Investment readiness checklist (angel investment round)

This checklist is targeted at entrepreneurs seeking first round of 'external' investors (i.e. beyond family and friends), helping you to understand what such investors often will look for, and increase the likelihood that you can provide satisfactory answers to key questions, as well as provide required documentation for a due diligence process.

The typical stage for the first external investors is after the development of a 'minimum viable product' (MVP), before or after a limited number of early stage customers ('early adopters') have validated the 'problem/solution fit' by actually using and paying for the product or service. This implies that extensive attention on sales activities and interaction with potential customers will be expected at this stage, even if quite few of them have already become paying customers.

A key type of investors at this stage is so-called 'angel investors' (or 'business angels'), who are individuals using their own money, typically in combination with advisory roles, based upon past experience as entrepreneurs and/or corporate executives. Angel investors vary a great deal in how professionally they address investments in startups, in particular regarding the depth of the due diligence process and the conditions stated in terms sheets, investment agreements and shareholders' agreements. Experienced angel investors will often invest through a group of cooperating business angels (a 'syndicate'), where one of the business angels take the role as lead investor. The due diligence is then often conducted by 2-4 of the investors on behalf of the syndicate, under the leadership of the lead investor, and with each individual investor covering a certain area of expertise (e.g., business planning vs. financials vs. product development).

This Investment readiness checklist is structured in a way where a clear 'yes' should be the response to each question. While one or more no's may be accepted, even a single 'no' may imply that the startup is not really investment ready – unless you have a very clear action plan aimed at closing the open points, and the investors have actually agreed to both your actions and the proposed timeline.

Pangea Accelerator runs accelerator programs, investment programs and training aimed at making it easier for early stage African startups to succeed by connecting them with competence, network and capital. While our focus in on Africa, the criteria for perceived 'investment readiness' seem to be more or less the same around the globe for a certain stage and type of investment round (e.g., an 'angel investment round' vs. a 'venture capital round' at a later stage of development). And while some due diligence checklists are available through various business angel networks, we have not found much really helping the entrepreneurs. This is why we release this checklist under a 'Creative Commons' license, hoping this will prove useful for entrepreneurs and startup ecosystems elsewhere.

Please note that fulfilling all checklist requirements does not mean that you will actually get funding. And as a final introductory advice, make sure all your claims are 100% true, both regarding the responses to the specific key questions below and regarding other statements. E.g., if you claim to be in close contact with prospective customer x, be prepared for the lead investor to make a call to company x, and/or for you to put the documentation of this customer interaction into the data room. A single 'white lie' may damage the entire investment round, even if you have responded 'yes' to all key questions.

<u>Overall business concept</u>

1. Have you expressed the business model in a well-documented 1-page 'lean canvas', that can 'survive' tough questioning? If you have a double-sided business model (e.g., some kind of a marketplace), have you provided well-documented lean canvases for each side of the business model?

2. Have you <u>in practice</u> followed the principles of a lean startup so far? In particular, this implies extensive customer contact early, using interviews, prototypes, experiments and 'minimum viable products' as means for ensuring a product that will in fact meet customer problems and needs, as opposed to product development in a 'closed room', targeting first heavy customer contact on or just after 'the big launch event'.

3. Do you have a strong and <u>validated</u> understanding and prioritization of the problems, needs and buyer values of the customer groups you are addressing? Have you captured these viewpoints in well-documented interviews?

4. Do you have a clear understanding of the market you are actually entering, including its different stakeholders and value chains, as well as the way your future customers <u>currently</u> address the problems or needs that your company's solution will provide?

5. In your value proposition, do you really address <u>need-to-solve</u> business problems as opposed to <u>nice-to-solve</u>?

6. Have you made a <u>realistic</u> competitive assessment, identifying your <u>key</u> competitors? In this assessment, have you made sure competitive strengths and weaknesses are seen <u>from the customer's point of view</u>? In particular, have you <u>avoided</u> making a quasi-assessment based upon criteria that are really not important for your customers?

7. Have you defined a value proposition and an underlying set of solution components that not only meet customer problems and

needs, but really makes your offering stand <u>out in</u> the competitive landscape?

8. Have you calculated the market size in a realistic and well-documented way, with verified <u>facts</u> whenever possible?

9. Have you clearly stated your own <u>ambitions</u> with this startup, in particular what market position, revenue and profitability you aim for 3 and 5 years from now? Are these ambitions realistic given your understanding of customer segments, problems/needs and competitive situation?

Team

10. Does your team cover the <u>crucial skills</u> for this kind of startup? E.g., you cannot run a successful tech startup without strong technology skills <u>within</u> the team.

11. Are the team members open, honest and <u>trustworthy</u>, following high ethical standard?

12. Have you been open and fully honest regarding the background of the team members and your relationship to each of them? The same question applies to the board and advisors, to your business partners and suppliers, and to your key customers.

13. Do you have a clear understanding on what key skills and experience are <u>missing</u> from the team? Do you have a clear plan for how you are going to 'fill these holes'? Have you been successful in securing skills and experience through the use of external advisors?

14. Are all key team members fully <u>committed</u> to this startup? Have they demonstrated this by spending <u>significant</u> time, and only their own <u>money</u>? (directly and/or through working for free) If some team members are in fact <u>not</u> fully committed, it is clear who they are, and why not?

15. Are all key roles actually staffed with strong individuals? Has it been ensured that no key tasks 'fall between chairs'? Have tasks and responsibilities been divided between team

members in a clear and well-documented way?

16. Have all team members signed formal employee contracts with proper clauses to ensure full commitment, secure company IPR and exclude them from working for competitors in a critical time period?

17. Where non-key personnel have been engaged through subcontractor or consultancy agreements, do the contracts in a similar way secure IPR and non-competition?

18. Have the team members actually demonstrated that they are coachable, i.e. they will listen to advise from others, and respond as required?

Solution

19. Do you have a clear strategy for how you will secure the intellectual property rights (IPR) of your own assets in the best possible way? Have you executed the right means for securing this IPR? E.g., through patenting, copyright, trademarks and/or design protection.

20. Has at least the overall functional and technical solution architecture and the overall product roadmap been properly documented?

21. Do you have a well-documented list of all own assets related to the solution? E.g., applications, databases, solution modules, patents, trademarks, web sites, web addresses. This list will at least be needed for due diligence purposes.

22. Do you have a list of all third-party components (e.g. database systems, workflow engines, communication protocols, programming tools) used to build or operate the solution? This list will at least be needed for due diligence purposes.

23. Have you checked that your solution does not violate other companies' IPR? Have you checked that your use of third-party components does not violate the licenses for these components? In particular, have

you explicitly checked for unforeseen consequences of using software components based on open source licenses?

24. Do you have formal, written and signed contracts with every single company or individual that have been involved in assisting your startup in some way? In particular, do these contracts formally assign all IPR to your startup company? This should also include friends and family that have been involved, e.g. for logo design or setting up a web site.

25. Have you ensured that the solution fully complies with applicable laws and regulations in all areas where you plan to operate? Can you confirm that you have fully operated within the law to obtain any approvals or licenses so far?

26. Do you actually use a 'best practice' way of handling product iterations, experiments and development tasks, also addressing quality assurance in a good way?

Financials

27. Does your startup have a clear and well-documented revenue model? Have you validated the probable price points with your early stage customers? Do you have a clear well-defined cost structure, avoiding unnecessary fixed costs?

28. Do you have accurate and up-to-date financial statements for all past time periods, based on sound accounting principles? In particular, have you ensured correct periodization of revenues and (associated) costs?

29. Have you made sure there are no hidden loans or liabilities? E.g. an implicit 'debt' to founders, suppliers or other parties based on accrued (but not paid) work.

30. Have you produced a well-documented financial model for at least the next 24 months, based upon clearly identified assumptions, parameters and growth targets? Does this model clearly document your burn rate and cash needs given

realistic, optimistic and pessimistic scenarios?

31. Have you developed a clear set of key performance indicators (KPIs) that should drive the success of the company?

Ownership and governance

32. Has the company itself and all subsequent records been formally registered in a correct way? E.g., capital injections, changes in the company board, formal financial statements.

33. Does the company have a well-documented ownership structure, with up-to-date records of all changes in ownership? Does this give a 'clean' cap table?

34. Can you confirm that there are no third party hidden rights to any ownership, e.g., through options, warrants or convertible loans?

35. Does the ownership structure reflect the relative importance of individuals in the team? Does the combined ownership of the founders control a clear majority of the shares?

36. Are the founders in general willing to offer shares to other key employees? Has a stock option program, share purchase program or some other incentives been established for key employees?

37. Has a company board with at least some external key people been established? Are the board members independent; meaning that their opinions and actions are not influenced by hidden relationships or mechanisms? Can it be demonstrated (through minutes of meeting etc.) that the company board ensures a certain level of corporate governance on behalf of the shareholders?

Traction

38. Do you have regular and valuable contact with a well-defined set of pilot customers (early adopters)? Do you clearly use these

prospects in a good way for understanding the customer needs and problems, shaping the value proposition and testing out the various components of prototypes and 'minimum viable products'? Do you handle the feedback from pilot customers in a structured way?

39. Have you actually validated a problem/ solution fit by making a reasonable number of the pilot customers actually sign up and pay for your solution? Are formal customer contracts in place, with required regulation of IPR, duties and responsibilities?

40. Have you established a well-defined go-to-market strategy, building on your pilot customers, and outlining an expansion (segment by segment) in the best possible way? If the startup has completed a true 'problem/solution fit' checkpoint, does the go-to-market strategy so far prove to be successful?

41. Do you handle leads generation and opportunity pipeline in a professional way, with well-defined marketing and sales principles, and with clear checkpoints? Have you clearly defined who should be in your next 'batch' of customers and why?

42. Have you established a good set of key performance indicators (KPIs) for tracking customer behavior and a plan for corrective measures? E.g., customer satisfaction (like net promoter score), customer acquisition costs (CAC), customer lifetime value (LTV). activation rates, retention rates, churn etc. Are the projected KPIs in line with both best practice and your financial model?

Action plan and pitching

43. Do you have a clear view on the overall strengths and weaknesses of the company?

44. Do you have a clear and documented risk assessment? (i.e., responding to the key question 'what can go wrong?') Do you have a clear assessment and plan for disaster recovery?

45. Do you have a well-defined short-term action plan (6-12 weeks' time perspective)

that clearly addresses urgent activities, issues and risks? Does you short-term action plan also clearly document the planned experiments to reach the next level of MVP and/or business model?

46. Do you have well-defined key milestones for the next 6-12 months, that can be relevant for following up an investment into your company?

47. Have you established a minimum business plan in the format of a well-structured pitch that will give prospective investors a good a realistic overview of your business idea, business model, products and markets, team and financials?

48. Have you run necessary rounds of pitch training for yourself and your team to deliver consistently good pitches of durations 1 minute, 3 minutes and 6 minutes?

49. Have you identified the most likely key questions and issues to be raised by prospective investors, as well as possible ways to address these issues? Have you and your team trained on responding to these questions and issues?

Investment, terms and conditions

50. Is the founders' team fully aware of investors' expected return and how this affect future dilution of ownership as the company grows and is taking in new capital?

51. Have you made a well-defined funding strategy and calculation of capital needs for the next 18-24 months? Are the assumptions and parameters both realistic and clearly documented? Have you clearly documented what the capital will be used for?

52. Do you have realistic and well-documented viewpoints on the pre-money valuation of the company, and why this is a reasonable valuation?

53. Have you clearly identified what kind of investor(s) you are looking for, including

what competence these investors should bring to the table?

54. Do you have a good shareholder agreement (SHA) in place today, regulating key points like lock-up period, vesting, tag along, drag along etc.? If not, do you have a clear view on what clauses should be part of a future SHA with the new investors? Have you reviewed standard SHAs and sources of best practice to really understand what should be covered by a SHA?

55. Have you established a clear strategy and action plan for how you will attract investors? Have you used your own network to the maximum extent? In particular, do you have a clear idea about <u>who</u> could be willing to serve as a lead investor, and how to attract this individual?

56. Does the group of co-founders have clear and <u>shared</u> viewpoints on the type and timeline for a future exit? Are you able to name individual companies that may be candidate for an industrial exit?

57. Do you have a clear understanding about the natural steps and documents in the subsequent investment process? In particular, do you understand the commitments you (most likely) will need to do when signing the (initial) term sheet and the following investment agreement? Do you understand what documentation will be needed for the data room used during the investors' due diligence process?