October 2010

THE EVOLVING INVESTOR LANDSCAPE: WHAT REALLY MATTERS TO STARTUP ENTREPRENEURS

DORSEY & WHITNEY LLP

Survey Overview

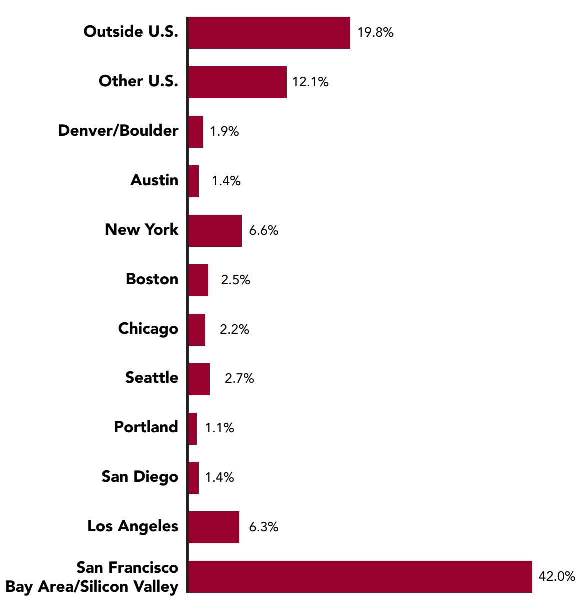
Dorsey & Whitney's Palo Alto office surveyed CEOs of emerging growth companies in August and September of 2010. The survey was titled "Calling all CEOs: 2010 Fundraising Survey." Administered over four weeks, there were a total of 363 respondents. The survey brought to light current perspectives along a range of primary factors that are driving startup CEOs' decisions for selecting and closing a funding round with an investor. The survey dispels some previously held views about what CEOs value and underscores key criteria that are important to them.

This survey gauges the perspective of early-stage entrepreneurs predominantly in the consumer Internet space. Respondents were sourced from Dorsey & Whitney's internal contact lists that include clients and others, as well as readers of technology blogs TechCrunch, VentureBeat, and StartupDigest.

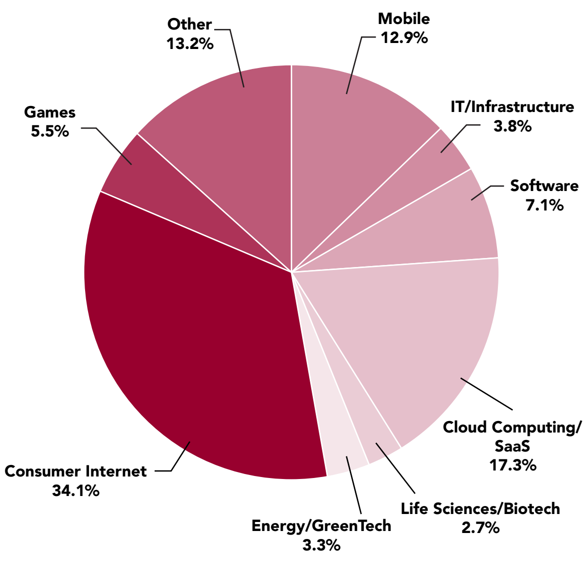
Respondents

All respondents were CEOs, Managing Directors, or Presidents of high tech startups, and had either raised funds over the past 12 months and/or were planning to raise funds within the next 12 months.

Geographic Distribution



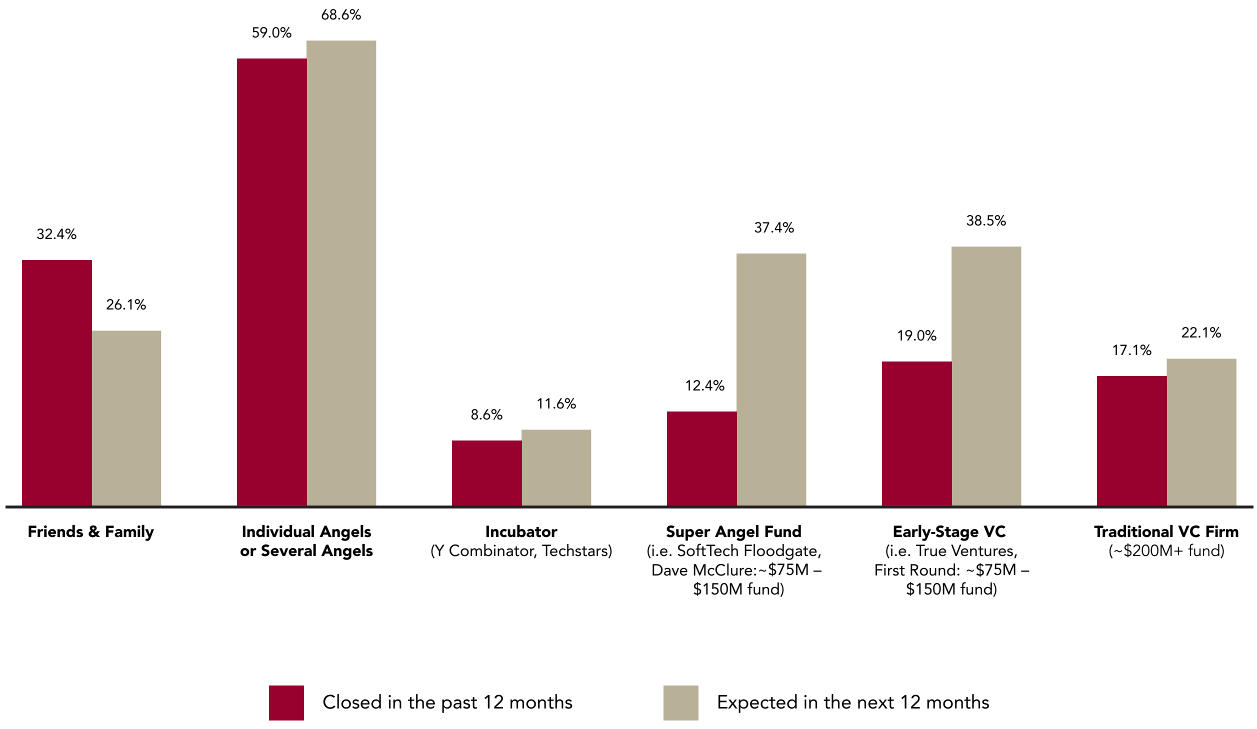
Industry



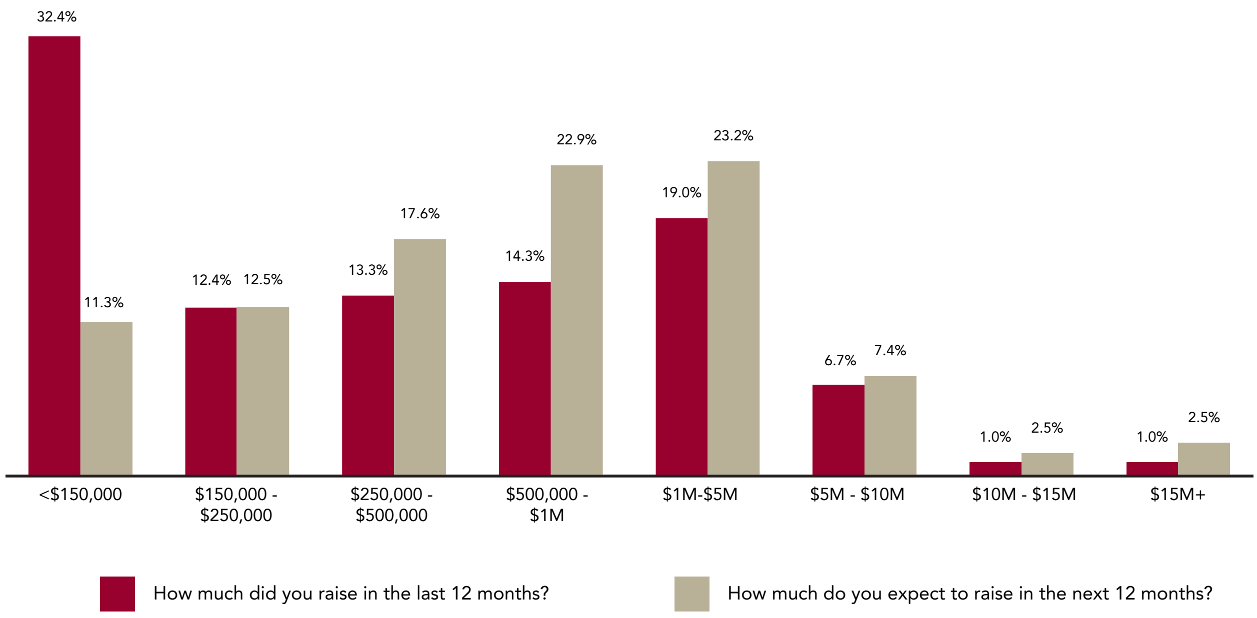
Sources of Funding

The survey sheds light on the direction that startup CEOs are headed when they raise their first or second round of funding. For those who have previously secured funding, they received it from a combination of individual angels or several angels (59%), friends and family (32%), or from early-stage VC firms (19%). Just over 17% had received funding from a traditional VC firm. Yet, when these startup CEOs go out for a new or next round of funding, they expect funds to come from individual angels or several angels (68%), early-stage VC firms (39%) or super angel funds (37%). With the availability of more funding available, startup CEOs plan to seek less funding from friends and family in subsequent funding rounds (26%). Seeking funding from traditional VC firms increased marginally to 22% compared to the others.

Who did you receive funding from?



How much are you raising?



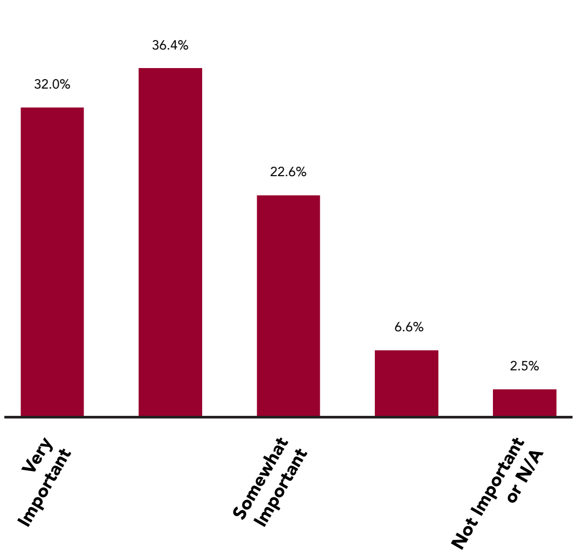
What's important to CEOs besides valuation?

While CEOs still find traditional deal terms like **valuation, dilution, liquidation preferences** and **board control** as very important elements in completing a deal, several additional criteria are also critical. Following are some of the findings:

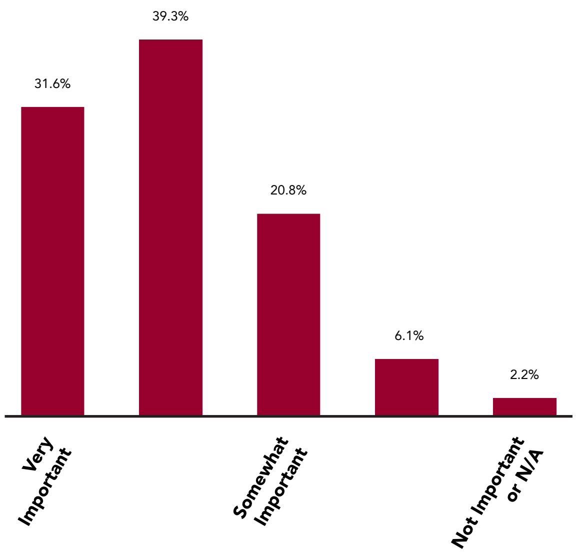
- While **valuation** rated important, a full 32% of CEOs said that this factor was only "somewhat important" to "not important."

- Significant criteria include (1) **the speed at which the deal can get done**, and (2) **whether the investor understands the startup's funding requirements** and encourages them to not take more or less than what the business requires. Respondents collectively ranked these two factors between "somewhat important" to "very important," at 91% and 92%, respectively.

Speed With Which The Deal Gets Done

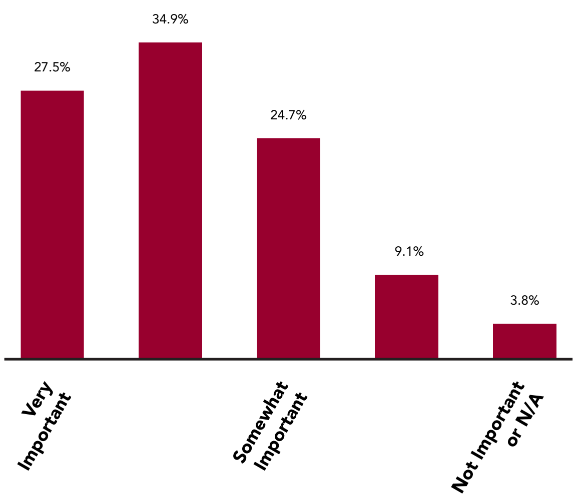


They Understoood My Funding Needs



- Another key factor startup CEOs value is that they want to feel that the **investor really wanted the deal**. Collectively, 87% of respondents weighed this factor as "somewhat important" to "very important."

Investor Really Wanted The Deal



- Startup CEOs value an investor that has a **focus and expertise in their industry**. Almost 85% rated this factor as "somewhat" to "very" important.
- 48% of respondents ranked **prior relationships with an investor** as "not important."
- Although traditional VCs have an advantage in their **ability to invest in future rounds** compared to angels and super angel firms, 33% of respondents ranked this factor as only "somewhat important."

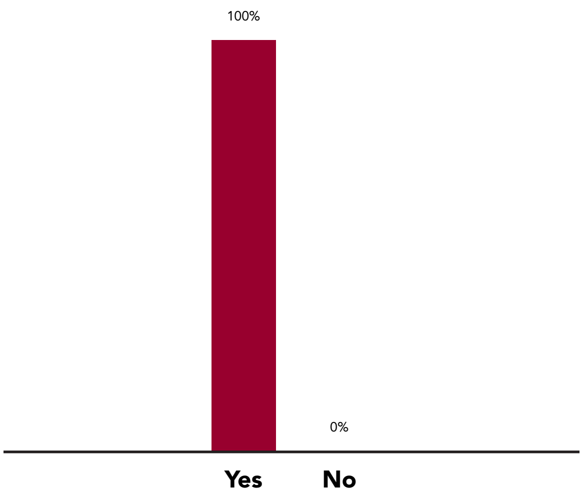
Brand, Global Expertise & Geographic Proximity Considered Less Important

- The perception of the **investor's brand** no longer appears to carry the prestige and value with today's entrepreneurs. Slightly more than 75% thought that a tier-one "brand name" VC was only "somewhat important" to "not important."
- Despite U.S. startups eyeing international markets, and presumably valuing investors who can help them break into these emerging markets faster and more successfully, 70% of CEOs rated an **investor's global presence** and **expertise** as "somewhat" to "not" important. **Geographic proximity** to the startup company also did not prove to be a critical element, as 74% rated this as only "somewhat" to "not" important.

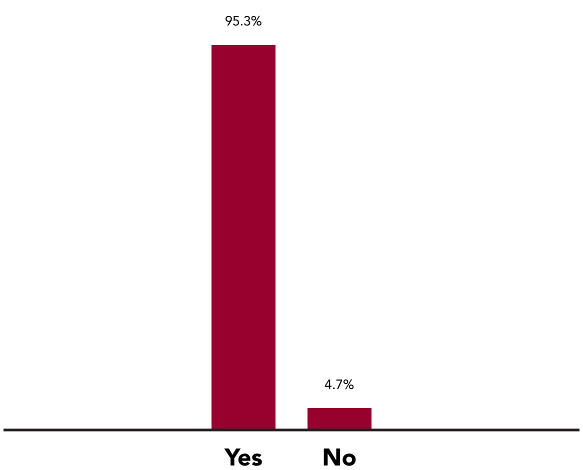
Calling All CEOs: 2010 Fundraising Survey

Results

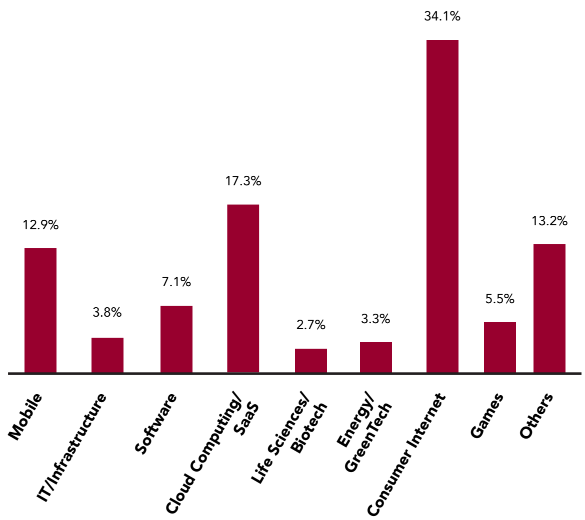
1. Are you a CEO of a tech startup?



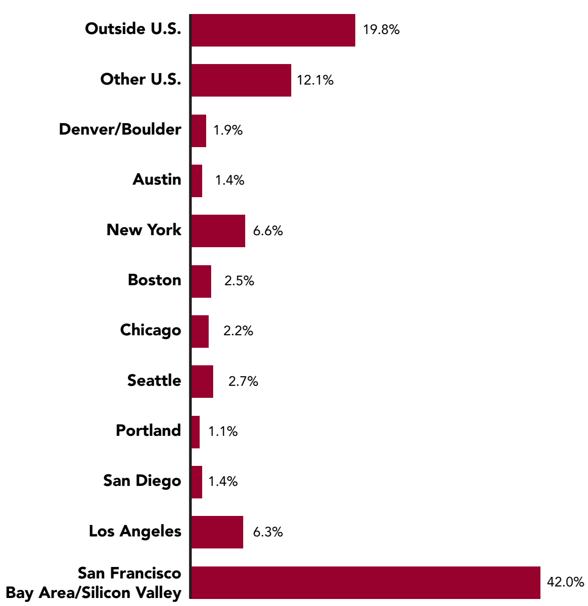
2. Are you a founder or co-founder of this company?



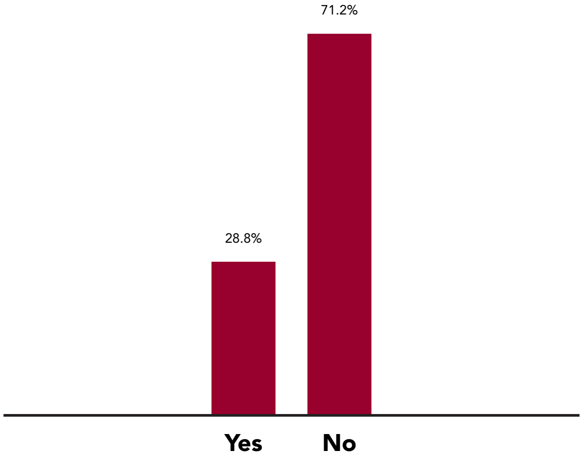
3. Which best describes your company?



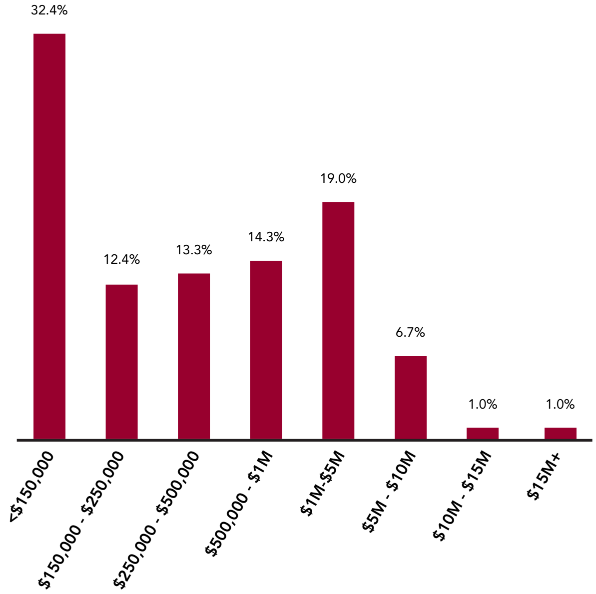
4. Where is your startup located?



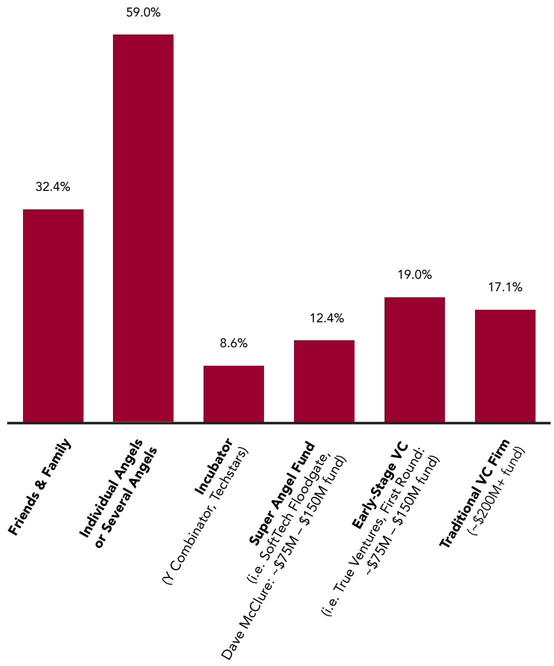
5. Have you completed a round of funding in the past 12 months?



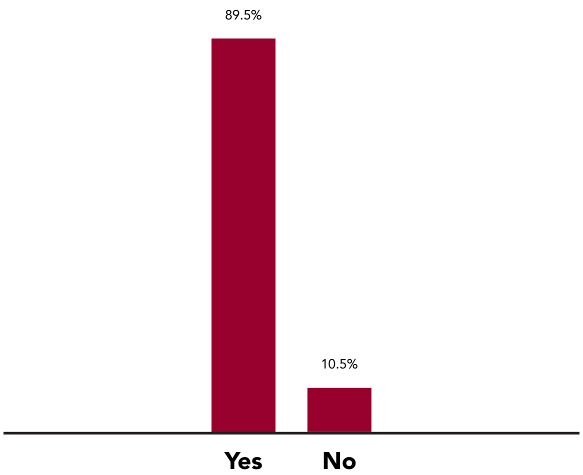
7. How much did you raise in that round?



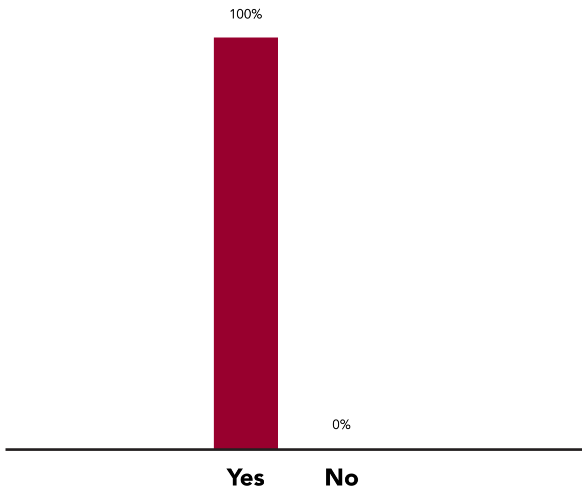
6. The funding was from (check all that apply):



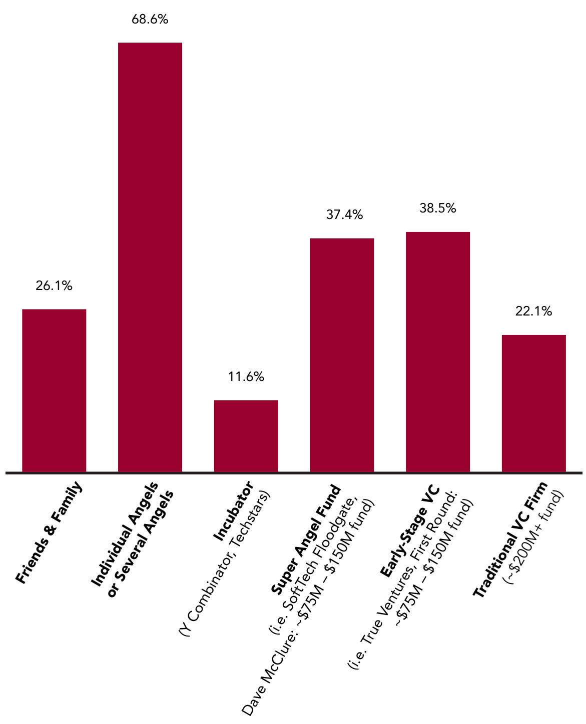
8. If you have raised funds in the last 12 months, do you expect to raise a round of funding in the next 12 months?



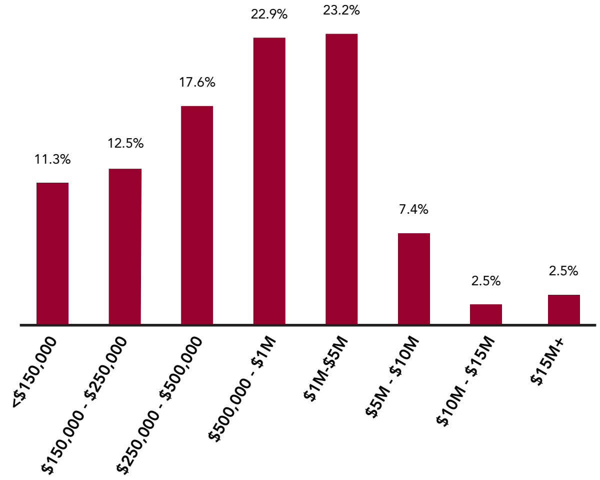
9. If you have NOT raised funds in the last 12 months, do you expect to raise a round of funding in the next 12 months?



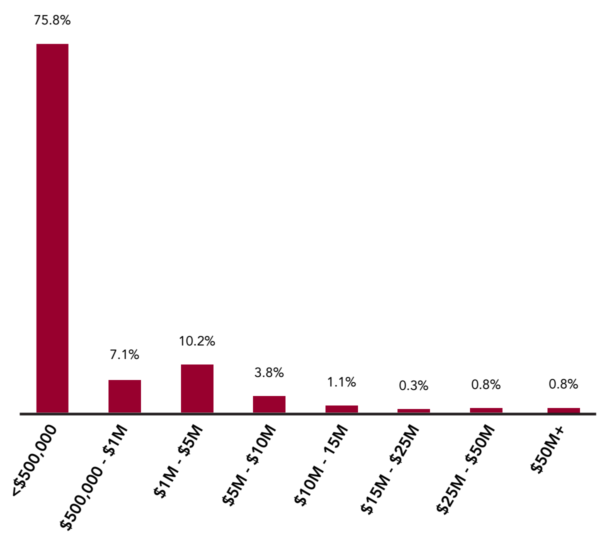
10. Who do you expect the funding to come from (check all that apply)?



11. How much do you expect to raise in the next round?



12. How much in total has your company raised to date?



13. From your perspective, how important were/will each of these elements be in getting your funding completed? (In other words, how important are each of these factors in wanting to complete a deal with an investor?)

	Very important		Somewhat important		Not important or N/A
Valuation (Pre-money valuation offered by an investor)	39.7%	27.8%	27.5%	3.3%	1.7%
Dilution (Percentage of ownership that the investor is requiring)	44.5%	30.8%	19%	3.6%	2.2%
Liquidation preference (Payment preference required by investor in a sale of the company)	27.3%	30.3%	29.2%	8.0%	5.2%
Board control/Board seat (How many seats the investor wants)	30.8%	31.3%	24.7%	8.8%	4.4%
Specialist in my space (The investor has a focus and expertise in my industry)	28.1%	33.3%	23.4%	10.7%	4.4%
Operational expertise (The investor has experience running companies, not just investing in them)	24.0%	29.6%	26.0%	14.1%	6.4%
Ability to bring in key customers (The investor can help introduce my company to influential customers or partners)	24.7%	25.5%	23.1%	17.3%	9.3%
They're a brand name (The investor is an established tier-one brand)	8.8%	15.7%	28.1%	29.5%	17.9%
Understand global markets (The investor has a global presence or expertise in international markets)	12.2%	17.7%	27.7%	25.5%	16.9%
Speed with which the deal gets done (The investor kept things moving quickly)	32.0%	36.4%	22.6%	6.6%	2.5%
They understood my funding needs (The investor didn't want me to take more or less than my business required)	31.6%	39.3%	20.8%	6.1%	2.2%
I felt like they really wanted the deal	27.5%	34.9%	24.7%	9.1%	3.8%
I've raised funds with them before	3.6%	8.3%	16.8%	22.0%	49.3%
They have the resources to invest in future rounds	13.2%	29.1%	33.0%	16.8%	8.0%
We had an existing relationship	8.8%	15.7%	27.0%	23.1%	25.3%
The investor was close to me geographically	9.1%	17.3%	27.5%	24.2%	22.0%

14. Please let us know what else is important to you in selecting an investor (below is a selection of write-in responses to this question).

"Ability to help syndicate the raise."

"Corporate investors also can play a key role in this market."

"You have no box for strategic partners, nor for self-funding. The capital costs for my venture are low, so I will probably not even go to a VC."

"Have to feel that they will not try to take over the company and remove the founders."

"Ethics/common sense approach."

"References from bad investments they have made."

"A sense of humor."

"The deal is finalized quickly without too much run-around."

"Knowing that the investor looked at more then just the financials when making their decision, as It shows that they have an actual concern for the company's long term growth, not just their exit strategy."

"Not too much greed."

"Honesty, lack of pretentiousness, down to earth, not acting like a know-it-all, willingness to work as hard as I am, not wasting my time and money, willingness to think about the plan and opportunity and not just call some buddies to get their opinion, interest in making money instead of having a great story to tell at cocktail parties...."

"Responsive. If I send an email, I'd like to get a response in a timely manner."

"Drawing out a true and viable plan for the next couple of years. It is always an advantage when one understands the market and is able to attract the right contacts."

"I trust them."

"Level of involvement in managing the company (some involvement is good, too much is bad)."

"Investors who not only understand the market but also play games and like them [this company designs games]. It is also important for investors to truly understand the philosophy and business model of the company and allow the founders to run the company and make the titles they see fit."

"That they don't want 6x to 10x for no risk. That they invest in 'real' products, not just software."

"Chemistry with our team."

"They are well funded, and not at the end of their cycle -- i.e., they do not have to return the funds in couple of years and show immediate return."

"Synergistic (and noncompetitive) portfolio companies. Ratio of prior investment successes to failures. Reputation in market. Place in fund lifestyle (e.g., should be within the first two years of fund). Board experience. Personality of board representative. References from CEOs of other companies they've funded."

"Peer references. Specific partner at a firm I wanted to work with. Ability for that partner to drive a deal through without 100% partnership approval."

"Understanding of sales processes and cycles in the sector."

"Could I enjoy a beer with the guy sitting on my board."

"Very personable. We admire those types of VCs, angels."

"They are willing to take the lead, and not simply wait around for someone else to take the lead. I want an Alpha Investor."

"It's important that I've received positive feedback from other entrepreneurs funded by the investor."

Dorsey & Whitney

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Dorsey & Whitney Palo Alto

Dorsey & Whitney's Palo Alto office has a strong focus on technology-based startups and venture capital. Partners Matt Bartus (bartus.matt@dorsey.com) and Ted Hollifield (hollifield.ted@dorsey.com) specialize in corporate and securities law with an emphasis on representing emerging growth companies, venture capital financings, public equity and debt offerings, as well as mergers and acquisitions.

Matt Bartus, Partner

Matt is a partner in the Corporate Group. His practice focuses on representing emerging growth companies throughout their lifecycle, from startup through initial and expansion rounds of financing to an acquisition or IPO. His startup practice involves counseling entrepreneurs on the formation of their companies, equity structures, negotiations with seed and venture capital investors, and employment and intellectual property matters. Matt's clients are involved in a broad spectrum of industries, including consumer internet, technology, information systems, life sciences/biotechnology, medical devices, financial services, clean-tech/renewable energy, and software. Matt also represents venture capital and other institutional investors in a variety of venture financing, private equity and recapitalization transactions.

Matt also specializes in representing companies in M&A transactions. In his M&A practice, Matt has represented public and private companies in many transaction structures, including private equity transactions, auction contests, cross-border transactions, tender offers, joint ventures, stock and asset purchases, mergers and leveraged buyouts.

You can read Matt's blog "A View From the Valley" at www.mattbartus.com, or contact him at bartus.matt@dorsey.com.

Ted Hollifield, Partner

Ted specializes in corporate and securities law with an emphasis on public equity and debt offerings, venture capital financings, mergers and acquisitions and general representation of emerging growth companies. His clients include established public corporations and private, venture-backed companies with substantial experience representing clients in the telecommunications, electronic design automation (EDA), semiconductor, Internet and software industries. Ted also counsels Boards of Directors, CEOs and executive management on equity compensation, corporate governance, Sarbanes-Oxley Act and other regulatory and disclosure matters.

Ted has successfully completed numerous venture capital and other private placements, as well as several public offerings and secondary public offerings. He has also consummated multiple negotiated acquisitions and dispositions, including stock and asset purchases and mergers. You can reach Ted at hollifield.ted@dorsey.com.

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