# On-boarding a new investor

## Overview

There are a series of transitions that a company passes through as it grows. This memo describes one such transition: bringing on a new major investor.

For the first phase of a company, an entrepreneur will typically raise funds from friends and family. During this period, often the entrepreneur and possibly their co-founder(s) are the only board members. Even in this period, it is important to rely on competent legal counsel to assure that the basic corporate documents are created and maintained. In addition, certain steps, including the granting of stock options, require action by the board of directors. Your legal counsel, particularly if you have sought out an attorney specializing in startups, will make sure this part of your company is well maintained. But these basics should be in place from the earliest possible time in your startup.

Communications with your existing friends and family investors can be very relaxed and generally entirely in your control with no particular expectations on behalf of those investors. A good practice can be simply sending a quarterly update letter that keeps your investors apprised of your progress.

## Transitioning to a new investor

Following the friends and family round, inviting an institutional investor into your company requires a deliberate upgrade to your investor relations. Typically, when a lead investor executes a priced-round financing into your company, you will likely have that lead investor join your board of directors. This will mark a significant change to how you operate the board of directors and how oversight of management is executed.

A helpful first step is simply to ask your new board member what they expect to see? How often would they like to have board meetings? It is typical to have monthly board meetings, but the schedule can vary depending on the desire of your investors. Can your new board member provide you with examples of board meeting agendas and presentations that they like? What structure do they like to see?

### Milestones

One of the key elements of raising a round of funding is establishing the milestones that will be achieved with the funds raised. To the extent possible, milestones that are more achievable even in the face of uncertainties, are better to set with your investors. Meeting or even exceeding your milestones is vastly better position to be in, than setting stretch goals that you fall short of. Keeping these milestones as your primary objectives and reviewing progress against them with your investors is crucial. Especially if obstacles or issues arise that might require revisiting your objectives or adapting to new circumstances. Keeping your investors up to date will avoid the path of delaying updates and ultimately surprising your investors. An old and important adage is "Never fail alone". Seek out assistance and support from your investors, legal counsel and others in and around your company earlier rather than later.

# Financial health & reporting

## Financial Statements

Likely, a new requirement will be to produce monthly financial statements. If you haven't already, it can be a good time to bring in an out-sourced bookkeeping / accounting firm to handle the books for you. For most startups, the bookkeeping needs are best fulfilled with an outsourced solution, as this approach can provide fractional controller and CFO support even though most of the month-to-month work will be data entry and bookkeeping.

Plan to produce an income statement (P&L), a balance sheet, and a statement of cash flows each month. While it is nice to deliver these at board meetings, more often than not, the timing of board meetings will not align with the preparation and release of financial statements. Therefore, it's better to simply let your board members know that they can expect to receive the financial statements for the prior month by x days from the end of that month. It should be safe to say that you can deliver this within 21 days of the end of the month, but the key thing is to pick a date that is at the outer end of the time you expect you'll need. As always, it's best to under-promise and over-deliver.

The other important attribute of your financials is that they are most likely using accrual-based accounting, rather than cash-based accounting. For the purposes of historical analysis of your financial performance, accrual accounting is superior because it will allocate the dollars you are spending or making over the period of time that it is relevant.

For example, if you purchase an annual insurance policy for $12,000, accrual accounting would charge $1,000 per month for a year on your financial statements. Similarly, if you sell a one-year product support service to your customers for $12,000, your accrual accounting revenue for this would show up as $1,000 per month over the one-year period. In each of these cases, your actual cash in the bank account would decrease by $12,000 for the insurance policy and increase by $12,000 in the support service case in the month that those transactions occurred. Based on this, you'll quickly see that accrual accounting, while appropriate for the history books, is not helpful in tracking the cash position of your company.

It's helpful to take a step back regarding monthly financials. These statements are backward-looking. That is to say, your financial statements tell the story of where your company has been – it doesn't tell you anything about where the company is going. No window on the future!

## Cash

Maybe the most critical threshold you need to track in a startup is the cash position that you hold in the bank. You cannot let it drop to zero. In fact, zero isn't the low water point that you should manage to for a number of reasons. First, if your company offers vacation accruals, you will accumulate an obligation to make these payments to your employees. This means that zero is really a slowly growing value > zero as you have more employees and they accrue more vacation days.

Then, one of the aspects of payroll that you don't typically need to pay attention to, is the fact that payroll is paid in arrears. That means that on any given payroll payment day, your company is likely around halfway through the next payroll period. When you have adequate cash in your bank account, this fact is not material, but as you get close to the cash out point, you will need to make sure that you are not starting a payroll period for which you no longer have the cash available to meet. Another somewhat more minor point, most companies pay employees either every two weeks or twice a month. This is yet another one of those subtle details that can impact your cash forecasting in ways you hadn't anticipated.

Obviously, the total number of dollars that you are expending for your payroll is the same on an annual basis. However, if you are paying twice a month, you end up having 24 payrolls a year, in contrast to paying every two weeks, where you end up with 26 payrolls a year. Since we tend to look at cash flow and forecasting on a monthly basis, with the "every two-week" payroll schedule you will end up with two months each year where there will be a third payroll falling in that month.

Because cash is so crucial to the survival of your company, maintaining a cash flow forecast helps see into the future and will help you anticipate when trouble maybe looming.

All of this should serve as a heads up that your cash position is important and, while there are some quirks, like accrued vacation time and timing of payroll, you can do a remarkably good job projecting out your expenses. The bigger challenge, typically, is forecasting revenue. It's best to lay out your revenue forecast in a conservative way. For example, if you sell a product on net-30 terms, put those revenue items out 45 or even 60 days in your forecast (based on your industry and experience with payments, even 60 days may not be the best answer). Being conservative in your cash flow forecast means that changes are more likely to improve your runway, rather than shrink it.

Maintaining a 13-week cashflow forecast that tracks the bank cash balance for your company will be the best way to assure that you are staying on track with the most important lifeblood of your business. Board members will be extremely pleased to have an updated cashflow forecast to review with each board meeting. So long as you are in good shape for the full 13-week period that the forecast tracks, monthly updating is all you need to do. However, once you begin to see trouble on the horizon, you should switch to updating your forecast each week, and communicating this with your board members even on a weekly basis to enlist their help and support, will help prevent the surprise emergency board meeting, where people find out that the company is out of cash in a week. Remember, no surprises! At least not the bad kind.

## Board meetings

As described above, once you have an institutional investor on your board of directors, the character of board meetings and the professionalism you bring to reporting needs to be upgraded. It is typical for institutional investors joining your board of directors to request monthly board meetings. However, a helpful first step is simply to ask what board meeting cadence they would like to manage to. Even in the case of monthly board meetings, one or two will likely fall away due to schedules, so you can expect ten meetings a year in the case of a monthly cadence.

This section will describe some best practices, but it can be easiest to simply ask your new board member what information they would like to see. Also, ask if they have some example board meeting decks that they like? What have they seen that works well, what doesn't?

### The cast of characters

Another element to consider is having your corporate legal counsel present for board meetings. I have found this to be exceedingly helpful. Your legal counsel can serve as secretary of the meeting and maintain your board minutes, which are required. Also, in board meeting discussions, questions routinely arise that can be quickly discussed with the benefit of your legal counsel present. Otherwise, discussions will often create a point that questions will require your counsel to advise on.

While I recommend an executive coach to support all CEOs, having your coach attend board meetings is also very helpful. This is particularly so for CEOs who have difficulty simultaneously presenting and

reading the room. Your coach can be your eyes in the room and help process the body language that you may not catch as you run your board meetings.

### The board book

On whatever schedule you and your board members agree on, a board book that provides a high-level overview of the state of the company is important. This is an operational review that should provide an update since the last board meeting on progress against objectives and identifying any items that are falling behind, delayed or requiring a new approach. This is also a good opportunity to share the learning that you are doing in the business. It's our view that the most crucial metric for a startup is the rate of learning. Sharing that learning journey with your board is helpful to them and also will help prepare the ground for conversations that might be needed in the future.

### Other considerations

Board meetings can be divided into two main portions: the operational review and board discussion with decision-making. The operational review tends to be delivering the primary contents of the board book. Once you have a level of comfort with your board members, you can consider having some or all of your executive team present the operational review that they are responsible for. It's a good idea to experience the process without others presenting to get a feel for the areas of focus and interests of your board. Then you can prep your executive team to ensure that they are able to handle as much of the operational review portion of the board meeting interaction they are responsible for, as possible without getting taken off course or having some other issues arise.

### Executive session

If you have your executive team present for the operational review, it's helpful to ask them to depart to be able to hold an executive session with only your board present. This is the portion of your meeting that is best suited to discussion and decision-making. There may well be questions or issues that arise in the operational review that you can declare will be addressed in Executive Session. It's your job to manage the meeting and this process and use your best judgement when allowing an extended conversation during the operational review, versus in executive session.

In addition to the board meeting in executive session, it's also good practice, though not mandatory, for the board to meet without the CEO. Best practice is to have this element in each board meeting, even when, as might be typical, there isn't anything for the board to discuss without the CEO. However, if this is practiced, then it doesn't create unnecessary turbulence at the times when there is a need.

### An important thought on board management

Much of the content of board meetings is devoted to operational review, new stock option grants, and the like. However, important questions occasionally need to be discussed in board meetings. Build the habit of 1:1 conversations with <u>each</u> board member in advance of <u>each</u> meeting. This will enable you to socialize proposals and understand, in advance, what board members think. Avoid asking a question in a board meeting that you don't already know the answer to, and design out runaway meetings!

Finally, keep in mind asks you want to make of your board. How can they help you succeed? Have your list updated and ready to go – put your board to work!

# Additional materials

13-week cashflow forecast template

Stock Option Grant Proposal template

*Please reach out to 1CC to request these additional resources.*