# KNOW YOUR INVESTOR!

*Financial Investor or Strategic Investor?*

The entrepreneur and management team should carefully consider what they really need from their investors. If the company only needs money, then the company may want to consider targeting strategic investors. Strategic investors are notorious for investing at much higher valuations then a VC fund. The reason for this is that the strategic investor is not evaluating the investment opportunity strictly upon its financial merits. Instead, the strategic investor will make investments simply to learn about new technology or consider how the company can benefit the strategic investor. If the strategic investor realizes any return at all it is often irrelevant. Strategic investors are like other VC funds and like other professionals; they run the gamut from being excellent, to above average, to average, to very poor. Again, it comes down to "know who you are dealing with." Ask around about the potential investors. Are they easy to deal with? Will they open doors for the company? Will they help the company develop or will they try to stifle the company's technology because it is competitive with their own technology?

A mistake that some companies make is to obtain a strategic investor early who buys stock at an extremely high valuation. However, the strategic investor may not want to participate in later rounds, so the company is forced to seek capital from VC funds. The valuation accepted by the strategic investor may not, and probably will not, be accepted by other VC funds. Consequently, stock will have to be sold at a lower price per share, which is known as a "down round." Selling stock in a down round may trigger anti-dilution provisions, which means that the original shareholder's ownership interests may be diluted more.

The entrepreneur—investor relationship is like other relationships -- husband—wife, parent— child, employer—employee. The success of every long-term relationship depends upon several factors including good faith, regular and clear communication, give-and-take, mutual benefit, and more. Entrepreneurs should understand that when they take money from an investor, they will have to deal with that investor for some period of time, maybe quite a number of years. So, entrepreneurs should consider whether they are compatible with their investors. This is not to say that entrepreneurs and investors have to become the best of friends, but their styles, personalities, and values should be compatible.

As stated earlier, investors often ask entrepreneurs for various documents and ask many questions, spending a substantial amount of time doing their due diligence. It is only fair that the entrepreneur do similar due diligence on their potential investors.

Entrepreneurs and their management teams may want to ask potential investors a number of questions including the following:

1. Do you currently have money available to invest?

2. If you decide to invest in our company, how long will it take you to make a decision?

3. Have you invested in any company in our industry?

4. What value can you add to the company besides your invested capital?

5. How active would you like to be? Will you serve on our board of directors?

6. Can you help the company find other investors?

7. Will you participate in future rounds of financing?

8. If dealing with a VC fund: Who has the authority within the fund to make the final decision?

Most VCs are not trying to get the last nickel - such an approach would be counterproductive. If a VC invests in a company, the entrepreneur and VC will be partners. Trying to take advantage of the entrepreneur and getting the very best deal possible is not conducive to a long-lasting relationship. No one enjoys dealing with another party when they feel like they have been taken advantage of by the other party. Such a feeling only leads to resentment, poor communication, "pay backs" and other problems. Likewise, entrepreneurs should check out the potential investors. The VC-entrepreneur relationship may last several years if an investment is made. Entrepreneurs need to ask themselves if they want to deal with a particular investor for a number of years. Do their personalities mesh? Are their values and goals similar?

Finally, be aware that some investors, and I like to think that it is a small number, may review a company with no intention of investing in it. They take the time to review the company simply to learn more about it and the market, especially if the company is a competitor or potential competitor of a company the investor has already invested in. Or, potential investors may want to meet with various members of the management team because they are looking for talent to recruit for other companies. In short, every entrepreneur and management team should find out as much as they can about potential investors