Five Tips for a Successful Exit

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Any number of factors can trigger a tech company's exit: worn-out founders, anxious investors, industry consolidation, or wild, Instagram-like success. As tech founders and executives contemplate the possibility and timing of their exits, they inevitably encounter a multitude of questions about the approach, process and strategy.

While every situation differs, all entrepreneurs should be familiar with the core characteristics of successful exits. A thriving company and valuable product are the first and most necessary steps, but any exit can be enhanced with well-executed strategies that almost always improve outcomes for all the parties: founders, investors and employees.

As a company and its product matures, founders and executives thinking about an exit should consider these five tips:

1. Set Realistic Pricing and Terms Expectations

Everyone on the company side should understand and accept an honest valuation. Setting these expectations early, with as much industry due diligence as possible, will avoid morale issues during the exit process and keep founders, investors and employees grounded and united. Many deals have been lost because of divergent expectations among founders and investors. This risk can be mitigated through clear communications among all key members of the team.

Setting realistic goals on the exit front requires a critical mass of due diligence and valuation information. The main factors include: recent acquisition and valuation activity in the space; the perceived value of the team, especially engineers; and the potential for outsized demand — for instance, is there latent interest in the space from behemoths such as Amazon and Google? Check out Twitch, a site where gamers can watch others play which sold to Amazon for $970 million in 2014.

2. Stage Your Company — and Yourself

You don't sell a house without washing the windows and thinning out the closets. Likewise, your company should be orderly and tidy before you show it to prospective buyers. Building and running a company is hectic and time-consuming. A lot of seemingly small details can get lost in the noise generated by a growing company, but the time to address those details is before any diligence begins.

- Financial cards must be current and audited to ensure that all transactions have been recorded correctly and that standard Generally Accepted Accounting Principles (GAAP) have been followed.
- Develop and verify all documents regarding the onboarding of employees, including at-will work agreements; prior-inventions intellectual property contracts; confidentiality and non-

compete agreements; and equity, options and vesting agreements. These documents from all relevant employees should be in good order prior to starting the due diligence process. Combing through files and fixing any issues before such a process begins is far easier than doing it in the heat of negotiations, or worse, as diligence requests pour in.
- Founders should ensure their own interests are well protected in company vesting and equity contracts. This includes locking down elements like double-trigger acceleration vesting, as well as change-of-control incentives. Double-check personal and estate planning issues. The tighter your ship appears, the more comfortable potential acquirers — and their lawyers — will be in bidding for it.

3. Understand the Impact of the Current Funding Environment
There are many different types of investors pursuing startup companies: accelerators, crowdsourcing, angels, traditional venture capital and private equity funds. This tsunami of capital has fueled not only a large crop of startups, but it has also led to more exits. Founders face new pressures, as disparate classes of investors have varying goals and requirements.

Traditional growth capital investors often have a longer horizon when weighing the risk and reward of exiting now versus holding out for a chance at a much larger deal or even, in the rare case, an IPO. Growth capitalists answer to their limited partners, many of whom are institutional investors such as college endowment funds, and expect their capital to be locked up for long amounts of time.

Smaller investors, from angels to funds comprised of lower net-worth individuals, often have more constrained timelines. They may prefer to sell early and eliminate risk. The demand for liquidity from these new kinds of tech investors can accelerate exit paths and create dynamic sets of influences on founders.

Even companies that weren't venture backed may face pressures to sell from family members who had no part in creating or building the company. In many cases, company founders from the baby-boom generation, approaching retirement, don't see their own zeal for the business reflected in their younger scions. When there is nobody in the family to carry on, it can be an attractive time to sell.

4. Leverage the Larger Pool of Potential Acquirers
Just as the universe of tech investors has changed, so, too, has the profile of potential acquirers. Big tech companies still drive much of the acquisition demand, but companies ranging from media and advertising to insurance and retail are now acquiring tech companies not only for their products, but also for an injection of creative spirit.

Companies like Aetna, Home Depot, Wal-Mart and Capital One have all made acquisitions in the tech space lately. Understanding how these firms value talent and products is essential when striving for full value in a competitive acquiring scenario.

When dealing with any potential buyers, it's best not to be coy, but, as with any negotiation, it's also prudent to never show your entire hand. Companies seeking an exit are well advised to have at least two suitors before charging into an acquisition process. This gives the seller true clout that will net better terms and, often, even more interest in the deal from others. Corporate development officers operate like most other humans: they want things that other people want.

5. Leverage Your Advisers Early
Deciding whether to hire an investment banker as part of the active solicitation process is complicated. Some bankers with specific domain knowledge and experience can greatly enhance a deal. But many investment bankers only work on large transactions — $10M plus of EBITDA or

$50 million in deal value are common thresholds—so this isn't always an option. Further, finding the right banker, the one with industry chops and connections in a particular space, takes time and usually requires an adviser with a deep network.

Lawyers with tech M&A experience can help determine if a banker is necessary and narrow the field of those who should be contacted—so having the right legal counsel on board early is particularly helpful in this realm. Experienced legal firms will also be able to brainstorm with founders and executives on appropriate ways to approach the market, whether to take a more organic approach or whether to formalize the process with a banker.

If the consensus is that a banker would greatly enhance the chances for success, your law firm can help you prepare and make your company more attractive to the right bankers, who prefer to take on projects that are already well buttoned-up and organized.

A banker can also make sense for smaller tech companies with lean executive teams, as the bankers will typically assume much of the work of finding a buyer and honing all the financial modeling, a substantial task that must be completed by a pro. Financial models, often carried out on multi-level spreadsheets with macros and adjustable inputs, will be the first thing on which any corporate development officer will spend a great deal of time.

Experience in dealing with the dynamic influences of investors, acquirers, employees and founders is paramount. It's also critical that any keystone adviser, be it a lawyer, banker or board member, possess a keen understanding of typical deal structures and the "gotcha" clauses often inserted into agreement language by acquirers and equity investors.

Every exit process unfolds differently, so there is no standard template to follow. However, there are certain common traits that distinguish the most successful sellers. And while there's no guaranteeing success in a complicated transaction, understanding the steps described here will drastically boost your chances of getting to an exit that leaves everyone on the selling side satisfied.

TOP 5 TIPS FOR A SUCCESSFUL EXIT

READY TO SELL YOUR COMPANY?

1. **SET REALISTIC PRICING AND TERMS EXPECTATIONS.**
   SETTING EXPECTATIONS EARLY, ALONG WITH DUE DILIGENCE, WILL HELP KEEP FOUNDERS, INVESTORS, AND EMPLOYEES ON THE SAME PAGE.
2. **STAGE YOUR COMPANY.**
   LIKE SELLING A HOUSE, EVERY ROOM MUST DAZZLE. ORGANIZE FINANCIALS; EMPLOYEES AND CHANGE OF CONTROL INCENTIVES; HR, PAY, AND BENEFITS; IP; AND PERSONAL AND BUSINESS TAX PLANS.
3. **UNDERSTAND THE CURRENT FUNDING ENVIRONMENT.**
   INVESTORS ARE EVERYWHERE — FROM ACCELERATORS TO CROWDSOURCING TO ANGELS TO VC AND PE FUNDS. KNOW YOUR STAKEHOLDERS DEMANDS AND HOW THAT AFFECTS YOUR EXIT STRATEGY.
4. **LEVERAGE THE LARGER POOL OF POTENTIAL ACQUIRERS.**
   ACQUISITIONS ARE DRIVEN BY PRODUCT, PEOPLE, AND MARKETS. GET AT LEAST TWO SUITORS BEFORE CHARGING AHEAD.
5. **LEVERAGE YOUR ADVISERS EARLY.**
   THE RIGHT ATTORNEY CAN HELP DETERMINE IF YOU NEED TO HIRE A BANKER, AS WELL AS WHO IS THE RIGHT BANKER.

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