

THE STARTUP CHECKLIST

25 Steps to a Scalable, High-Growth Business

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Audiobook Supplement



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Program

<i>Foreword</i>	<i>Bill Gross</i>
<i>Preface</i>	<i>Why Every Entrepreneur Needs This Book . . . Instead of the Other 93,210 Books on Entrepreneurship</i>
<i>Introduction</i>	<i>25 Key Action Steps (Plus One) for Every Entrepreneur</i>

Part I Prepare to Launch

1. Translate Your Idea into a Compelling Business Model
2. Craft a Lean Business Plan to Serve as Your Venture's Road Map
3. Find and Know Your Competitors
4. Build Your Dream Team
5. Allocate the Equity in Your Startup
6. Build a Minimum Viable Product and Validate Your Plan with Customers

7. Establish Your Brand with Online Public Profiles
8. Network Effectively within the Entrepreneurial Ecosystem

Part II Launch and Build Your Company

9. Incorporate Your Company for Protection and Investment
10. “Lawyer Up” the Right Way
11. Recruit Your Boards of Directors and Advisors
12. Select an Accountant and an Accounting System
13. Establish and Manage Your Credit Profile
14. Open Bank, Credit Card, and Merchant Accounts
15. Choosing Your Key Technologies, Platforms, and Vendors
16. Measure Your Business with Data Analytics
17. Round out Your Team with Employees and Freelancers
18. Establish a Stock Option Plan to Incentivize Your Team

Part III Raise Funds; Collaborate with Investors; Plan for Your Exit

19. Understand the Funding Process and What Investors Want to See
20. Nurture Your Investor Pipeline
21. Crowdfunding and Online Platforms

-
22. Survive the Term Sheet Negotiation and Investor Due Diligence
 23. Get the Most from Your Investors, Now and in the Future
 24. Understand Your Company's Valuation
 25. Keep Your Eye on the Exit and Reap the Benefits of Success
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The Startup Checklist Online: Gust.com/Checklist

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- Appendix C Starting a U.S. Corporation from a Foreign Country
- Appendix D Sample Convertible Preferred Stock Term Sheet
- Appendix E Sample Convertible Note Term Sheet
- Appendix F Sample Founder Accord

Acknowledgments

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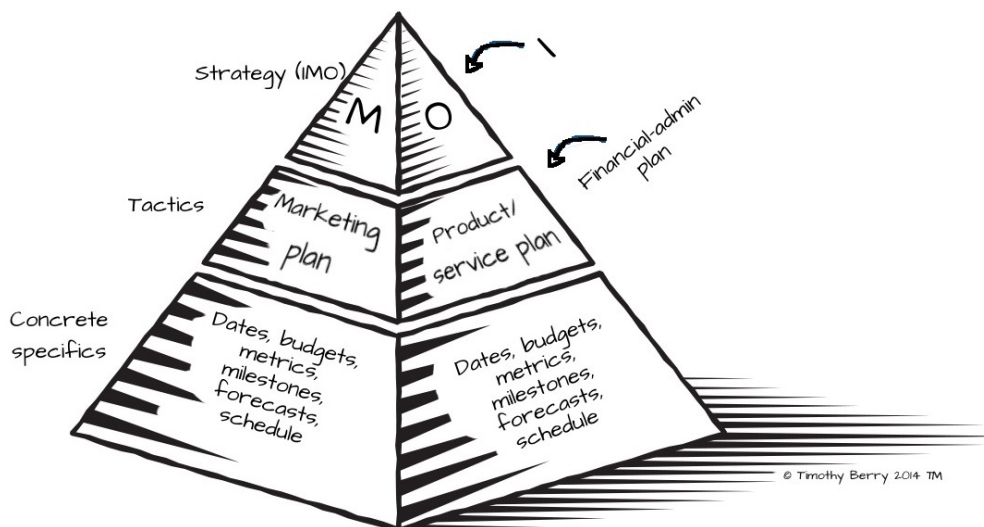
Translate Your Idea into a Compelling Business Model

Key Partners Who are the partners? Who are the suppliers? What do partners do to support your business? What do partners do to help you grow? What do partners do to help you succeed?	Key Activities What key activities do you have to perform to make your business model work? What key activities do you have to perform to make your business model work? What key activities do you have to perform to make your business model work? What key activities do you have to perform to make your business model work?	Value Propositions What value do you offer to the customer? What value do you offer to the customer? What value do you offer to the customer? What value do you offer to the customer? What value do you offer to the customer?	Customer Relationships What type of relationship do you offer to your customer? What type of relationship do you offer to your customer? What type of relationship do you offer to your customer? What type of relationship do you offer to your customer? What type of relationship do you offer to your customer?	Customer Segments For whom are you creating value? For whom are you creating value? For whom are you creating value? For whom are you creating value? For whom are you creating value?
	Key Resources What key resources do you have to perform to make your business model work? What key resources do you have to perform to make your business model work? What key resources do you have to perform to make your business model work? What key resources do you have to perform to make your business model work?		Channels Through which channels do you reach your customer segments? Through which channels do you reach your customer segments? Through which channels do you reach your customer segments? Through which channels do you reach your customer segments? Through which channels do you reach your customer segments?	
Cost Structure What are the most important costs in your business model? What are the most important costs in your business model? What are the most important costs in your business model? What are the most important costs in your business model? What are the most important costs in your business model?			Revenue Streams For what value are your customers willing to pay? For what value are your customers willing to pay? For what value are your customers willing to pay? For what value are your customers willing to pay? For what value are your customers willing to pay?	

The Business Model Canvas

2

Craft a Lean Business Plan to Serve as Your Venture's Road Map



Milestones Table

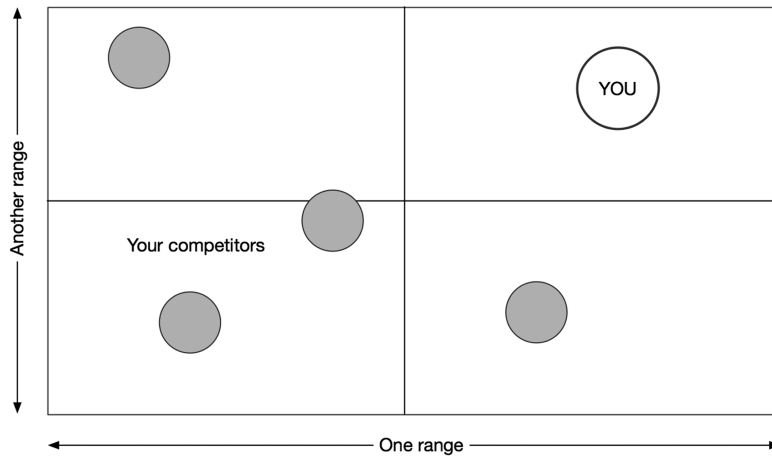
Milestone	Due Date	Who's Responsible	Tactics, Details
Reconfigure social media accounts	Completed	Terry	Marketing tactics
Investigate inventory turns	Completed	Garrett and Leslie	Financial review
Meet with Caroline to review market strategy	Completed	Garrett and Terry	
Top 10 customer list	November 13, 2014	Terry	Tactic: focus
Social media program	January 14, 2015	Terry	Let's make sure we're all on the same page with the new year. Social media priorities, context, emphasis, specific plans.
Monthly review	February 19, 2015	Garrett	
Spring promotion plans	March 18, 2015	Terry	Bicycle season coming again. Review general marketing, specific sales and event schedules.
Host bike repair workshop	May 02, 2015	Terry	Tactic: more per customer
Summer marketing programs	May 20, 2015	Terry	Time to establish specific social media content and events for the summer. Participation in community bicycle events.
Summer finance strategy	May 20, 2015	Leslie	Annual financial checkup on cash flow, working capital, and financial needs during the summer slow season.
Review summer inventory plan	June 20, 2015	Garrett	Financial review
Back-to-school programs	August 19, 2015	Garrett	Special sales, promotions, events, and social media spin for the next school year
Annual strategy review session	October 07, 2015	Garrett	SWOT session, strategy and tactics review.

Sample Lean Plan Milestone Table

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Find and Know Your Competitors

Competitive Factors	Your Offering	Competitor A	Competitor B	Competitor C
Product Quality				
Product Price				
Ease of Purchase				
Service Quality				
Brand Reputation				
Operational Strengths / Weaknesses				
Access to Resources				



Quadrant Chart (above)

Petal Chart (below)



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Allocate the Equity in Your Startup

	Founder 1	Founder 2	Founder 3	Founder 4	
Idea	70	21	21	0	
Business Plan	6	16	2	0	
Domain Expertise	30	20	30	20	
Commitment & Risk	0	49	0	0	
Responsibilities	0	36	0	0	
Total Points	106	142	53	20	321
% of Total	33.0%	44.2%	16.5%	6.2%	100.0%

*“DO NOT Split Equity Between Founders Equally” by Martin Zwilling (<http://www.businessinsider.com/splitting-startup-equity-for-your-piece-of-the-pie-2010-11>), “The Only Wrong Answer Is 50/50” by Dan Shapiro (<http://www.geekwire.com/2011/wrong-answer-5050-calculating-cofounder-equity-split/>), and “Founder’s Dilemmas: Equity Splits” by Eric Ries (<http://www.startuplessonslearned.com/2012/04/founders-dilemmas-equity-splits.html>).

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Establish Your Brand with Online Public Profiles

The screenshot shows a user interface for a company profile. At the top, there is a navigation bar with the company name "Gutenberg Printing" and a search icon. Below the navigation bar, there are tabs for "Home", "Company Profile", and "Reports". The main content area is divided into several sections:

- Profile Status:** A message states "Your profile is in Stealth mode. Your profile is only visible to investors with whom you've shared your profile. Publish your profile to get discovered by investors on Gust." A "Publish Profile" button is visible.
- Company Overview:** A large image of a printing press is shown. Below it, the company name "Gutenberg Printing" is displayed, along with a quote: "The leader in disruptive innovation for the communications industry, our proprietary technology produces perfect Bibles in 1/100th the time at 1/100th the cost." Navigation tabs for "Overview", "Pitch Deck", "Executive Summary", "Financials", and "Documents" are present.
- Company Summary:** A text block describes the company's technology as "the Black Art" and mentions its speed and cost advantages.
- Company Details:** A table lists key information:

Stage	Full Product Ready
Industry	Media and Entertainment
Location	Mainz, Germany
Currency	EUR
Founded	January 1449
Employees	15
Website	gutenberg-museum.de
- Social Presence:** A section for adding social media links.
- Contact:** A section for adding contact information.
- Team:** A section for listing team members, with "Johan Gutenberg" listed as an "Entrepreneur".

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“Lawyer Up” the Right Way

Bryan Cave	Gunderson Dettmer	O'Melveny & Myers
Choate, Hall & Stewart	Hogans Lovells	Orrick, Herrington & Sutcliffe
Cooley	Holland & Knight	Paul, Weiss
Covington & Burling	Jones Day	Perkins Coie
Dentons	K&L Gates	Pillsbury Winthrop
DLA Piper	Latham & Watkins	Proskauer Rose
Duane Morris	LeClairRyan	Pryor Cashman
Fenwick & West	Locke Lord	Venable
Fish & Richardson	Lowenstein Sandler	White and Williams
Foley & Lardner	McDermott Will & Emery	Wilkie Farr & Gallagher
Foley Hoag	Mintz Levin	WilmerHale
Gibson, Dunn & Crutcher	Morgan, Lewis & Bockius	Wilson Sonsini
Goodwin Procter	Morrison & Foerster	
Greenberg Traurig		

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Measure Your Business with Data Analytics



Figure 16.1 Management Dashboard

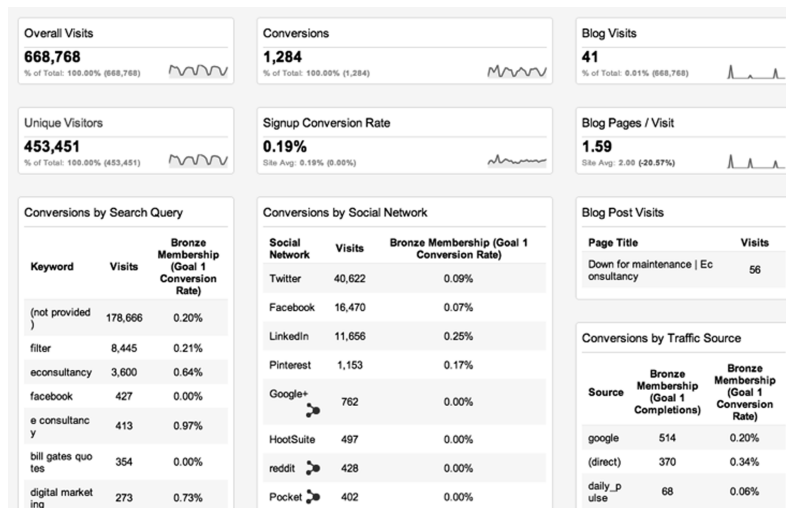


Figure 16.2 Google Analytics



Figure 16.3 Chartbeat

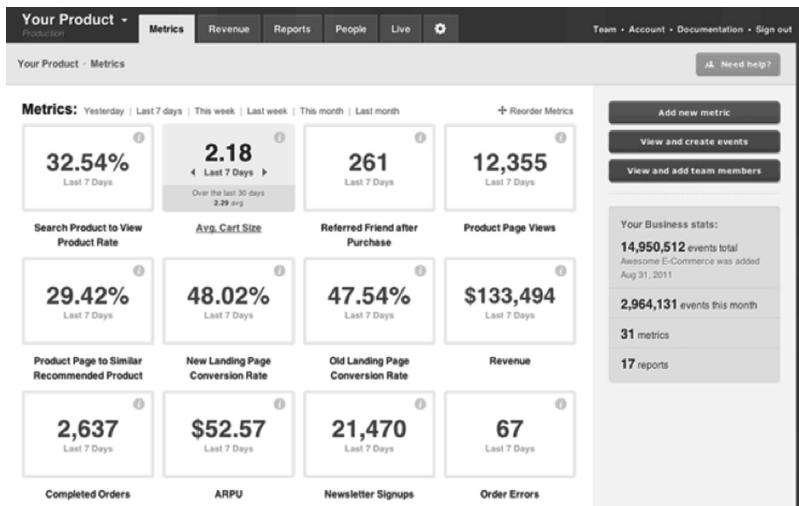


Figure 16.4 Kissmetrics

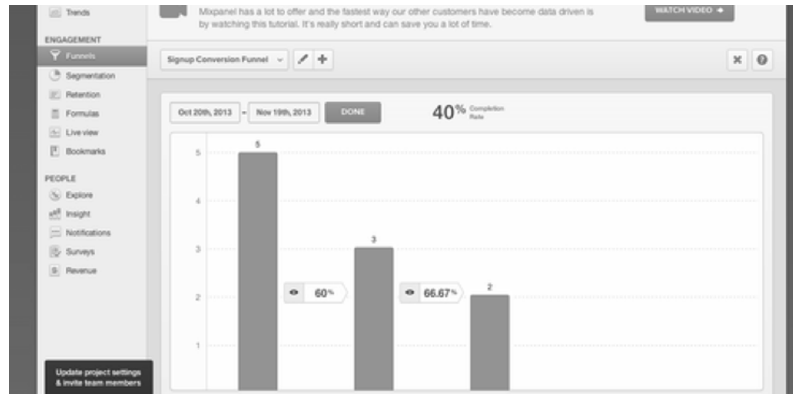


Figure 16.5 Mixpanel

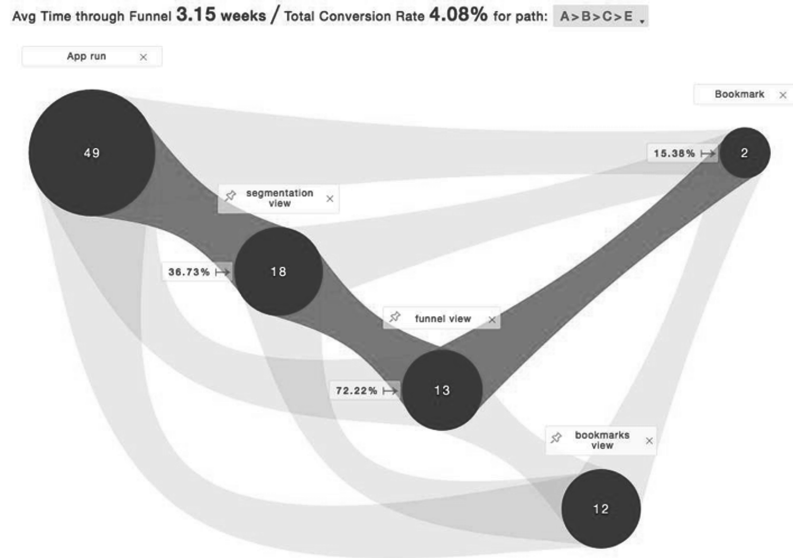


Figure 16.6 Indicative

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Round out Your Team with Employees and Freelancers

		High	Skill and Fit	Low		
Shared					At/Below Market	
Vision and Values		1. Team Leaders		2. Team Players	Candidate Demands	
	Unshared	3. Specialists		4. Waivers		Above Market

Figure 17.1 New Hire Draft Board

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Establish a Stock Option Plan to Incentivize Your Team

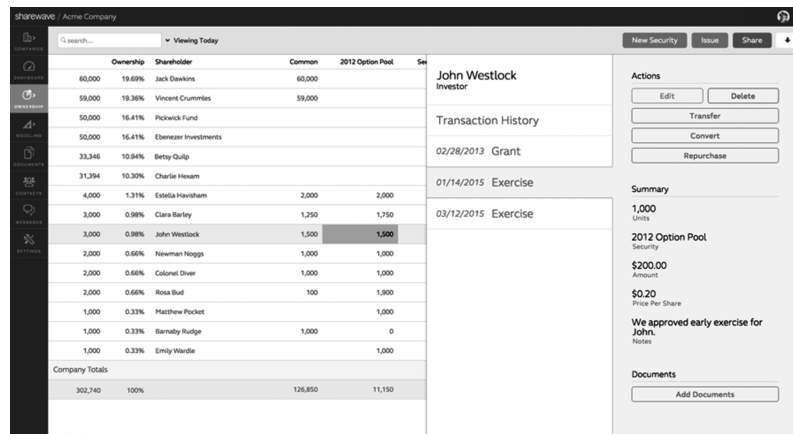


Figure 18.1 Sample Cap Table

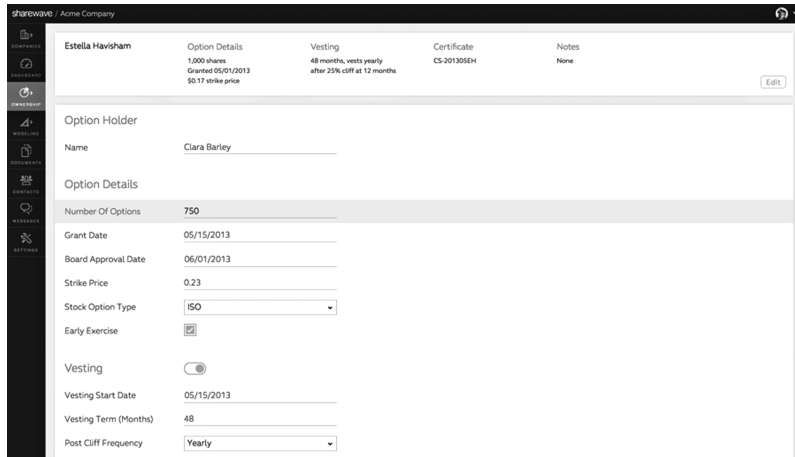


Figure 18.2 Sample Stock Option Account Statement



Figure 18.3 Sample Waterfall Analysis

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Understand Your Company's Valuation

Sample Screening and Valuation Worksheet			
COMPARISON FACTOR	SCALE	TARGET COMPANY	FACTOR
Strength of Entrepreneur and Team	30% max	125%	0.3750
Size of the Opportunity	25% max	150%	0.3750
Product/Technology	15% max	100%	0.1500
Competitive Environment	10% max	75%	0.0750
Marketing/Sales/Partnerships	10% max	80%	0.0800
Need of Additional Investment	5% max	100%	0.0500
Other (Great Customer Feedback)	5% max	100%	0.0500
Sum			1.1550

Figure 24.1 Sample Screening and Valuation Worksheet

Characteristic	Add to Premoney Valuation
Quality Management Team	Zero to \$0.5 million
Sound Idea	Zero to \$0.5 million
Working Prototype	Zero to \$0.5 million
Quality Board of Directors	Zero to \$0.5 million
Product Rollout or Sales	Zero to \$0.5 million

Figure 24.2 Berkus Valuation Factors

- Management risk
- Stage of the business risk
- Legislation/political risk
- Manufacturing risk
- Sales and marketing risk
- Funding/capital raising risk
- Competition risk
- Technology risk
- Litigation risk
- International risk
- Reputation risk
- Potential lucrative exit

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—David S. Rose

The Startup Checklist Online

gust.com/checklist

IF YOU HAVE read all the way through this book, you will no doubt have come to the conclusion that starting up a high-growth company the right way (1) is non trivial, (2) is not cheap, and (3) requires that you find a lot of different players and get them all working together. And even then, keeping an ongoing tight handle on all of the various pieces, from your Business Model Canvas and lean plan, to your cap table and option plan, to your employees and legal agreements, to your finance and accounting issues, is enough to make anyone want to hide under the covers.

Coinciding with the publication of this book is the launch by Gust of a companion web site: a powerful new platform that pulls together everything that you have been reading about and provides a single online tool to manage your startup from the Big Idea to the Big Exit.

At gust.com/checklist you will find a free, cloud-based version of the checklist to help you keep track of your progress, along with updates to the book, downloadable copies of supplementary materials, and links to a wide variety of tools to help you at every step of the startup progress.

Good luck with your scalable, high-growth business!

The Startup Checklist

- Develop and iterate your Business Model Canvas
- Craft and maintain your lean business plan
- Find and monitor your competitors
- Find and collaborate with your founding team
- Establish and maintain your founder accord
- Track and monitor your lean startup experiments
- Establish your online profiles
- Network within the entrepreneurial ecosystem
- Incorporate your venture as a Delaware corporation
- Work with your startup lawyer for incorporation and financings
- Recruit and communicate with your board and advisors
- Manage your financial accounts and accountant
- Establish and manage your credit profile
- Establish your bank, credit card, and merchant accounts
- Integrate your key online platforms and vendors
- Measure your business with data analytics
- Hire your team for best fit and work with freelancers
- Establish and maintain your stock option plan
- Assess your funding readiness and develop your fund-raising pitch
- Reach out to investors and manage your investor pipeline
- Raise funds online from the crowd, angel investors, and VCs
- Execute your investment term sheet and manage all due diligence
- Manage your investor relations
- Keep your 409(a) valuations current
- Plan for a strategic merger or acquisitions or an IPO

Appendix

A

The Startup Reading List

THE E-MYTH REVISITED: Why Most Small Businesses Don't Work and What to Do About It, by Michael E. Gerber (HarperCollins, 1995)

For anyone considering starting his or her own business, this classic is an absolute must; read it before you do anything. It lays out in explicitly stark terms the difference between small business ownership and entrepreneurship. After you finish this, you should have a pretty good feel for whether you have what it takes to create a high-growth business.

The Lean Startup: How Today's Entrepreneurs Use Continuous Innovation to Create Radically Successful Businesses, by Eric Ries (Crown Business, 2011)

This book, based on the experiences of Eric Ries (my successor as entrepreneurship chair at Singularity University), and Steve Blank (originator of the Customer Development approach) has sparked the most significant revolution in the startup world since the rise of venture capital funding in the 1950s. Its premise is simple and stark: Build, measure, learn . . . and then keep repeating. As Eric describes, the first steps in the lean approach are figuring out the problem that needs to

be solved and then developing a minimum viable product (MVP) to begin the process of learning as quickly as possible. Once the MVP is established, a startup can work on tuning the engine by continually measuring, learning from the measurements, and then changing the product in response to what you have learned. I discuss the lean methodology at greater length in Chapter 6.

The Startup Owner's Manual: The Step-By-Step Guide for Building a Great Company, by Steve Blank and Bob Dorf (K & S Ranch, 2012)

This guide takes the lean theories and shows you how to put them into practice, based on the seminal Lean LaunchPad course that Steve developed for the National Science Foundation and that is taken by thousands of startup entrepreneurs (and corporate “intrapreneurs”) every year.

Business Model Generation: A Handbook for Visionaries, Game Changers, and Challengers, by Alexander Osterwalder and Yves Pigneur (John Wiley & Sons, 2010).

One of the tools Steve discusses that has become a hallmark of the lean methodology is the Business Model Canvas. This book is where it all started and uses a deceptively simple graphic visualization of all parts of a business to help you figure out the whys and hows of your business proposition. I explore the Canvas in some detail in Chapter 1.

Lean Customer Development, by Cindy Alvarez (O'Reilly, 2014), and ***Traction: How Any Startup Can Achieve Explosive Customer Growth***, by Gabriel Weinberg and Justin Mares (Portfolio, 2015)

These are great books to help you rapidly get sales and traction during your lean development process.

The Customer-Funded Business: Start, Finance, or Grow Your Company with Your Customers' Cash, by John Mullins (John Wiley & Sons, 2014)

This should be mandatory reading for every startup convinced that the only path to success runs through angel or venture capital. In fact, only a tiny subset of companies will successfully raise money from angel investors, and an infinitesimally small number from venture capitalists. John lays out practical, effective strategies for bootstrapping your startup without investors—which paradoxically is also often the best way to get investors.

From Impossible to Inevitable: How Hyper-Growth Companies Create Predictable Revenue, by Aaron Ross and Jason Lemkin (John Wiley & Sons, 2016)

The ultimate guide to massively scaling up your sales enroute to becoming a unicorn, this book by the team that created the famous SaaStr blog on Quora is mandatory reading for every Software as a Service business, and highly recommended for everyone else as well.

The Definitive Guide to Raising Money from Angels, by Bill Payne (billpayne.com, 2007), is the basic primer on startup fund-raising.

My own book ***Angel Investing: The Gust Guide to Making Money & Having Fun Investing in Startups*** (John Wiley & Sons, 2014) has become the official textbook for how to be an angel investor—and therefore will be of even greater value to you as an entrepreneur, because it gives you the ability to effectively read the mind of a prospective angel investor.

Finally, if you're in the tiny group that can indeed attract a venture capitalist, before you have your first meeting you should read ***Venture Deals: Be Smarter Than Your Lawyer and Venture Capitalist***, by Brad Feld and Jason Mendelson (John Wiley & Sons, 2012) which will let you know what to look for . . . and why.

With all that guidance under your belt, I suggest rounding out your pre-education by sitting down with smart people who have been through this route before and have learned the hard way. While few of us will have the opportunity to do this in person, the next best thing is sitting down with them vicariously.

The Startup Playbook: Secrets of the Fastest-Growing Startups from Their Founding Entrepreneurs, by David Kidder (Chronicle Books, 2013), is a series of interviews with the founders of companies like PayPal, LinkedIn, AOL, TED, and Flickr. Like you, they all began as first-time entrepreneurs, and here they share many of the painful lessons they have learned along the way. Read this along with the shortest book on this list: ***Lucky or Smart?: 50 pages for the First-Time Entrepreneur***, by Bo Peabody (BookSurge, 2008). A tale from one of the first successful Internet entrepreneurs who found himself rocketed from his dorm room to an IPO in the earliest days of the web, Bo's lessons are simple, wise, and an easy read.

Two other collections of very useful tips from successful entrepreneurs and early stage investors are ***INSIGHTS: Reflections from 101 of Yale's Most Successful Entrepreneurs***, edited by my former associate Chris LoPresti (Merry Dissonance Press, 2015), and ***Basic Berkonomics***, edited by my good friend, super angel Dave Berkus (The Berkus Press, 2012).

The above handpicked collection of wisdom, guidance, and cautions will at least get you up to speed on what some really smart people think is important. Together, these books will form the backbone of your entrepreneurial library, give you an understanding of the basic terminology of the field, and hopefully prevent you from making a ton of rookie mistakes.

(By the way, if you are an insatiable reader looking for more suggestions for the high-growth entrepreneur, you might want to check out the reading list that I prepared for my finance, entrepreneurship, and economics students at Singularity University. It includes books on entrepreneurship, presentation skills, global economics, the coming technological singularity, and much more. It is available online at <http://amzn.to/1mzQ6US>.

Appendix

B

Sample Due Diligence Request

BELOW IS A preliminary list of documents and other information that Investor and its outside counsel will need to review in connection with the proposed investment. This is a preliminary document request and upon review of any materials provided to us hereunder, additional requests for documents or information may be forthcoming.

Please furnish for our review copies of the following documents or indicate in writing on a copy of this list that none exist. In addition, please provide a written summary of each oral agreement or arrangement which is responsive to the requests set forth below. We would like to receive all materials responsive to this request at our offices. Any documents identified as originals will be returned to you promptly.

Unless otherwise indicated, (i) all requests are for any matters which are currently existing and in effect or which occurred at any time since the Company's incorporation but which are not now existing or in effect, and (ii) each request applies to all past and present direct or indirect subsidiaries (if any), and all predecessors, whether corporations, partnerships, or joint ventures. For purposes of this

request, all such entities are included in the term “Company.” Where there is no information responsive to the request, please so indicate by writing “N/A” or the equivalent in the margin.

I. Corporate Records.

- A. Chart showing, or a narrative description of, the corporate, partnership, limited liability company structures (parents, all subsidiaries, and other financially or legally related entities) and ownership (including the number of shares and/or percentage of ownership) of the Company.
- B. Copies of the certificates of incorporation, bylaws, partnership agreements, operating agreements, and other similar organizational documents of the Company.
- C. Stock record books and copies of all stock certificates, including reverse sides, of the Company and affiliates.
- D. List of all subsidiaries and affiliates of the Company, if any.
- E. List of jurisdictions in which the Company is qualified or has applied for qualification to do business and evidence of such qualification or application.
- F. List of jurisdictions where the Company has substantial contacts (e.g., real or personal property owned or leased, employees, sales representatives, etc.).
- G. List of the Company’s current shareholders, the numbers of shares owned, and the consideration paid for such shares.
- H. Warrants, stock options, agreements relating to any warrants or options to purchase securities, any convertible security, and other rights to subscribe for or purchase securities.
- I. Schedule of all outstanding stock options and warrants, including name of individual, grant date, expiration date, and exercise price, of the Company.
- J. Voting agreements, voting trusts, shareholder agreements, or other similar arrangements with or among shareholders or equity owners of the Company.
- K. Stock purchase and repurchase agreements.
- L. Stock restriction agreements.
- M. Registration rights agreements.
- N. Minutes or other records of meetings of the Board of Directors, committees of the Board of Directors, or shareholders of the Company.

- O. All materials distributed to members of the Board of Directors, committees of the Board of Directors, or shareholders of the Company since incorporation or organization (or written consents in lieu of meetings).

II. Employee Benefit Plans and Other Employment Matters.

- A. Employment, consulting, compensation, or other agreements or arrangements to which any director, officer, or employee of the Company is a party.
- B. Copies of any provisions of any contract or arrangement, pursuant to which any director or officer (or other applicable principals, partners, or members) of the Company is insured or indemnified in any manner against liability.
- C. All documents relating to pension, deferred compensation, stock option (including SARs), profit sharing, and any other similar plans of the Company; all IRS determination letters relating to the foregoing; and the most recent actuarial report for any defined benefit pension plan for the Company.
- D. All other employee compensation, bonus, incentive, benefit (e.g., life or health insurance), or similar plans of the Company, including plan evaluation and actuarial evaluation reports.
- E. Any standard form employment agreements used by the Company as well as any agreements that deviate in any material respect from such standard forms, and all severance or special termination agreements with senior management of the Company.
- F. Information with respect to any pension benefit plan subject to Title IV of ERISA maintained by an entity other than the Company which is, or was within the past five years, in a single controlled group with the Company.
- G. All collective bargaining agreements to which the Company is a party or by which it is bound, including any side letters.
- H. Any policy manuals or materials with respect to trade or employment practices of the Company.
- I. Confidentiality, proprietary rights, and noncompetition agreements (i) between the Company and any officer, director, employee, consultant, representative, supplier, or customer or (ii) which the Company's employees or consultants have entered into with a prior employer.

- J. Information as to employment arrangements and/or compensation plans where any benefits or rights are triggered by a change in control of the Company, including any so-called golden parachute or similar arrangements.
- K. Information as to employment arrangements and/or severance plans where any benefits or rights are granted upon severance or termination of an employee, whether or not in connection with a change in control of the Company.
- L. Any contracts for consulting or management services.

III. Regulatory Matters.

All applications, filings, findings, reports, registration statements, correspondence, complaints, consent decrees, determinations, orders, etc. relating to federal regulatory agencies and all foreign, state, and local agencies performing similar functions. Include all exhibits for all filings, unless duplicative of material requested elsewhere.

IV. Properties, Assets, and Leases.

- A. List of all real property owned, leased (as lessee or lessor), or used by the Company, including all documentation of ownership, leasehold interest, any encumbrances or restrictions against transfer on such property, and any title insurance policies or title searches.
- B. List of all intangible or intellectual property—e.g., patents, trademarks, copyrights, trade names, trade secrets, and customer lists—owned, leased, licensed, or used by the Company and any patent or trademark registrations or similar documents in any domestic or foreign jurisdiction. Please include any required permits, licenses, approvals, related regulatory reports, or agreements and any actual or threatened claims of infringement or misappropriation.
- C. List of all fixed assets, personal property, and equipment owned, leased, or used by the Company, including all documentation of ownership, leasehold interest, or any encumbrances or restrictions against transfer of such property.

With respect to all of the properties and leases described in this Item IV, please identify any officers, directors, shareholders, or employees of the Company holding an interest in such properties or leases.

V. Material Agreements and Financing Documents.

- A. Loan agreements, lines of credit, indentures, revolving credit agreements, note purchase agreements, notes, other evidence of indebtedness, and all related documents concerning any debt financing.
- B. Venture capital financing documents.
- C. Any agreements in principle or otherwise with respect to mergers, acquisitions, divestitures, or sales of material assets of the Company, whether or not consummated.
- D. Mortgages, security agreements, pledges, and other evidence of liens or letters of credit securing any obligations of the Company.
- E. Corporate and personal guarantees of any obligations and powers of attorney executed in the Company's name.
- F. Schedule and copies of all contracts, agreements, arrangements, or understandings under which the Company (i) has any surviving representations or warranties or any ongoing obligation to indemnify, defend, or hold harmless any party; (ii) is subject to any other material commitment, contingency, or liability; or (iii) which restrict in any manner the right of the Company to conduct its business or to compete with any party.
- G. List of bank accounts belonging to the Company and its affiliates.
- H. Correspondence and internal memoranda relating to any documents requested in this Item V.

VI. Marketing, Sales, and Operations.

- A. Licensing agreements (including inter company).
- B. Patents, patent applications, trademarks, trademark applications and copyrights (domestic and foreign), service marks (domestic and foreign), and documents relating to know-how, trade secrets, and other proprietary information used by the Company.
- C. Promotional material, sales literature, and other advertising documents distributed to potential customers.
- D. Agreements with any educational institutions or relating to the Company's provision of private student loans.
- E. Joint venture, partnership, and limited partnership agreements.

- F. Agency, commission, distribution, franchise, or sales representative agreements.
- G. Governmental contracts, agreements, or purchase orders.
- H. Agreements under which the company is obligated to provide or purchase a material amount of goods or services.
- I. All other contracts (including executory contracts) material to the Company.

VII. Accounting, Financial, and Insurance Matters.

- A. Previous year annual and current year to date monthly financial statements (including balance sheet and income statement).
- B. All documentation relating to any transaction between the Company and any director and officer, including any loans or similar arrangement.
- C. Budgets, fiscal projections, and strategic plans, together with a review of or comparison with actual results, if available.
- D. Summary of federal, state, local, and foreign income tax status, including consents and agreements with any tax authority or any pending or threatened disputes concerning tax matters and all audit papers and communications between the Company and the Internal Revenue Service.
- E. Any documents relating to liabilities and obligations, including material contingent liabilities, write-downs, or write-offs of notes or accounts receivable, incurred otherwise than in the ordinary course of business since formation.
- F. Copies of all insurance policies and a history of insurance claims, with details of any pending claims or incidents which may arise in claims.

VIII. Legal Proceedings.

- A. List and description of all material litigation, administrative proceedings, arbitration proceedings, investigations, claims, or disputes (including pending or threatened litigation or claims) involving the Company or any principal shareholder, officer, director, principal, partner, or member of the Company as a plaintiff or defendant.

- B. All consent decrees, judgments, other decrees or orders, settlement agreements, injunctions, or similar matters (continuing or contingent) to which the Company is a party or involving any person in his capacity as a shareholder, officer, director, principal, partner, member, or employee of the Company.
 - C. Documentation with respect to any pending or threatened disputes with any governmental agency to which the Company is or may become a party.
 - D. All correspondence dealing with actual or alleged infringement of patents, trademarks, and copyrights.
 - E. Any waivers or agreements canceling claims or rights of substantial value other than in the ordinary course of business.
- IX. All other materials and documents involving the Company, not otherwise covered by the foregoing items, which, in your judgment, may be material to the business of the Company or which should be reviewed in making disclosures regarding the business and financial condition of the Company.

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Appendix

C

Starting a U.S. Corporation from a Foreign Country

MANY OF THE discussions in this book pertaining to incorporation, stock option plans, term sheets, and exits relate specifically to U.S. companies. The United States has a long history of supporting entrepreneurship, stable corporate law, and a robust ecosystem of investors who fund scalable, high-growth companies. Indeed, each year more than \$50 billion is invested by American business angels and venture capitalists into early stage businesses.

Because the United States has such a standardized structure for early stage investments (relatively speaking), because U.S. investors are familiar with it, and because there are so many local opportunities for early stage investments (over 700,000 incorporated employer businesses are founded each year in the United States), most American business angels and venture funds invest primarily domestically. For them, the challenges of making international seed investments are typically not worth the trouble and unfamiliarity of dealing in another country.

For that reason, many international founders who are interested in approaching the U.S. investor market have begun to consider

incorporating their venture in the United States and then operating the business in their home country as a subsidiary of the U.S. parent. This makes it just as easy for American investors as it would be if the firm had been a domestic company formed by an American citizen.

What's interesting is that it turns out this is not as difficult as it might sound! The process of forming a Delaware C corporation, as I discussed in Chapter 9, is exactly the same for a nonresident alien as it is for an American citizen. All you need to do is ensure that you provide your real name and real foreign address as the responsible party who will be running the company. You would then form a subsidiary company in your home country, owned entirely by the Delaware corporation. That process is regulated by your own government, with the only wrinkle being that you will need to get your Delaware documents "apostilled" (a somewhat cumbersome process through which the state of Delaware certifies that your corporate documents are legitimate).

Where things begin to get a little tricky, however, is when it comes to financial transactions. If you find American investors who are willing to wire their funds to your overseas bank account, that should be fine. But if instead they insist upon only funding in the United States, you will need to open an American bank account.

It is here, because of the strong anti-money laundering and tax regulations in the United States, that you will have to jump through several bureaucratic and security hoops. Specifically, all U.S. banks are required to know their customer, which means that they are required to do *very* detailed background checks on all of their account holders. You will need to prove your identity, sources of income, address, and more . . . and in many cases do so with original documents or certified copies. This can be a challenge.

Then, once you have convinced the bank that you are who you say you are, you will need to give them the U.S. Employer Identification Number (EIN) for your company in order to open your account. EINs are provided by the U.S. Internal Revenue Service (IRS), the federal government's tax agency, and are typically procured right after your company is incorporated and often by the same registered agent service that handled your incorporation.

The problem is that getting an EIN requires you provide the IRS with a U.S. Social Security Number (SSN), or an Individual Taxpayer

Identification Number (ITIN). While all U.S. citizens will have one (so it's not a problem for them), *you* won't. That means you will need to apply to the IRS to give you one. And while this is certainly not impossible, or even improbable, it can be time-consuming, bureaucratic, and a major pain. But it *can* be done, so follow the instructions at <https://www.irs.gov/Individuals/International-Taxpayers/Obtaining-an-ITIN-from-Abroad>, and keep your sense of humor while exercising patience.

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Appendix

D

Sample Convertible Preferred Stock Term Sheet

This term sheet for financing early stage companies with investments from sophisticated angel investors was developed by Gust, the platform powering over 90 percent of the organized angel investment groups in the United States. The goal was to standardize on a single investment structure, eliminate confusion, and significantly reduce the costs of negotiating, documenting, and closing an early stage seed investment.

For those familiar with early stage angel transactions, this middle-of-the-road approach is founder friendly and investor rational, intended to strike a balance between the Series A model documents developed by the National Venture Capital Association (NVCA) that have traditionally been used by most American angel groups (which include a 17-page term sheet and 120 pages of supporting documentation covering many low-probability edge cases), and the one-page Series Seed Term Sheet, version 2.0, developed in 2010 by Ted Wang of Fenwick & West

as a contribution to the early stage community (which deferred most investor protections and deal specifics until future financing rounds).

Terms for Private Placement of Seed Series Preferred Stock of [Insert Company Name], Inc.

[Date]

The following is a summary of the principal terms with respect to the proposed seed series preferred stock financing of _____, Inc., a [Delaware] corporation (the “**Company**”). Except for the sections titled “Expenses,” “No Shop/Confidentiality,” [and “Special Terms”], such summary of terms does not constitute a legally binding obligation. Any other legally binding obligation will only be made pursuant to definitive agreements to be negotiated and executed by the parties.

Shares of stock are only applicable to an incorporated company, which means that this term sheet is only applicable to a C Corporation. (Angel investments in a limited liability company are more complex and require a different structure.) Delaware is the favored state of incorporation for U.S. businesses (including more than half of the Fortune 500) because it is considered corporate friendly, with well-established case law. While not required either by law or by this term sheet, incorporation of the company in Delaware is strongly advised. Recently, Nevada has developed a similar reputation and is sometimes used as the incorporation venue for companies based on the West Coast.

This term sheet is, for the most part, “nonbinding,” which means that it is used only to document the general meeting of the minds between the two parties and not to serve as the legal basis for the investment. However, its first paragraph makes clear that the three specific sections referenced, “Expenses,” “No

Shop/Confidentiality,” and “Special Terms” (if such a section is included), ARE legally binding, and once this term sheet is signed by both parties, those sections only are immediately in force. Therefore, regardless of whether the investment is ultimately made, any breach of things such as the confidentiality provisions, or the requirement to pay legal fees, can subject the breaching party to legal action by the other.

Note that the company name should be inserted in both the title and in the first paragraph, the state of incorporation should be inserted where indicated, and the brackets should be removed. If there is a Special Terms section added to the document, the brackets around that phrase should be removed; otherwise delete the whole bracketed phrase.

Offering Terms

Securities to Issue: Shares of seed series preferred stock of the Company (the “*Series Seed*”).

In exchange for their financial investment, the investors under this term sheet are acquiring shares of stock in the company. Unlike common stock (which is what is usually purchased on the public stock markets), this term sheet specifies preferred stock. The difference is that in the case of a sale, liquidation, or winding up of the company, the preferred stock gets paid back first, before any common stock (which is typically what founders and employees of the company hold). However, because preferred stock gets back ONLY the amount invested, all of the upside goes to the common stock holders. For that reason, a subsequent section of this term sheet provides for the option of the investors to convert the preferred to common, if such conversion would be in the investors’ interest.

Note that the class of stock being purchased in this investment round is named “Series Seed.” This is a purely arbitrary name, for reference purposes. Traditionally, a first, relatively small investment round from angel investors or a seed fund would be called a Series Seed. The first institutional investment round from a venture capital fund would be called a “Series A,” with each subsequent round incrementing one letter (Series B, Series C, etc.).

Aggregate Proceeds: Minimum of \$ _____ [and maximum of \$ _____ in aggregate].

This sets forth how much money the company is planning to raise in this round. Investors typically would not want to fund their commitments until they are sure that the company will receive enough money to be able to achieve its objectives for this round. As such, even if the investors and the company sign the term sheet today, no money will change hands until at least the minimum amount is committed by adding additional commitments from other investors. If the company and investors have agreed upon a maximum amount to be raised, insert it here and remove the brackets. If there is no maximum, delete the bracketed phrase.

Lead Investors: _____, who will invest a minimum of \$ _____

This sets for the identity of the investor(s) who are signing this term sheet and committing to invest in the company. While other investors may participate in the funding, the primary investor (whether individual, fund, or group) may (but need not) be granted additional rights in the term sheet. The amount here is the minimum amount that the lead investor(s) are committing to this round, and is distinct from the minimum amount required to consummate the investment.

Price per Share: \$ _____ (the “*Original Issue Price*”), based on a premoney valuation of \$ _____, calculated based upon the capitalization of the Company as set forth in Exhibit A inclusive of an available postclosing option pool of 15 percent after receipt of maximum aggregate proceeds.

The price that investors will pay for each share of preferred stock is calculated on the basis of the other factors noted in the term sheet, as well as the number of shares that the company has authorized (or will do so as part of this round). This price is usually filled in last, with the important number in this paragraph being the premoney valuation. This is the amount that the founders and investors agree that the company is worth as of the date the term sheet is signed, before the investors’ money is received by the company.

To make this section absolutely clear for everyone, it refers to Exhibit A to the term sheet, which is a capitalization table for the company, showing in names and numbers exactly who owns what shares, both before and after the investment.

In the second part of the sentence the parties agree that before the investment happens, the company will set aside extra shares of common stock that will be used to attract and compensate future employees. This is known as the “unallocated, postclosing option pool.” The important thing to understand here is that the 15 percent for the option pool is what will exist AFTER the investment, but the calculation is done BEFORE the investment is made. That means all of the shares for the option pool come out of the founder’s shares, not the investors’.

Here is an example: A founder owns 100 percent of a company. Investors put in \$350,000 in exchange for 35 percent ownership. That means the postmoney valuation of the company is \$1 million, and the premoney valuation (after subtracting out the \$350,000) is \$650,000. However, as the term sheet indicates, there needs to be a pool of 15 percent of the stock available for employee options. This means the postclosing cap table shown in Exhibit A will show 35 percent for the investors, 15 percent for the option pool, and 50 percent for the founder.

Dividends: Annual 5 percent accruing cumulative dividend payable when as and if declared, and upon (1) a redemption or (2) a liquidation (including a Deemed Liquidation Event) of the Company in which the holders of Series Seed receive less than 5 times the Original Issue Price per share (the “Cap”). For any other dividends or distributions, participation with common stock on an as-converted basis.

A dividend on preferred stock is roughly equivalent to interest on a loan. This paragraph says that investors are entitled to a 5 percent dividend each year on their investment but that the company’s Board decides when, as, and if dividend payments are actually made. Since growing companies always need cash, it would be extremely unusual for a Board to declare a dividend payment during the early years. However, “accruing cumulative dividends” means that if the dividends are not paid each year, they continue to accrue until such time as they are.

This paragraph sets out a couple of additional cases where the accrued dividends must be paid: (1) is the highly unusual case in which after seven years (as laid out in a subsequent section) the company is successful but the investors have not been able to get their money out, and therefore require the company to repurchase their stock, and (2) a sale or other winding-up of the company . . . but only in a case where the investors would otherwise receive less than a 5× return.

Finally, the last sentence says that if the common stock (usually held by the founders) gets a dividend, so does the preferred stock held by the investors.

Liquidation Preference:

One times the Original Issue Price plus any accrued and unpaid dividends thereon (subject to the Cap) plus any other declared but unpaid dividends on each share of Series Seed, balance of proceeds paid to common. A merger, consolidation, reorganization, sale, or exclusive license of all or substantially all of the assets or similar transaction in one or a series of related transactions will be treated as a liquidation (a “Deemed Liquidation Event”).

This paragraph says that if the company is converted to cash (“liquidated”) whether for happy reasons, such as getting acquired for a billion dollars, or sad ones, such as going out of business and selling the furniture, after paying all of its debts (which always get paid before equity) any remaining money first goes to pay back the amount put in by the investors and then goes to pay the accrued dividends. After that, everything and anything that’s left goes to the common stock holders (typically the founders and employees).

While this sounds good for investors in the sad case, it means that in the happy case, even if the company is sold for a billion dollars, the only money the investors will get back is their original investment plus the 5 percent dividend. That’s the reason for the next section: Conversion.

Conversion: Convertible into one share of common (subject to proportional adjustments for stock splits, stock dividends and the like, and broad-based weighted average antidilution protection) at any time at the option of the holder.

Here's where investors get their return: While preferred stock gets paid off first, it doesn't participate in any upside benefits. On the other hand, common stock gets a proportional share of any incoming money (such as a from the proceeds of an acquisition) but has to stand in line behind the preferred. So this paragraph says that investors who hold preferred stock can choose at any time to convert it into common stock. The result is that in a bad scenario (the company is going out of business) the investors stay with preferred and get the first money out. But in a good scenario (an acquisition at a high price), they will choose instead to convert to common and share in the good things.

The "broad-based weighted average antidilution protection" means that if the company at some point in the future raises money at a lower valuation than that being used for the current round, the current investors will be partially protected. This provision is a middle-of-the-road industry standard, halfway between the founder-biased "no antidilution" approach and the investor-biased "full ratchet antidilution" version.

Voting Rights:

Votes together with the common stock on all matters on an as-converted basis. Approval of a majority of the Series Seed required to (i) adversely change rights of the Series Seed; (ii) change the authorized number of shares; (iii) authorize a new series of preferred stock having rights senior to or on parity with the Series Seed; (iv) create or authorize the creation of any debt security if the Company's aggregate indebtedness would exceed 50 percent of the aggregate proceeds of the Series Seed; (v) redeem or repurchase any shares (other than pursuant to the Company's right of repurchase at original cost); (vi) declare or pay any dividend; (vii) increase in

the option pool reserve within two years following the closing; (viii) change the number of directors; or (ix) liquidate or dissolve, including any change of control or Deemed Liquidation Event.

This is where most of the protective provisions for investors are found. It says that even though investors hold preferred stock, when it comes to voting we will treat them as if they had converted to common stock so that everyone who owns stock (founders, investors, et al.) gets to vote together on things requiring shareholder approval. However, in addition to their voting alongside every other shareholder, this paragraph provides for a Series vote on certain issues. That is, even if the Board of Directors and 100 percent of all the other shareholders voted to do something in one of these areas, it wouldn't happen unless a majority of the investors in this round agreed. The subjects requiring a Series vote are generally ones that protect the investors from having their rights stripped, having their voting power diluted out of existence, or having the money they just put in go to someone else.

Documentation:

Documents will be based on Seed Series preferred stock documents published at <http://gust.com/SeriesSeed>, which will be generated/drafted by Company counsel.

A term sheet lays out the general outline of an investment, but the devil is in the details. Once the term sheet is signed and the company and investors proceed to a closing, the lawyers then draft dozens of pages of documentation, including an amended certificate of incorporation, a shareholders agreement, an investors' rights agreement, and so on. The Gust website has a set of standard model documents that match the provisions of this term sheet and make it very easy for an attorney to use them as the basis for his or her work.

While nothing will be signed and finalized until both the parties and their respective attorneys are satisfied, someone has to take the first step in drafting the documents. This paragraph says that the Company's counsel will do so, based on the Gust standard docs.

Financial Information:

All investors will receive annual financial statements and narrative update reports from management. Investors who have invested at least \$25,000 (“**Major Investors**”) will receive quarterly financial and narrative update reports from management and inspection rights. Management rights letter will be provided to any investor that requires such a letter. All communications with investors shall be conducted through Company’s secure investor relations deal room on the Gust platform, which Company shall be responsible for maintaining with current, complete, and accurate information.

Because private companies are not required to file any statements with the Securities and Exchange Commission, this section lays out what information the company will be required to provide to its investors so that they are aware of what is happening with their investments. It provides for annual financial and written update reports from the company’s management be sent to all investors. In addition, investors who have put in more than \$25,000 are entitled to quarterly reports, and have the right to visit the company on request and see the corporate books and records (subject, of course, to confidentiality).

A management rights letter is a particular document required by certain venture funds.

To ensure timely communications with investors, the company is required to keep its information updated and current in its Gust deal room, which will greatly enhance both the company’s investor relations and the investors’ portfolio management activities.

Participation Right:

Major Investors will have the right to participate on a pro rata basis in subsequent issuances of equity securities.

If the company sells additional stock at any time in the future, this says that each investor has the right (but not the obligation) to participate in such future rounds on the same terms as the new investors, at least up to an amount that will enable them to maintain the same percentage ownership after the new investment that they had before.

**Redemption
Right:**

The Series Seed shall be redeemable from funds legally available for distribution at the option of the holders of a majority of the outstanding Series Seed commencing any time after the seventh anniversary of the closing at a price equal to the original purchase price plus all accrued but unpaid dividends and any other declared and unpaid dividends thereon. Redemption shall occur in three equal annual portions.

If, after many years, the company ends up as a lifestyle business, where it is profitable but not likely ever to have an exit, this paragraph gives the investors the right to require the company to buy back their stock for what they paid for it (plus dividends). The repurchase (known as “redemption”) would take place over three years, starting at the investor’s option any time after the seventh year.

**Board of
Directors:**

Two directors elected by holders of a majority of common stock, one elected by holders of a majority of Series Seed. Series Seed director approval required for (i) incurring indebtedness [**exceeding \$25,000**] for borrowed money prior to the Company being cash flow positive; (ii) selling, transferring, licensing, pledging, or encumbering technology or intellectual property, other than licenses granted in the ordinary course of business; (iii) entering into any material transaction with any founder, officer, director, or key employee of the Company or any affiliate or family member of any of the foregoing; (iv) hiring, firing, or materially changing the compensation of founders or executive officers; (v) changing the principal business of the Company; or (vi) entering into any Deemed Liquidation Event that would result in the holders of Series Seed receiving less than five times their original purchase price.

The Board of Directors of a company is in charge of making all major decisions, including hiring/firing the CEO. This paragraph establishes a three-person board, with two of the members appointed by the common stock holders and one by the investors in this round.

While this 2:1 ratio means that the directors appointed by the commons (usually the founder[s] themselves) could always outvote the investor, the term sheet equalizes things by setting forth a number of areas in which not only does a majority of the board have to approve, but the director appointed by the investors must also specifically approve. The \$25,000 limit on borrowing is rational for smaller deals but can be increased for larger ones.

Expenses:

Company to reimburse investors a flat fee of \$_____ for background check expenses, due diligence and review of transaction documentation by Investors' counsel. Company shall be responsible for expenses related to Company's Gust investor relations deal room.

Out-of-pocket expenses related to closing an investment are typically picked up by the company out of the investment proceeds. Given no deviation from this standard term sheet, a moderate flat fee for all of the investors' legal work is eminently reasonable, likely much less than the \$20,000 or more when a full-scale NVCA term sheet is used. Including the cost of maintaining the company's investor relations site means that investors are assured of always getting up-to-date information in a form that is immediately usable to them.

Future Rights:

The Series Seed will be given the same contractual rights (such as registration rights, information rights, rights of first refusal, and tagalong rights) as the first series of preferred stock sold to investors on terms similar to, or consistent with, NVCA or other standard documents customary for venture capital investments by institutional investors.

This is the magic paragraph that ensures investors are protected with all the provisions included in the NVCA model documents, assuming that the company does a follow-on investment round with an institutional investor, such as a traditional venture fund. It is what allows us to cut 14 pages' worth of detail out of this term sheet, compared with the NVCA one.

**Founder
Matters:**

Each founder shall have four years vesting beginning as of the closing, with 25 percent vesting on the first anniversary of the closing and the remainder vesting monthly over the following 36 months. Full acceleration upon "Double Trigger." Each Founder shall have assigned all relevant IP to the Company prior to closing and shall have entered into a nondisclosure, non-competition, and nonsolicitation agreement (to the fullest extent permitted by applicable law), with such noncompetition and nonsolicitation covenants to be applicable during the term of his or her employment by the Company and for one year after the termination thereof. Founders shall be subject to an agreement with the Company pursuant to which the Company shall have a right of first refusal with respect to any proposed transfer of capital stock of the Company at the price offered.

This section provides for what is called "reverse vesting" for the company's founders. Even though they may start out owning 100 percent of the company's stock, this gives the company the right to repurchase the stock owned by the founder(s) if they leave the company. The terms are the standard four-year vesting/one-year cliff, which means that if the founder leaves within the first year after the investment, the company can reacquire all of his or her stock, and after the one-year anniversary, the remaining stock vests monthly over the next three years. While some founders initially find this onerous, it is actually *very* much in each founder's best interest, because otherwise one cofounder (say, out of two) could theoretically walk away from the company the day after the closing and retain nearly half of the equity . . . something that would be manifestly unfair to the other founder.

The “full acceleration upon Double Trigger” means that if the company is acquired before the four years are up, and the new owners terminate the founder, all of the remaining stock owned by the founder immediately vests.

Other provisions of this section ensure that the founder(s) have fully assigned all of their intellectual property so that it is owned by the company, that they have entered into an employment agreement providing for nondisclosure of confidential information, and that if they leave the company, they are restricted for a year from either directly competing with the company or poaching its employees.

Finally, this section says that if founders want to sell any of their stock, they are required to first offer it to the company.

**No Shop/
Confidentiality:**

The Company and the founders agree that they will not, for a period of 60 days from the date these terms are accepted, take any action to solicit, initiate, encourage, or assist the submission of any proposal, negotiation, or offer from any person or entity other than the investors relating to the sale or issuance of any of the capital stock of the Company and shall notify the investors promptly of any inquiries by any third parties in regards to the foregoing. The Company and the founders will not disclose the terms of this term sheet to any person other than officers, members of the Board of Directors, the Company’s accountants and attorneys, and other potential investors acceptable to the investors, without the written consent of the Investors.

The idea behind a No Shop provision is that investors do not want to be used as a straw man for helping the company get a better deal from someone else. So there can be as much discussion as necessary, and as many unsigned drafts of the term sheet exchanged as necessary, but the minute the company signs this term sheet, they are agreeing that for 60 days they won’t talk to anyone else about investing, without the investors’ approval.

**Special
Terms:**

[Deal-specific comments/conditions inserted here.
Otherwise delete this section.]

In order to keep the rest of the term sheet absolutely standard and reduce legal and drafting costs, there should be absolutely NO modifications within the text of the other sections of the term sheet. This "Special Terms" section is the one place that anything unusual or specific to this particular investment should go, although the more special terms or modifications there are, the longer it will take to negotiate and the more the legal fees will cost. Remember that every page in the term sheet ultimately translates into 10 or more pages of the actual deal documentation, and every new or special provision added requires that the lawyers on both sides write, read, and negotiate something nonstandard. As a rule of thumb, every time the documents need to go back and forth between the lawyers, it adds approximately \$5,000 to the overall legal costs for the transaction.

Company: [_____, Inc.]

Name: _____

Title: _____

Date: _____

FOR THE INVESTORS:

Name: _____

Title: _____

Date: _____

Since parts of the term sheet are legally binding, it should be signed by someone legally able to bind both parties. This would normally be the CEO of the company and a lead investor who is firmly committed to investing in the company on these terms.

This sample term sheet was developed by Gust with the legal support of Lori Smith, Esq. of White and Williams, and extensive comments from the members of the New York Angels Term Sheet Committee, including Larry Richenstein, Jeffrey Seltzer, and Mark Schneider. Annotations and commentary copyright © 2013 by David S. Rose.

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Appendix

E

Sample Convertible Note Term Sheet

Terms for Convertible Note Bridge Financing of NewCo, Inc.

_____, 20__

The following is a summary of the principal terms with respect to the proposed convertible note financing of NewCo, Inc, a Delaware corporation (the “**Company**”). Except for the sections entitled “Expenses” and “No Shop/Confidentiality,” such summary of terms does not constitute a legally binding obligation. Any other legally binding obligation will only be made pursuant to definitive agreements to be negotiated and executed by the parties.

Securities to Issue:	Convertible promissory notes of the Company (the “ Notes ”).
Aggregate Proceeds:	Minimum of \$_____ and maximum of \$_____ in aggregate, including the conversion of any prior convertible notes outstanding as of the Closing.
Lenders:	Nice Guy Angels, LLC (the “ Lead Lender ”), who will lend a minimum of \$_____, and other lenders acceptable to the Company and the Lead Lender.

Purchase Price:	Face value.
Interest Rate:	Annual 5 percent accruing cumulative interest, payable at maturity.
Term:	All principal, together with accrued and unpaid interest under the Notes, is due and payable on the date that is 12 months from the Closing (the “ Maturity Date ”). The Maturity Date may be extended by the consent of holders of the Notes that hold a majority of the aggregate outstanding principal amount of the Notes (a “ Majority Interest ”).
Note Priority:	Notes shall be senior to all other indebtedness. All unsecured indebtedness of the Company for borrowed money will be fully subordinated to the prior payment of all principal and interest on the Notes.
Prepayment:	The Notes may not be prepaid without the consent of a Majority Interest.
Conversion:	<p>The “Conversion Sales Price” shall be a price per share equal to the lesser of (i) 80 percent of the lowest price per share paid by any other party purchasing common or Preferred Stock upon a Conversion Event as defined below or (ii) the price obtained by dividing (x), \$_____ (the “Valuation Cap”), by (y), the number of Fully Diluted Shares outstanding immediately prior to the Conversion Event. “Fully Diluted Shares” shall mean the number of shares of Common Stock of the Company outstanding at the applicable time assuming full conversion or exercise of all the outstanding options, options reserved for issuance, warrants, and convertible securities (other than the Notes).</p> <p>A “Conversion Event” shall mean any one of the following events:</p> <p>(i) <i>Qualified Financing</i>. The Company consummates, on or prior to the Maturity Date, an equity financing pursuant to which it sells shares of a series of its preferred stock (“Preferred Stock”) with an aggregate sales price</p>

of not less than \$_____ (excluding all indebtedness other than the Notes that are converted into Preferred Stock in such financing) with the principal purpose of raising capital (a “**Qualified Financing**”).

(ii) *Nonqualified Financing*. The Company consummates, on or prior to the Maturity Date, an equity financing pursuant to which it sells shares of a series of Preferred Stock, which is not a Qualified Financing (a “**Nonqualified Financing**”).

(iii) *Change of Control*. On or prior to the Maturity Date and prior to the consummation of a Qualified Financing, the Company consummates a change of control or sale transaction of its Common Stock (a “**Change of Control**”).

(iv) *Maturity*. The Company has not consummated a Qualified Financing or a change of control or sale transaction on or prior to the Maturity Date, and the Maturity Date has not been extended by a Majority Interest.

**Conversion
under**

(i) shall be automatic. Conversion under (ii)–(iv) shall be at the option of a Majority Interest.

In the event of a financing conversion described in (i) or (ii) above, the Notes shall convert into a series of Preferred Stock that is identical to the securities issued in the Qualified or Nonqualified Financing and on the same terms as the other parties purchasing such stock upon the Conversion Event, except that for the purposes of the Notes, the Original Issue Price in such financing shall be the discounted price actually paid per share by the note holder.

In the event of a Change of Control conversion described in (iii) above, the Notes shall convert into Common Stock.

In the event of a Maturity conversion described in (iv) above, the Notes shall convert into nonparticipating convertible Preferred Stock with a 1× liquidation preference, customary dividend preference, customary broad-based weighted average antidilution protection, and customary

protective provisions which will entitle the holder to customary contractual pre-emptive rights and other customary contractual rights (each as provided in the Seed Series Convertible Preferred model documents maintained at gust.com/seedseries) (“**New Preferred Stock**”).

**Special
Approvals:**

So long as a Majority Interest is entitled to elect a Lender Director, the Company will not, without Board approval, which approval must include the affirmative vote of the Lender Director: (i) incur any aggregate indebtedness in excess of \$50,000; (ii) make any loan or advance to any person, including employees, subject to customary exceptions; (iii) make any expenditure not in compliance with the annual budget approved by the Board, including the Lender Director (other than expenditures within 25 percent of budget, individually, and in the aggregate); or (iv) approve or enter into any related party transactions (including any amendment of agreements with the founders).

The Company will not, without the consent of a Majority Interest: (i) approve the voluntary liquidation or dissolution of the Company (or any subsidiary), a sale of all or substantially all of the Company’s assets, a merger or consolidation of the Company with any other company, or a lease or exclusive license of the Company’s assets (each a “**Liquidation Event**”) (other than a Liquidation Event in which net proceeds exceed \$_____); (ii) authorize, create (by reclassification or otherwise), or issue any new class or series of shares (including in connection with a Qualified Financing) or debt security; or (iii) declare or pay any dividend or distribution or approve any repurchase of capital stock.

**Use of
Funds:**

Proceeds shall be used for general corporate operations, and not for repayment of any existing debt obligations of the Company.

**Documenta-
tion:**

Transaction documents will be drafted by counsel to lenders.

Financial Information:	All lenders will receive quarterly financial statements and narrative update reports from management. Lead Lender will receive such information monthly.
Board of Directors:	Following the initial Closing, the Company's board of directors (the " Board ") shall include one representative designated by the Lead Lender (the " Lender Director "), so long as any principal or interest remains outstanding under the Notes.
Expenses:	The Company shall pay the reasonable fees and expenses of a single counsel to the lenders up to \$5,000 if the financing closes. If the financing is not consummated, each party will bear its own legal fees and expenses, unless the financing is not consummated by reason of the Company's refusal to proceed, in which case, the Company shall pay the lenders' out-of-pocket expenses, including legal fees.
Founder/ Employees:	Founder(s) and all employees and contractors as of the Closing shall have assigned all relevant IP to the Company and shall have entered into nondisclosure, non-competition, and nonsolicitation agreements in a form reasonably acceptable to lenders, with such covenants to be applicable during the term of their employment by the Company and for one year after the termination thereof.
No-Shop/ Confidentiality:	The Company agrees to work in good faith expeditiously toward a closing of this note financing (the date the earliest Note is issued shall be the " Closing "). The Company and its officers and founders agree that they will not, for a period of 30 days from the date these terms are accepted, take any action to solicit, initiate, encourage, or assist the submission of any proposal, negotiation, or offer from any person or entity other than the lenders relating to the sale or issuance of any of the capital stock of the Company or the acquisition, sale, lease, license, or other disposition of the Company or any material part of the stock or assets of the Company, or the execution of any debt instruments of any kind, and shall notify the lenders promptly of any inquiries by

any third parties in regards to the foregoing. The Company will not disclose the terms or existence of this term sheet or the fact that negotiations are ongoing to any person other than officers, members of its board of directors, the Company's accountants and attorneys, and other potential lenders acceptable to the Lead Lender, without the written consent of the Lead Lender.

Expiration: This term sheet expires on _____, 20__, if not accepted by the Company by that date.

This Term Sheet may be executed in counterparts, which together will constitute one document. Facsimile or digital signatures shall have the same legal effect as original signatures.

NEWCO, INC.

Name: _____
Title: Founder and CEO _____
Date: _____

NICE GUY ANGELS, LLC

Name: _____
Title: _____
Date: _____

Appendix

F

Sample Founder Accord

THIS FOUNDER ACCORD among the Founders of XXX, Inc. memorializes the respective rights and obligations of the Founders prior to the creation and execution of customary corporate actions and long-form agreements pertaining to these matters (“Formal Setup”). The terms and conditions specified in this Founder Accord shall control any future disagreements among the Founders with respect to the matters covered herein until such time as the Company completes the Formal Setup consistent with the terms of this Founder Accord to supersede it. The Founders anticipate completing the Formal Setup in connection either with the Company’s initial financing or at such time that the Company’s revenues are sufficient to permit such expenditures, but desire to enter into this agreement to confirm their collective understanding, and for this agreement to be legally binding, as to the matters sufficiently described herein.

Issue	Agreement	Notes
Company/ Status	To be incorporated as a Delaware corp.	Full organization, capitalization to be completed as determined by the Founders
Business Idea	Half-hour comedy “television” program utilizing overt and exaggerated slapstick humor.	“Television” is an emerging technology that transmits cinematic images directly into a magic box installed in individual homes. These images can then be viewed in your living room.
Founders	Larry, Moe, & Curly	
Equity	Larry: XX% Moe: XX% Curly: XX%	Equity to be allocated upon corporate organization.
Titles	Larry: CTO Moe: CEO & President Curly: Chairman	
Board	Larry, Moe, & Curly	Majority for all Board decisions. Any exceptions TBD.
Vesting	—4-year reverse vesting —1-year cliff; quarterly thereafter	All founders to have reverse vesting.
Vesting Commencement Dates	Larry: as of [date] Moe: as of [date] Curly: as of [date]	—Vesting agreements to reflect vested portion at time that the agreements are created.

		—Continuous involvement required, but full time/exclusive status not required for continuous vesting prior to Formal Setup
Commitment/ Outside activities	Larry: Part-time status (for supplemental compensation) until sufficient initial funding obtained. Moe: Part-time status until sufficient initial funding obtained (for supplemental compensation). Curly: Full-time status	
Salary or Other Cash Compensation	Larry: TBD at Formal Setup Moe: TBD at Formal Setup Curly: TBD at Formal Setup	
Company IP, Confidential- ity, etc.	Each Founder will enter into a customary long-form PIIA Agreement in connection with Formal Setup, but each Founder agrees as of the date of this Founder Accord that he: —will not utilize any Company IP for any purpose unrelated to the Company —will assign any IP he created or developed in connection with his relationship with the Company to the Company —will not disclose any confidential information regarding the Company to any third party other than in furtherance of the Company's business.	

Modifications	Changes to this Founder Accord shall require the consent in writing of all Founders.	
Disputes	Should any dispute arise, the Founders shall attempt to resolve it in good faith. If such efforts fail, New York law shall apply and the courts of New York, NY, shall be the forum for any dispute resolution proceeding.	

January __, 2016

January __, 2016

January __, 2016

Acknowledgments

AS WITH MY PREVIOUS BOOK on angel investing, this book is my attempt to codify and explain current best practices in the entrepreneurial finance industry—in this case, the intricacies of starting up a company the right way. As such, virtually none of it is original to me, and I have simply served as the interlocutor who brings together the hard lessons learned over long careers in the startup world by much better entrepreneurs, investors, lawyers, mentors, and advisors than I will ever be. In particular, many chapters owe enormous debts to the leading experts in their respective fields. These include:

Bill Gross, the internationally renowned entrepreneur and CEO of Idealab, who has long been a role model not only for me, but also for millions of entrepreneurs around the world, for graciously contributing the Foreword.

Alexander Osterwalder and Yves Pigneur for their seminal work on the Business Model Canvas described in Chapter 1;

Legendary business planning expert Tim Berry for entire sections of Chapter 2 on creating a lean business plan;

Charles McCormick of McCormick & O'Brien, who created the Founder Accord described in Chapter 4;

Frank Demmler of Innovation Works, one of the most respected startup mentors in Pittsburgh, for his practical Founders' Pie Calculator discussed in Chapter 5;

Eric Ries of lean startup fame (and my successor as entrepreneurship track chair at Singularity University) for the essentials of the lean startup methodology in Chapter 6;

Rick Bell of Harvard Business Services, the ultimate incorporator, for teaching me nearly everything I know about Delaware corporations, which I have now relayed to you in Chapter 9;

The terrific startup attorneys, Lori S. Smith and Dan De Wolf, who made sure that Chapter 10 was indeed “Lawyered Up” correctly, and the inimitable Gil Silberman, who provided pages and pages of detailed, brilliant notes and corrections;

Lex Sisney, the wizard of *Organizational Physics*, who created the Hiring Board methodology covered in Chapter 17; and

Bill Payne, my longtime friend and angel mentor, who is justly regarded as the global dean of angel education, for the various valuation methodologies covered in Chapter 24.

Many, many others have contributed to my education in the startup world. In no particular order just a few of the most notable investors and entrepreneurs include John Huston, Basil Peters, Alan Patricof, Fred Wilson, Josh Kopelman, Chris Fralic, Rob Hayes, Brad Higgins, Brian Cohen, Charlie O’Donnell, Jason M. Lemkin, Jim Silver, Yuval Almog, Candace Johnson, Yossi Vardi, Dušan Stojanović, Philippe Gluntz, Reid Hoffman, Scott Kurnit, and Gideon Gartner.

As with *Angel Investing*, many of the thoughts here found their first appearance on the unique question-and-answer website Quora.com, to which I am *not* addicted (no, really, I’m not!), but where I have answered nearly 5,000 questions from aspiring entrepreneurs and business angels over the past several years. Quora’s Marc Bodnick (who also happens to be a venture capitalist himself) was a great help in getting them off-line and into this book, and several entrepreneurs who contribute to the Quora community graciously volunteered to read the manuscript in draft and provide early comments. They include Peter Baskerville, Dominic Brown, Nandan Choksi, CJ Cornell, Archie D’Cruz, Ghassane Hajji, Leonid Knyshov, Arit Raj, Sarang Ananda Rao, and Mayeasha Tashin.

Because of the multiple complex subjects covered in *The Startup Checklist*, this book proved quite challenging to bring together. Fortunately, I was backed up by my top-notch editorial and production team, including acquisitions editor Richard Narramore of John Wiley

& Sons, who greenlighted the project and kept me on track with the help of his brook-no-nonsense assistant, Tiffany Colon; Wiley senior production editor Lauren Freestone who deserves a special prize for her saintly patience with exasperating writers; Dejan Jovanovic of 99designs.com, who designed the cover, with a jacket photo of me by David Noles; my agent, Susan Ginsburg of Writers House; Mark Fortier and his team, who led the launch publicity, together with Group Gordon, Gust's public relations team, led by Zigis Switzer; David Kumin of Blane & DeRosa Productions, who produced the audiobook version for Gildan Media; and the person who lets me get away with nothing, my assistant, Sadie Schley.

A very special thanks must go to my developmental editor, Karl Weber of Book Editors Alliance, who has been my partner from the very beginning of this process. He undertook the daunting task of boiling down my Quora contributions into something usable for a book, did much of the basic research on all of the topics I have covered, and provided the armature to support what he and Richard charitably describe as my "unique voice."

Two groups of very special people have contributed to this book in ways large and small. My colleagues at Gust comprise the most extraordinary team I have ever worked with, and they get up every morning focused on supporting startup founders and investors by delivering on the most comprehensive vision in the industry. I am honored to have an extraordinary board of directors in the legendary Howard L. Morgan, cofounder of First Round Capital; Bob Rice, managing partner of Tangent Capital (and author of *The Alternative Answer*); and Richard Zenker, president of Overbrook Management. Together with David Marrus, Peter Jungen, Richard Katzman, John Katzman, Mark Allison, and Liam Lynch, they keep me on a straight and narrow path and provide deep insights into the private equity industry.

The amazing staff at Gust have spent years working to deliver the unique and comprehensive platform that is debuting along with this book, under the guidance of a leadership team including Ryan Nash, Jess Compagnola, Alan McGee, Keyvan Firouzi, Peter Swan, Todd Mohny, Miklos Grof, Will Brown, Jun Simmons, Mike Frederick, Justin Cina, and former members Rich LaFauci, Lisa Balter Saacks, and Ilana Grossman.

Finally, I owe a greater debt to my family—nuclear and extended—than can ever be repaid. I can say without exaggeration that I am the underachiever among a group of extraordinary people. My father, Daniel Rose (author of *Making a Living*, *Making a Life*, a Kirkus Best Book of 2015), has always been my role model as a thinker, a doer, an entrepreneur and a mensch. My mother, Joanna Semel Rose, widely regarded as the single smartest person in New York City, taught me to write in my younger days, and then rose to the challenge half a century later of painstakingly copyediting this manuscript (which, in case you are curious, included over 3,000(!) “suggestions for improvement”). While I take full responsibility for all remaining errors, without her ministrations I would have come across to you as a complete illiterate. My siblings, Joseph, Emily, and Gideon, have managed to mostly suppress their snickers during my decades-long entrepreneurial career and provided significant help in myriad ways at myriad points where it really counted. My three children—the prime focus of my life—have had the dubious privilege of putting up with decades of my entrepreneuring, investing, and pontificating. One has served as my primary entrepreneurial pupil and protégé, the second keeps me honest on Quora, and without the third I would never have actually finished writing this book.

Most of all, I am grateful to my wife, who has put up with me for well over 30 years, and is an enabler for someone who is as different from her as two people could possibly be. Once again, this is not the book she wanted to see—one consisting of only stories from my investing career—but never fear, that one will eventually be forthcoming!

New York
March 2016