number of shares) of firm.
  - Average Transaction multiple is the average multiple of recent transactions (IPO or takeover as the case may be).
- If valuation is being done to estimate firm value:
  - Value of firm = Average P/E multiple in industry x EPS of firm
- This method can be used when:
  - Firms in the industry are profitable (have positive earnings).
  - Firms in the industry have similar growth (more likely for "mature" industries).
  - Firms in the industry have similar capital structure.

Relative to Revenue multiples

- Price/ Sales (PS)
- Value/ Sales (VS)
- Usually used in valuing service and retailing firms

Transaction Multiples – EMAT Database

A unique valuation tool for:

- Establishing the "market value" of private investments.
  - BVCA/ EVCA recommendations and increasing investor pressure for regular portfolio valuations
  - For "fair value" valuations, the use of comparable transaction multiples is key
- Valuing portfolio investments/ exits.
  - Put together a sample of comparable multiples in an instant
  - Use Epsilon's sector classification, based on the International Classification Benchmark
- View all available deal information to check multiples and ensure they are relevant.
  - Standard methodology (consistent financial restatements, multiple calculation)
  - Transparent use of information, relevant data
- Use Epsilon's research service to:
  - Carry out ad-hoc research on a business sector or specific deal
  - Receive copies of source info used in a report by e-mail
  - Contact our financial analysts regarding specific sectors or reports

Transaction Multiples – EMAT Database

Unique online access to European private transaction analysis reports & acquisition multiples

Online access to reports covering all major European small and mid-market M&A and LBO transactions.

Detailed analysis of each transaction: deal context and structure, target business and financials, transaction multiples (calculation, comparison and analysis).

All information sources are systematically given.

A powerful search facility: date, size, deal type, country and industry sector + key words.

Possibility to compose your own comparable indices.

Optional access to monitor all transactions not retained for multiple analysis (see "CorpfinDeals").

Referenced Transactions

Transactions M&A – LBO maj. (ncluding a control premium, giving the qcquirer > 50% of the target's shares)

Equity Value: €1- 500m

Target in the EC

Since 01/01/2004 (deal announced date)

All industry sectors >> see our industry coverage

Transaction value not confidential

Enough information (deal value and target financials) to be able to calculate at least one significant multiple

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Valuation: Price to book multiple

- The application of this method is similar to that of the P/E multiple method.
- Since the book value of equity is essentially the amount of equity capital invested in the firm, this method measures the market value of each euro of equity invested.
- This method can be used for:
  - Companies in the manufacturing sector which have significant capital requirements.
  - Companies which are not in technical default (negative book value of equity).

Valuation: Value to EBITDA multiple

- This multiple measures the enterprise value, that is the value of the business operations (as opposed to the value of the equity).
- In calculating enterprise value, only the operational value of the business is included.
- Value from investment activities, such as investment in treasury bills or bonds, or investment in stocks of other companies, is excluded.

Value to EBITDA multiple: Example (1/2)

- Suppose you wish to value a target company using the following data:
  - Enterprise Value to EBITDA (business operations only) multiple of 5 recent transactions in this industry: 10.1, 9.8, 9.2, 10.5, 10.3.
  - Recent EBITDA of target company = $20 million
  - Cash in hand of target company = $5 million
  - Marketable securities held by target company = $45 million
  - Interest rate received on marketable securities = 6%
  - Sum of long-term and short-term debt held by target = $75 million

Value to EBITDA multiple: Example (2/2)

- Average (Value/ EBITDA) of recent transactions:
  - (10.1 + 9.8 + 9.2 + 10.5 + 10.3)/5 = 9.98
- Interest income from marketable securities:
  - 0.06 x 45 = $2.7 million
- EBITDA – Interest income from marketable securities:
  - 20 – 2.7 = $17.3 million
- Estimated enterprise value of the target:
  - 9.98 x 17.3 = $172.65 million
- Add cash plus marketable securities:
  - 172.65 + 5 + 45 = $222.65 million
- Subtract debt to find equity value: 222.65 – 75 = $147.65 million

Valuation: Value to EBIT multiple

- Since this method measures enterprise value, it accounts for different:
  - Capital Structures
  - Cash and security holdings
- By evaluating cash flows prior to discretionary capital investments, this method provides a better estimate of value.
- Appropriate for valuing companies with large debt burden: while earnings might be negative, EBIT is likely to be positive.
- Gives a measure of cash flows that can be used to support debt payments in leveraged companies.

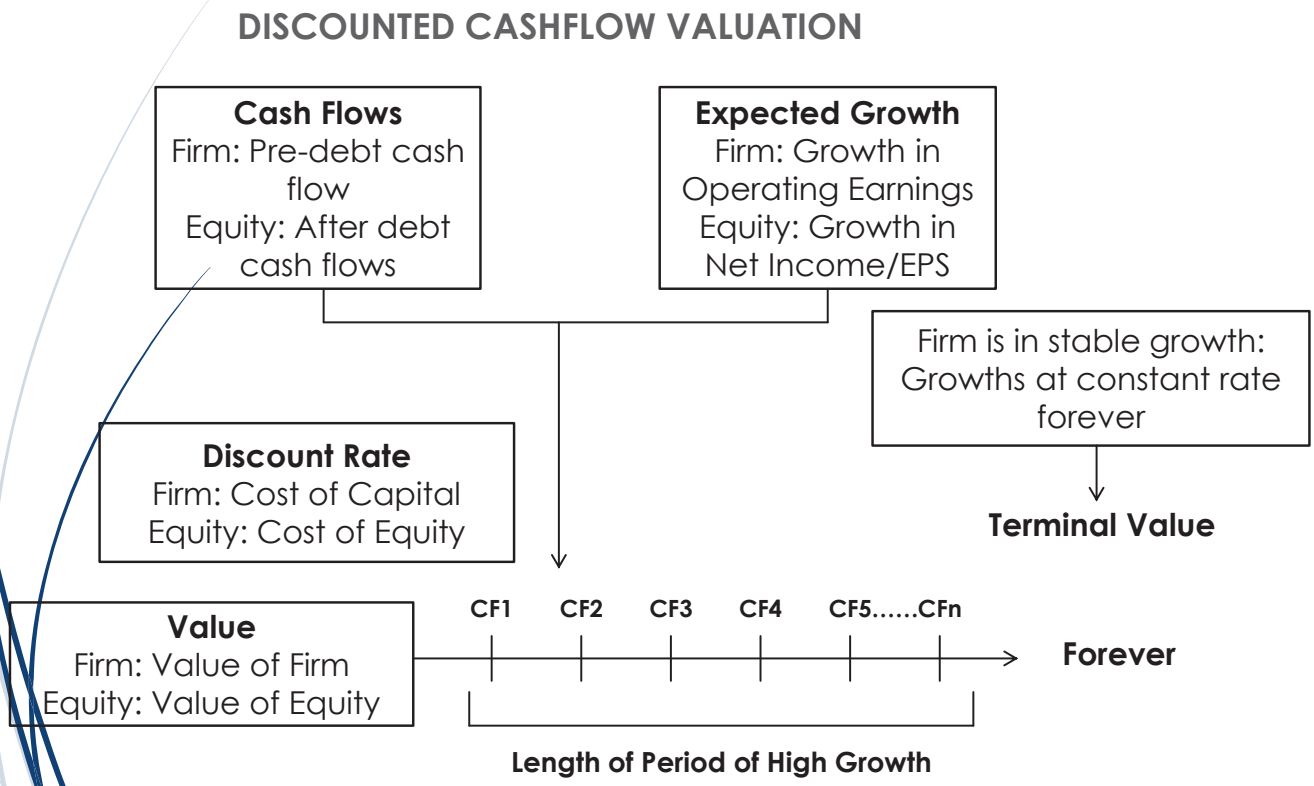
Business Valuation: Income Valuation Approaches

- Income Approach
  - The Income Approach is a valuation technique that provides an estimation of the value of an asset based on the present value of expected cash flows.
  - The various forms:
    - Capitalization of Earnings/Cash Flow Analysis (Gordon Growth Model)
    - Discounted Cash Flow Analysis (DCF)
    - Dividend Discount Model (DDM)

Discounted Cash Flow Valuation: The Steps

- Estimate the discount rate or rates to use in the valuation
  - Discount rate can be either a cost of equity (if doing equity valuation) or a cost of capital (if valuing the firm).
  - Discount rate can be in nominal terms or real terms, depending upon whether the cash flows are nominal or real.
  - Discount rate can vary across time.
- Estimate the current earnings and cash flows on the asset, to either equity investors (CF to Equity) or to all claimholders (CF to Firm).
- Estimate the future earnings and cash flows on the firm being valued, generally by estimating an expected growth rate in earnings.
- Estimate when the firm will reach "stable growth" and what characteristics (risk & cash flow) it will have when it does.
- Choose the right DCF model for this asset and value it.

Generic DCF Valuation Model



Business Valuation: Income Approach

- Capitalization of Earnings Approach
  - Single Period Discounted Cash Flow Analysis
  - Simplest for Companies with Stable Growth
  - Next Year Free Cash Flow to Firm (FCFF)
  - Next Year Free Cash Flow to Equity (FCFE)
  - Apply Appropriate Discount Rate

$$\text{Value} = \frac{CF_1}{(r-g)}$$

CF = Free Cash Flow (FCFF or FCFE)

r = Discount Rate Cost of Capital or Cost of Equity

g = Expected Growth Rate

Business Valuation: Income Approach

- Common Levels of Value
  - Enterprise Value: Free Cash Flow to Firm (FCFF)
    - This is the total cash flow a 100% owner would receive assuming no debt
    - Net Income + Depreciation +/- Non-Cash Items + Interest Expense*(1-Tax) +/- Change in Working Capital – CAPEX
    - Weighted Average Cost of Capital (WACC)
  - Equity Value: Free Cash Flow to Equity (FCFE)
    - This is the cash flow a shareholder would expect to receive after interest and net borrowings
    - Net Income + Depreciation +/- Non-Cash Items +/- Change in Working Capital – CAPEX +/- Net Borrowings
    - Cost of Equity (higher than WACC for the levered company)

Business Valuation: Weighted Average Cost of Capital (WACC)

- Weighted Average Cost of Capital (WACC)

- WACC = Weight of Equity (Cost of Equity) + Weight of Debt (Cost of Debt * (1-Tax)) + Weight of Preferred Security (Cost of Preferred Security)

- Provides Overall Cost of Capital to Whole Company

- Assumes Constant Debt to Capital Over Time

Business Valuation: Income Approach

- Discounted Cash Flow Analysis
  - More General and Flexible Than Capitalized Earnings Method

$$\text{Value} = \frac{CF_1}{(1+r)^1} + \frac{CF_2}{(1+r)^2} + \ldots \frac{CF_n}{(1+r)_n} + \frac{TCF / (r-g)}{(1+r)_n}$$

CF = Cash Flow
TCF = Terminal Cash Flow
r = Discount Rate (Weighted Average Cost of Capital) or (Cost of Equity)
g = Long-term Growth Rate

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Cash Flows and Discount Rates Example

- Assume that you are analyzing a company with the following cash flows for the next five years.

Year	CF to Equity	Interest Expenses (1-t)	CF to Firm
1	$50	$40	$90
2	$60	$40	$100
3	$68	$40	$108
4	$76.2	$40	$116.2
5	$83.49	$40	$123.49
Terminal Value	**$1603.0**		**$2.363**

- Assume also that the cost of equity is 13.625% and the firm can borrow long term at 10%. (The tax rate for the firm is 50%).
- The current market value of equity is $1,073 and the value of debt outstanding is $800.

Equity versus Firm Valuation

Method 1: Discount CF to Equity at Cost of Equity to get value of equity

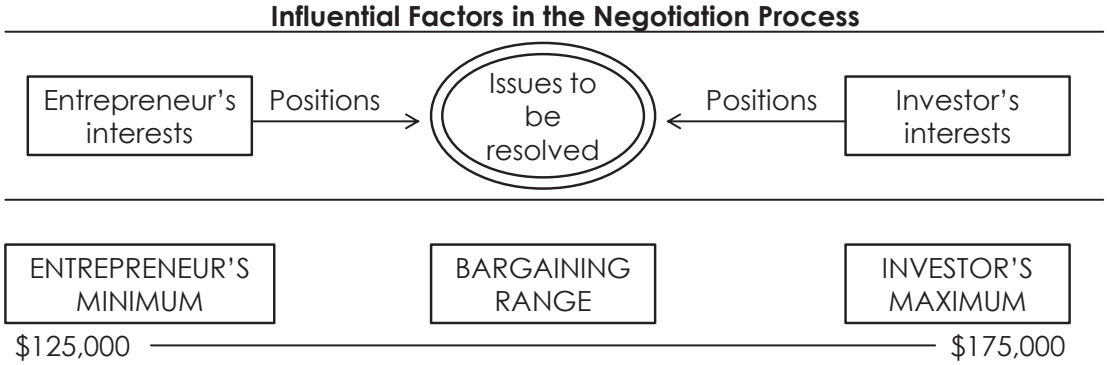
- Cost of Equity = 13.625%
- PV of Equity = 50/1.13625 + 60/(1.13625^2) + 68/(1.13625^3) + 76.2/(1.13625^4) + (83.49 + 1603)/(1.13625^5) = $1.073

Method 2: Discount CF to Firm at Cost of Capital to get value of firm

- Cost of Debt = Pre-tax rate (1- tax rate) = 10% (1- 5) = 5%
- WACC = 13.625% (1.073/1873) + 5% (800/1873) = 9.94%
- PV of Firm = 90/1.0994 + 1--/(1.0994^2) + 108/(1.0994^3) + 116.2/(1.0994^4) + (123.49 + 2363)/(1.0994^5) = $1.873
- PV of Equity = PV of Firm – Market Value of Debt = $1.873 - $800 = $1.073

Negotiating the Funding Agreement

Possibly the most misunderstood aspect of the relationship between entrepreneurs and potential investors is negotiating that relationship. This is likely because in popular use the term is loaded with pejorative connotations of high-pressure, sleazy, unethical tactics. Many entrepreneurs and private investors view negotiating an agreement as one of the more distasteful aspects of the whole process and are glad to put it behind them.



Value-Claiming Issues Versus Value-Creating Issues in Entrepreneurial Negotiations

Distributive Issues (Value-Claiming)	Integrative Issues (Value-Creating)
Share of equity	Timing of investment and vesting schedule
Price per share	Debt seniority
Value of company	Voting versus non-voting
Discount and interest rates	Investor involvement
Amount to be invested	Entrepreneurial team employment security
Performance milestones	Tax exposure (who bears it?)

Negotiation Prescriptions

Negotiation is a means of advancing the full set of your interests by jointly decided action. It is increasingly a way of life for effective entrepreneurs and managers, rather than a special skill mainly for important deals and disputes. Negotiation analysis involves ten steps that should be examined interactively to craft the most effective approach.

Negotiation Prescriptions

1. You should assess the relevant context (or situation): key elements of the setting that locate and shape the negotiation. Is this an Internet deal? What else is going on in the industry space? What other comparable companies have been funded recently, and for what amount? Is this investor savvy regarding this industry sector?
2. Relentlessly focus on how each side sees it's basic negotiation problem and how the solutions to these problems are interdependent. Venture capitalists may have concerns about the stage of your company relative to the age of their fund, or perhaps they are trying to establish a reputation for investing in a particular sector. Angel investors might have had a bad experience and want to understand how things will be different this time.

Negotiation Prescriptions

3. Each side constantly weighs it's basic negotiation problem: the choice between perception of the available deal and the alternatives in terms of how it's interests are served. Your job is to develop a superior alternative so that you are not unduly pressured at the table, and so that disaster does not result if the deal falls through.
4. Since agreement represents simultaneous solution of all sides' problems, solving their problem is part of solving your problem. This lecture has stressed again and again the issues facing investors, be they business angels or venture capitalists; the entrepreneur who focuses on those issues and tries to help the investor with these problems stands a far better chance of being funded. If you just want their money and don't care about their problem, you have dismal prospects for success.

Negotiation Prescriptions

5. A big negotiating challenge is to manage the tension between the cooperative and competitive aspects of the problem constructively. Although there are always some issues that are essentially distributive in nature, these should not consume the majority of effort and creativity in the deal-making process. Seek value-creating options as a means to escape the divide-the-pie mentality.
6. To understand the joint problem, assess the structure of a negotiation and the people involved. Remember that structure and people are mutually influential, not independent and separate sets of considerations.

Negotiation Prescriptions

7. Structural elements include the parties, interests, no-agreement alternatives, and the potential for a jointly beneficial agreement.
8. Assessing the people involved should focus both on individual and social aspects. Knowing, for example, that the person across from the desk is a first-year associate at a venture capital firm who is afraid of making mistakes affects the kind of information you stress and reassurances you give, relative to dealing with a senior and experienced partner in the same firm.

Negotiation Prescriptions

9. Asses the opportunities for creating and claiming sustainable value. Remember, this is a partnership. The desire to win at all costs is likely to spell disaster for the future relationship. This applies to both sides and should be raised as an issue if it is felt that the negotiation is becoming too distributive and competitive.
   Use these assessments to craft a strategy for actions both at and away from the table.