5 THINGS YOU CAN DO TODAY TO SAVE MONEY ON DILIGENCE LATER

A company whose board I serve recently decided to accept an offer to be acquired. About one third of the way through the due diligence period, I checked in with legal counsel to see where the legal bill stood and found out that we were already at $200k…..whaaaaat?

This was close to the overall budget we had set. I couldn't fathom that. Good legal advice is worth what it costs, and this group does world-class work at reasonable rates. But I realized I needed to better understand how and why it got so expensive so fast. In talking with the partner in charge, in this case, approximately $80,000 or 40% of the cost was because an overwhelming percentage of the documents that had to be uploaded for review were either incomplete, missing, disorganized, unsigned or not countersigned – for whatever reason not fully executed, as required.

This got me thinking about ways a company can be more "acquisition-ready" with its creation and maintenance of diligence materials in a way that wouldn't have been too burdensome for them along the way. Because, let's face it, in early stages of a company's life, product-market fit and not running out of cash are the most important tasks, and, during scale, creating a repeatable sales process, building a product management function and organizational development should occupy "poll-position" in CEO mindshare, not saving $80k to $100 five years into the future! So, these have to be easy things that can be done painlessly without much disruption.

I asked a partner at an advisory firm that provides due diligence services ranging from forensic accounting to post-acquisition integration, in industries ranging from defense to technology and just about everything in between. I also sat with Ed Reitler, the senior partner at an Associate at Reitler Kailas and Rosenblatt (Reitler), where I provide startup advisory services in the Reitler Advisory Group. Reitler specializes in venture law and does a lot of deals that mirror the transaction I mentioned above. To follow is the best of both contributions.

1) Avoid One-Offs – Create and Use Company Standard Forms and Contracts. Not building standard forms lacks foresight; building standard forms that you don't use (i.e., that are modified every time or just not executable) is waste of the money spent to develop them. This happens most often with sales contracts and employment or contractor and associated agreements. In sales agreements, when trying to accommodate a purchaser, companies may agree to a request to vary the choice of which state's law will govern the agreement. In employment documents, different employees may end up with different vesting schedules (three years vs. four years vesting duration, monthly or quarterly increments, one year cliffs, etc.). Some may get cashless exercise or even unique, non-standard description of duties. When time comes to diligence these contracts, not having a standard form (or maybe two standard forms – a Key Employee Option Grant Form and a Rank-and-File Option Grant form) that the company stuck with means the legal team has ***read every line of every***

document instead of simply reviewing the form which everyone signed. If you have sixty employees and they each signed Form A or Form B, it is quicker and cheaper than having attorneys read and analyze 60 distinct agreements to see if anyone had a severance arrangement or acceleration on a Change of Control event. Your lawyers will thank you.

2) Have a Process in Place for Employees. Have an employee manual and make people sign and acknowledge it; then be sure to enforce it. Like many things in life, the value of having A PLAN is more important than exactly what the plan says. The Plan not only gives your employees a fair understanding of the rules on day one, but it creates institutional memory for your HR coordinator (which may change multiple times) for how people are on-boarded and managed and what happens when they leave the company. Simple steps like signing an acknowledgment that the new hire read and received the Plan is the evidence you'll need to enforce the Plan. And a simple two line email on their exit, stating their final date of employment, whether they left "for cause" or not, how many options were vested as of the last day of employment, and when those options expire, saves a multitude of legal questions later, whether dealing with the former employee or in a round of transaction due diligence.

3) Track All Your Service Related Hours. Are you a software company about to be acquired by a larger company? Is the solution you are selling inclusive of all service related hours (training, customer support, etc.) What if the company acquiring you wants to add that as revenue stream and charge by the hour? Having employees report all hours: software development time, training, business development, internal reporting, etc. allows the acquiring company to understand and value the incremental revenue streams that are possible post acquisition, and allows you to be in a better position when arriving at the strongest possible valuation.

4) Regular Operational Reports. In order to understand how your business is progressing over the course of several years, you need to develop and use a reporting tool or choose one of many off-the-shelf solutions to track the key operating metrics that tell the real story of your company. You can save yourself significant time, energy and cost during the due diligence phase of going public or putting yourself up for sale. Save the snapshots and back them up somewhere. You don't need a fancy time keeping system to do this. Again, there are off-the-shelf solutions for this or you can do it in something as easy as a homegrown excel template.

Often in startup mode, the founders are narrowly focused on sales, controlling costs and growing revenue. Everyone knows the company is growing by looking around. You started with 3 people and you now have fifty. You had 1 client and now have 101. But did anyone create a timeline showing the growth trajectory and margins over time? This often gets overlooked, and most investors or acquirers want to see it before handing over money. Can you easily demonstrate that in three years' time revenue grew year over year by a certain percentage while operating margins stabilized at month 20, etc.? What about customer acquisition costs? What happened to it when the company reached scale? When did average employee utilization reach 75% and how long has it been there? Capturing this information real time saves a lot of money down the road because hiring someone to do it retrospectively is costly. Outside consultants will charge big bucks to come in and do this. Digging through data to recreate the timeline rather than audit the one you already have, could be 3-4 times as costly as it needed to be.

5) Asset Tracking. You will want to accurately know what assets you have at any given point. Ensuring there are proper tracking mechanisms and protocols to identify assets (IT equipment, vehicles or rental equipment, furniture, etc.) will be instrumental for knowing real time what assets you have, where they are located, and what they are worth. Asset tracking solutions available today are efficient and affordable. It will take a lot of time to recreate this after the fact, and it’s an annoying cost that can easily be avoided if thought about at the outset.

Worse than the cost of needless document recreation during due diligence is the additional time it might take to close a deal when diligence drags on. You might bump up against the expiration of an exclusivity date or there might be an adverse event in the business that spooks the acquirer. When the deal is right, close quickly!

About Jeff Finkle

Named one of the “25 Angel Investors in New York You Need to Know” by AlleyWatch in 2014, Jeff has been a venture investor for ten years, an angel investor for eight years. Jeff is presently Co-founder of the Viridian Members Fund, the first member-managed fund in cannabis. He is also a Managing Member of Viridian Ventures and serves as Chairman of the Evaluation Committee and Treasurer of the ARC Angel Fund. Jeff has been actively advising startups at Reitler Advisory Group.