

SURVIVING THE MANAGEMENT REVIEW PROCESS

A COMPREHENSIVE GUIDE TO PREPARING FOR AND PASSING MANAGEMENT REVIEWS WHILE SEEKING FUNDING

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A **Management Review** is the most critical part of the due diligence procedure which can make or break a deal, more than any other discovery in the process. In general, Management Reviews are a series of direct examinations conducted by professional investors to make an evaluation of your management team based upon answers you give, and statements you make.

It is an assessment of intelligence, professional competence, and other factors which are much more difficult to ascertain in people such as psychological disposition, attitude, character, chemistry and so on. You and your co-principals are evaluated as individuals and as a group. This process starts in the initial meeting and continues on in subsequent meetings provided you continue to survive the paperwork part of the due diligence investigation.

Your aim for participating in a series of management reviews is to impress upon the interviewer your genuine character as a highly focused and committed professional manager who can be trusted as a responsible custodian for the caretaking of the corporation with the common goal of building and maintaining shareholder value.

The section starting on the following pages lists the most common and even obscure reasons why management will usually fail to pass Management Reviews along with practical remedies that will help you to avoid most common and overlooked blunders that cause failure in this area. All of the reasons used as examples are based upon real life episodes experienced by every veteran venture capitalist and investment banker who regularly conducts due diligence sessions.

All reasons given in this text for the failure of management reviews fall into the following seven categories (labeled "A" through "G") called **General Points of Failure**:

- A. Management's Lack of Professional Competence
- B. Management's Lack of Integrity
- C. Management's Lack of Cooperation as Team Players
- D. Management's Lack of Sound Planning
- E. Management's Lack of Discretion in Business Dealings
- F. Management's Lack of Personal Commitment
- G. Management's Exhibit of Haste, Desperation and Anxiety

Each diagnosis starts by stating a **General Point of Failure**, followed by a brief definition of that problem, and then proceeds to list several **Examples** of incidental cases that specifically describe the problem in action. Then wherever relevant or needed, most of these examples are accompanied by a **Remedy** which is actually a suggestion on how to prevent or correct deficiencies that cause such problems to manifest to begin with.

The desired result of implementing these remedies is to remove impediments and defects that inhibit a favorable evaluation grade of your collective managerial prowess and to instill within your regimen of management practices and procedures, the right attitude, character, habits, concepts, protocol and other formulations that reflect a positive disposition of yourself and your executives as a team of competent managers.

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General Point of Failure “A” – Management’s Lack of Professional Competence:

Financier does not believe that the management team as a group is competent enough to achieve the business plan goals. Why? The words and actions of key people allude to professional incompetence and shows lack of managerial savvy and sound organization. How might this happen? Here are some examples:

“A” Example 1:

Financier does not believe that the management has been running their company as a real corporation and thus lacks such experience. This can be detected due to how you address everyday corporate management procedures and issues.

For instance, if your discussions about conducting shareholder and board meetings, keeping minutes and passing resolutions in reference to major actions taken by your company, has been only in the *future tense* versus the past or present tense, or you have chosen to make no mention of it at all, as if such tasks were not that important while you were developing, or as if such tasks aren’t all that important right now in this current stage of your development, this can and will send up an alarm signal about your lack of experience in maintaining good corporate housekeeping habits and practices.

And you will, no doubt, be asked about this in considerable detail, because this is the one area that gets most inexperienced and misconceptualized corporate managers into compliance trouble, especially as a pre-IPO or early stage public company. There is a zero tolerance policy in the financial and investment community for this type of professional incompetence and it is absolutely unacceptable to all knowledgeable shareholders, because it is all 100% avoidable.

“A” Remedy 1:

You must get into the practice of running your company as a corporation, and as an added measure, running your private corporation as if it were a publicly traded corporation. This means holding regularly scheduled shareholder and board meetings with all shareholders (in person or represented by proxy) and directors present where minutes are kept by the corporate secretary, and corporate resolutions are voted on and drafted for every significant action taken by the company.

“A” Example 2:

Instead of saying “I don’t know” in response to a question that you do not know the answer to, you attempt to banter back and forth to guess or flesh out an answer you think might buy you points for appearing to be knowledgeable, even if you must make one up.

“A” Remedy 2:

Instead of pretending as if you know the answer to a pressing question or trying too hard to guess an answer you never really knew to begin with, simply say the words “I don’t know”. If the question is something that you should know and are generally expected to know the answer to, respond by saying you do not know but will make an effort to find the answer while acknowledging that you recognize the need to be keenly aware of such a thing. It is utterly refreshing to hear the words “I do not know” than to appear to know everything, especially when

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the subject matter or answer is something you are not too sure on. You will lose more points on giving an obviously made up answer than simply admitting that you do not know.

“A” Example 3:

You pretend to be an authority on subjects you’re actually a novice on.

“A” Remedy 3:

It is better to avoid being so authoritative on certain subjects where you lack adequate expert knowledge than to make a fool of yourself by pretending. Simply refrain from exhibiting such pseudo-knowledge.

“A” Example 4:

The VC asks you about a current news event that directly affects your business, market and industry in a critical way and you appear to have no knowledge of, or concern about it, and may even downplay its possible effect on your business.

“A” Remedy 4:

You must be well studied up on your business, market and industry and know it better than anyone including your competition

“A” Example 5:

You lean too heavily on another person to answer questions addressed directly to you.

“A” Remedy 5:

Always answer questions directly to the best of your knowledge, and if there is someone who you believe may have a more useful answer to a highly technical question that may be more suitable for their expertise, and then make this suggestion after you have given your best answer, but do not throw the question off. There is usually a tactical reason why certain principals will be asked certain questions by an investor even though the investor is aware of the technical backgrounds of the management present at such reviews. Most answers to most questions however should be known commonly by all principals.

“A” Example 6:

You speak as if you do not have any “real” competition from existing or prospective participants who are already in your market, or who logically might or could consider doing so, and additionally you speak as if you never will have any such competition in the future.

“A” Remedy 6:

Always consider even if you might gain the advantage of being a first to market leader with your business proposition or offer (a.k.a. “first mover advantage”), competition can come from anywhere, and anyone, known and unknown to you. In such a case you would have to evaluate how much time and cost would it take for certain prospects in certain dispositions of financial prowess and expert capability to replicate or surpass your business offer as a competitor. In other words instead of denying existing and prospective competitive forces, active or not, acknowledge them always and concentrate on what your advantages and weaknesses would be if and when they were to surface. Having a duly registered patent or exclusive contractual relationship with a company or government agency that gives you special uncontestable rights

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of distribution, market penetration or other significant advantages are among such examples of presenting yourself properly under competitive analysis from an advantageous standpoint instead of merely saying that you have **no** competition.

“A” Example 7:

Financier determines that although representing itself as a complete core of competent managers, that management’s strengths are not cross complimentary but are actually lopsided, when they should be well balanced in all critical areas of corporate management discipline.

“A” Remedy 7:

There should be a well balanced mix of all corporate management disciplines represented by your management team. Some limited functions can be temporarily supplemented by interim management and outside consultants, but a plan for permanent managers should be made in all of these areas. The areas of competence will depend largely upon your line of business and method of marketing, channels of distribution, type of customers, level of sales, solutions for supply, type and extent of technology involved, and your capacity of participation in the market against other competitors. Disciplines that apply no matter what your disposition in business is include financial, accounting, business law, tax law, corporate law, banking, marketing, personnel/human resources, operations, shareholder and investor relations, administration, etc.

“A” Example 8:

Corporate managers seem apprehensive to the idea of undergoing corporate training and attending company sponsored professional development or managerial self-improvement courses or learning programs such as given in crash course seminars, etc.

“A” Remedy 8:

You must simply develop the attitude that you are never too old or too mentally developed to learn new things and consider advice given from others outside of your circle of already trusted advisors. The business environment endures constant changes all the time that will cause what you have learned in yesteryears to suffer from obsolescence to various degrees. Placing priority and importance on personal and professional self-development is a highly appreciable trait recognized by investors when it comes to having faith in your managerial competence.

“A” Example 9:

Corporate managers and employees do not employ use of certain forms and documentation procedure which are designed for time and resource management, and general record keeping is regarded as a bureaucratic procedure that does nothing more than waste time and human resources.

“A” Remedy 9:

Efficiency in corporate management is a matter of keeping some balance between controlling excessive paperwork to a minimum and providing for use of paperwork that is necessary to stay in compliance with regulators as well as maintain essential documentation on how the company is managed. Downplaying such record keeping altogether is a sure sign of trouble to come for financiers. You must demonstrate to investors that you are in a habit of constantly researching

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for and deploying use of systems and tools that aid you in saving time and costs while speeding up production in a way that gives you better managerial control over your business and causes your principals to be more efficient and competent as corporate managers. In a due diligence review of operations such forms and systems will be closely examined and questioned by managerial and technical experts. This is one of the most overlooked areas of due diligence compliance by entrepreneurs who are still in the R&D and early market penetration stages.

“A” Example 10:

Managerial résumés and corporate bios plus the statements and answers made by executives in management interviews illustrate lack of experience, education and other credentials that might weigh in favor of a manager being deemed as qualified for the job assigned. Your resume' has many holes in it and elicits many unanswered critical questions.

“A” Remedy 10:

Avoid overuse of adjectives and stick more to factual things you would like to know if you were to evaluate a manager yourself.

“A” Example 11:

Managers do not appear to be open to mentoring or undergoing sponsorship by other interim management who will help to launch the venture until permanent qualified and competent management can be fully secured.

“A” Remedy 11:

Most entrepreneurs feel they know their business more than anyone and may feel somewhat threatened or intimidated if “others” from the outside are brought in to “tell them what to do” or “show them how to do it”. But this is not an ego contest or a contest of wills. These people are trusted and experienced professionals placed by investors as insurance that the company will be well managed and certain areas of expertise that your current management team lacks will be compensated for. It is their job to also help train and orient existing and future principals of management to eventually take over their position when they are ready. This is one way the founders of a company can retain their current management structure provided that such principals pass at least minimum requirements for retention on the management team. In most cases, this is the only way you may get financed with such money. Chief Financial Officers and General Counsel Officers seem to be the most popular of such interim managers in demand these days because most startups and development stage companies usually lack personnel with strong financial and legal backgrounds more than anything.

“A” Example 12:

Key people in management appear to have significant and/or irreversible personal legal or financial problems, which will likely affect their focus on the business of the company as a priority

“A” Remedy 12:

A manager's shareholder interest is more of a personal consideration and one thing hard to change, but their managerial involvement is much more than a personal thing that affects everyone else involved in the corporation as a shareholder, director and officer in terms of

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income earning ability and fiscal corporate liability. Ordinarily, and if ran properly, the corporation is a veil that protects one's personal interest from the corporate interest with the exception of account and asset co-mingling and misrepresentation as an individual versus a principal of the corporation, but besides this type of exposure, managerial competence is usually compromised when the priorities and focus of corporate managers are overwhelmed by such personal problems. In such cases, such managers simply must be replaced if such problems seem to be too significant and/or irreversible.

“A” Example 13:

Members of management appear to have conflicting business philosophies that are in wide disparity with each other.

“A” Remedy 13:

The tone of the overall business philosophy should be set by the CEO and/or principal founder who is clearly and unequivocally the key visionary leader of the company, but at any rate this philosophy should be consistently honed and applied throughout the departments and personnel of the business. The management should be open to outside objective advice on which philosophies work to accomplish corporate goals and which ones are merely reflections of nuances in one's personal behavior that put undue restrictions upon people in performing their duties productively and competently. Every major action should be justified by intensive objective analysis and sound reason that does not cripple the decision making process, and should be done inviting all to participate barring personal opinions and whimsical reactions by key people in charge of ratifying decisions to be made. In such cases, a formal special meeting of the board of directors or the appropriate committee thereof is the most effective and ideal forum for such discussions and actions undertaken on major and even less pertinent matters. Total participation in such actions helps to dissolve conflicting philosophies and can even serve as a catalyst for a harmonious merger of concepts that work better in synergy once explored. If there cannot be a total consensus as to which philosophies are considered sound versus unsound, there should at least be a total consensus on the resolve to support the final decision to be made if each member of the management team is to continue in their position as a team player. Better still, such issues should actually be resolved before retention or engagement.

“A” Example 14:

The management and/or staff appear to be divided into two or more camps, cliques or factions to the point where there is one side versus the other(s).

“A” Remedy 14:

This type of management personnel setting usually includes a dominant side lead by the founder or CEO versus a less dominant side lead by a potential challenger to the CEO who has a different business philosophy and objective, as well as different methods to achieve the goals of the company. The goals themselves may in fact be different within these camps. To eliminate this, either the secondary dissenting camp must be dissolved or both camps must merge on one common philosophy, one set of common goals, and mutually approved methods of achieving such goals. If not, a major restructuring of management is in order. This type of situation exists to begin with when the CEO or founder tends to run the company like a

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dictatorship with a group of loyal “yes men” as opposed to run it like a corporation with an active group of directors and officers whose input and suggestions are valued where they have objective merit. A constant challenge and conflict of individual and personal wills is the wrong environment in which to set company policy. Such policies are best set in the environment of a formal corporate setting where there is a board meeting, a pro & con discussion, documentation of well research facts to present, and a vote for a decision, a record of such proceedings made in the corporate minutes, and a formal record of the decision made in a corporate resolution, even if the minority votes do not stand to win. This process will at least give you and other interested parties a chance to see how and where every manager stands about each critical corporate issue as well as give them an open forum to fairly present their opposing views without duress or threat.

“A” Example 15:

There appears to be some discord and distrust between members of management.

“A” Remedy 15:

There should not be any mix of management personnel where such distrust exists. If so, it will be noticed by investors and will be enough to shun them away. Such issues should be openly discussed, clarified and dealt with objectively, most preferably with outside mediation.

“A” Example 16:

It is perceived that the employees feel intimidated by upper management or the subordinates feel intimidated by top executives.

“A” Remedy 16:

Communication within the ranks of management should be conducted on a two-way path where all suggestions are taken under advisement and responded to with soundly derived rationale behind every final decision made. Every issue should be open to discussion at any time and no one should ever be caused to feel that they are treading on dangerous ground by addressing certain issues of concern to them. In an environment where the company is truly ran like a corporation, this is already allowed for.

“A” Example 17:

Key people in management appear to suffer from psychological dysfunctions or mental illness that might affect their ability to exercise sound judgment and execute sound business strategies with any meaningful performance.

“A” Remedy 17:

Some entrepreneurs are very creative people and may tend to exhibit impulsive neurotic behavior akin to someone considered to be “51-50” or experiencing occasional dementia, but this can be symptomatic of stress endured from taking on a larger than normal burden of responsibility and imposing undue expectations upon oneself as is the case of a true neurotic. When entrepreneurs insist on doing everything themselves out of distrust and increasing self-dependency, and refuse to delegate tasks that are out of their league to others who are much more likely to be competent in carrying them out, such negative traits quickly come to the surface. Perhaps some professional psychological counseling or psychiatric therapy may be in order for certain minor and temporary drawbacks, but for more permanent disorders, there is no room on a management team for set backs caused by uncontrolled egos, over-suspicious

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paranoia, split (schizophrenic) personalities, suicidal tendencies, and other severe mental or psychological instabilities. Such people may be great when it comes to creating things and inventing great ideas, but managing a business calls for a much more stable state of mind and sound psychological resolve. Would you feel comfortable if a management team that included a psychotic or neurotic was responsible for managing your passive investment? Absolutely not.

“A” Example 18:

Key managers seem to be unavailable too often at the office or by phone. Accessibility seems to be a recurring problem.

“A” Remedy 18:

During development operations key executives must commit themselves to being accessible and available seven days a week, on call and have mobile communications (cell phones) where they can be reached at any time for whatever reason. Also such managers must be committed to spending a fixed minimum amount of time at the office if appropriate to their function.

“A” Example 19:

Key people in management have health problems that may impair their ability to function properly while staying committed to meeting the demands of an executive in the business.

“A” Remedy 19:

This is not an equal employer opportunity discrimination concern, but a fact of life as an executive who will be part of a team of managers responsible for the future success of a company with extraordinary development goals. Managers with severe and permanent disabling health disorders simply cannot be competent as committed managers of a newly capitalized corporation. Their ill-health concerns will be too overwhelming for them to stay focused on corporation priorities. In consideration of this you must be keenly aware of any impending health problems and determine the impact on job performance. Age is also a related factor to the health situation. You have to avoid executives who are going to spend an inordinate amount of time in hospitals and medical clinics, become acutely subject to old age senility-type diseases that impair memory retention and sanity such as Alzheimer's and Parkinson's, and also avoid executives who have a high chance of dying during their term as corporate officer (or director to a lesser extent), and avoid having officers who will execute documents and contracts that may become null and void if they were to be declared "*non corpus mentis corpus*".

“A” Example 20:

In the case of nepotism (the employing of family members and the obvious privileges and shortfalls that comes with it for employer and employee), the founder did not appear to use much discretion in related hiring practices and personnel treatment.

“A” Remedy 20:

Founders and company owners who hire family members should do so based upon the merits of the family member's worth as an employee and should avoid incentive programs where there is room for manipulation by such people in these special relationships. Tolerance for incompetence is already a built-in suspicion about such hiring practices while trustworthiness and mutual respect as people may be a plus. But be prepared to justify such decisions with sound reason that objectively explains the competence of family members who are hired in executive management capacities.

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“A” Example 21:

Key managers seem to have too much trouble keeping appointments.

“A” Remedy 21:

Managers must be committed to keeping all appointments and being prompt for all meetings scheduled.

“A” Example 22:

Key managers appear to have drug abuse problems.

“A” Remedy 22:

There should be a zero tolerance policy for drug abuse and being under the influence of controlled substances that adversely alter the mind while performing job functions. Addictive and habitual drugs that replace and distort the user's priorities and impair their ability to focus and function as a competent manager should be especially prohibited. The reasons are not merely legal but more so medical, practical and mostly self-explanatory as to the obvious.

General Point of Failure “B” – Management’s Lack of Integrity:

VC has concerns about your integrity and your ability and conviction to be direct, frank and truthful. VC believes that they were being evasive or trying to hide something during the answering of questions or the making of statements. How might this happen? Here are some real life examples:

“B” Example 1:

Instead of giving direct answers to direct questions, you precede with dialogue most probably designed to soften the effect of a direct answer or possibly evade the question it altogether.

“B” Remedy 1:

When asked a question, answer the question first, and proceed with dialogue later, otherwise you will be seen as being evasive or attempting to avoid the question.

“B” Example 2:

You fail to make and maintain eye contact when addressing a particular person on an important matter, or your eyes shift about excessively while addressing one person

“B” Remedy 2:

The eyes are the number one body language signal that people read to make determinations about your character, attitude and disposition. Stability and being direct is the message that comes across when your eyes are steadily focused on the eyes of the person you are addressing. Maintain direct eye contact with everyone you address and with everyone who addresses you.

“B” Example 3:

You make statements where the stated facts do not add up or make much sense, leaving listeners skeptical. There are wide disparities and inconsistencies found or detected in these statements made.

“B” Remedy 3:

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This is not merely a matter of memorizing past and present statements to reconcile them for consistency. It is more a matter of being direct and truthful and resisting the temptation to add those other seemingly harmless but fabricated “minor” details that make up the source of disparities that draw negative attention to the heart of your story which may be substantially true. If you do tell a story that is in fact true but still sounds unlikely to the average skeptical listener, do take the time to clarify yourself to avoid the skepticism from being a barrier to your principal message.

“B” Example 4:

You attempt to answer a question addressed to someone other than yourself as if to rescue them from giving their version of an answer.

“B” Remedy 4:

Never interrupt to answer a question addressed to someone else unless they give their answer first and yield to you as the person who may provide a more appropriate answer.

“B” Example 5:

You made statements or documented disclosures which were contradicted or left the VC with uneasy questions following the VC’s verification process.

“B” Remedy 5:

Review all of your reported facts for accuracy and consistency and make it a point to eliminate contradictions by insuring that everything you make a claim on can be verified by sources of independent research. Do independent research on your own assumptions about your business if you do not know for sure.

“B” Example 6:

You exaggerate and lie about past or recent accomplishments that do not check out.

“B” Remedy 6:

Do not ever attempt to make up past accomplishments or exaggerate such stories.

“B” Example 7:

You were found to announce false, inaccurate or misleading information in press releases about matters such as relationships secured, financial capabilities, sales performance, technological capabilities, regulatory or legal compliance milestones and victories such as on regulatory agency rulings and the status of proposed litigation.

“B” Remedy 7:

Do not announce deals before they are actually closed, signed, sealed and delivered. Be particular about who you disclose deal developments with as such information is not for everyone through every form of media. Otherwise, this can lead to legal and social trouble with shareholders, investors, advisors, employees, partners, fiduciaries, confidants, clients, customers, suppliers, creditors and others who have a stake or interest in the performance of your business.

“B” Example 8:

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In a meeting, you abruptly change the subject matter during a focused conversation before an important idea has had a chance to become fully developed and resolved.

“B” Remedy 8:

In addition to being annoying to others who are trying to develop an idea or gain an understanding or consensus on a particular issue, this is also an outward signal that you yourself have an underlying motive to avoid the subject matter out of discomfort with what might be revealed if such a discussion continues as details are explored further.

“B” Example 9:

You hesitate to answer a direct question as if to avoid embarrassment or to buy time to think of a good sounding answer.

“B” Remedy 9:

If a question has to be bounced back to you at least once or more that is a very bad sign. Answer all questions promptly and concisely with answers that do not leave the listener guessing what exactly was meant by your answer given.

“B” Example 10:

Founder has been known to lie to employees, shareholders, debtors, customers, suppliers, financiers, and others about business, financial and legal developments, especially if having financial difficulties, which will affect their interest in knowing the truth.

“B” Remedy 10:

When a company is experiencing hard times and aren't able to keep up with their obligations such as payroll and other payments to people who basically work on good faith or credit, many founders invent stories to keep these supportive people on the “hook” until a turnaround evolves in their negative situation, but this backfires and does more harm than it does good. Being known in this way reduces your credibility among insiders and outsiders, as outsiders can read the confidence level of insiders when certain issues are openly addressed. Be honest and open in all cases. Deception is highly unappreciated and can lead to severe legal and financial consequences including regulatory sanctions, criminal charges, lawsuits, sabotage, embezzlement, hostile takeover infiltration, etc.

“B” Example 11:

You are hesitant or apprehensive about submitting to a background check or drug test.

“B” Remedy 11:

Most requests for background checks will reveal things that many people consider embarrassing about their credit or a misdemeanor such as a DUI. But at any rate failure to submit to one is a sign that the subject has something to hide and is necessarily a deal killer.

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General Point of Failure “C” – Management’s Lack of Cooperation as Team Players:

VC is not convinced that the founder(s)/management are team players, or the CEO is someone who has a token management team while dancing to the beat of his own drum. How might this happen? Here are some examples:

“C” Example 1:

Upon examination of corporate books and records VC finds that there have been no regular schedule and minutes kept of board meetings and resolutions that result from major decisions and actions taken.

“C” Remedy 1:

You must keep up to date on shareholder and director meetings, which means that regular meetings must be scheduled and followed through on, and also special meetings must be held and followed through for every major corporate decision that is made.

“C” Example 2:

The CEO or one person gives the answers to everything and his answers often contradict that of his subordinates, sometimes in an argumentative way.

“C” Remedy 2:

Everyone on the management team should be versed and oriented on the business in such a way that if the CEO was to be absent or had to be replaced in a presentation, any one of the other management team members could easily fill in and give answers that are consistent with what the CEO would have said.

“C” Example 3:

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The CEO or founder refers to “I” often and never “we” as to represent the entire management.

“C” Remedy 3:

This change will only come with attitude and a resolve in the mind of the CEO/founder that he/she is playing as part of a team and not as a lone ranger.

“C” Example 4:

The CEO fails to dedicate time to selling the strength of his management as a team and only talks about his own strengths and accomplishments in the firm.

“C” Remedy 4:

Every good CEO surrounds himself/herself with good competent people who compliment the CEO’s strengths and compensate for the CEO’s weaknesses. Hence it is the CEO’s job to sell his/her management team as a competent and committed team that he/she is part of.

“C” Example 5:

The CEO appears not to be candid in discussing his own personal and professional weaknesses and shortfalls.

“C” Remedy 5:

You should be just as open and eager to share your shortfalls with a solution for how it will be compensated for within planned management team and strategy.

“C” Example 6:

VC senses that the board of directors and/or officers is likely merely nothing more than token rubber stamp yes men under the dictation of the founder/CEO.

“C” Remedy 6:

Co-executives need to be an integral part of the corporate decision making process and the CEO cannot make decisions off the cuff that must include the input of a board of directors.

“C” Example 7:

It becomes apparent that company managers do not feel comfortable speaking candidly about the business in the presence of the founder.

“C” Remedy 7:

Executive should be free to openly voice their pro and con concerns without fear of retaliation. Opposing views force you to surface from your comfort zone and review your own policies which may be outmoded.

“C” Example 8:

It becomes known that the founder has made and still makes many major decisions without the procedure of consulting the board of directors, advisors to the board, fellow officers and consultants, and without properly informing staff.

“C” Remedy 8:

Before any major decision is made, you need to consult all relevant parties involved or affected, starting with the board of directors at a minimum.

“C” Example 9:

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Founder seems to have trouble delegating authority and even trusting other executive subordinates to carry out tasks they are supposedly qualified for, as he insists on doing it himself.

“C” Remedy 9:

This is not so much a trust issue as it is an egotistical control issue. There are many mechanisms in the corporate world to compensate for one’s lack of trust for employees and other types of co-associates, so many entrepreneurial types have strong egos and wish to take credit for many accomplishments themselves without attributing due credit to the team of players who have contributed their parts. Some “jack of all trades” entrepreneurs rather employ talented people or retain talented advisors to show them “how” to do things where they can take a shortcut to a desired result, as opposed to allow the expert to execute the procedure themselves. Sometimes saving cost is also an issue.

“C” Example 10:

Founder appears to be dangerously egotistical, egocentric, self-centered and self-serving, essentially to the point of not caring about anyone but himself or anything but his own interest.

“C” Remedy 10:

This personality-related quirk may not have an acceptable remedy if the problem is beyond a certain stage, but it is certainly a major liability if such a person were to insist on assuming a management role.

“C” Example 11:

VC discovers that it is clearly obvious that the founder is not competent enough to hold the office of CEO, but the founder refuses to step down to a position of say Chairman, and let someone else who is qualified take the position.

“C” Remedy 11:

In such a situation ego can be costly. Many founders are not qualified to run their own companies in the capacity of an executive manager. A company founder, inventor, dreamer, engineering or creative genius, etc. are not always and necessarily the best people cut out for corporate and business management. Some founders can be taught and groomed into a management role but many aren’t will to assume their roles via this process and it becomes a problem during the restructuring of management. You must keep in mind that once you take in the investment dollars of outsiders and make them shareholders, you owe them a duty to insure the best, most competent management team for the risk they have decided to take on your business offer.

“C” Example 12:

Principals of management are found in any way too be in a position that causes a conflict of interest between the manager and the interest of the company or shareholders. Certain key managers appear to have other business interests, which may affect their prioritization of time or their prospects for divesting off to operate as a competitor.

“C” Remedy 12:

In this situation the matter that causes the conflict of interest must be timed out or neutralized, or allowed to exist but properly disclosed to all interested parties if tolerable, or otherwise the

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principal who has the conflict must be compelled to modify his/her relationship with the company or his/her outside interests and terminate the relationship with the company.

“C” Example 13:

Founder seems to be paranoid about everyone around him as if he thinks that their plan is to conspire against him to take over his company or steal and plagiarize his idea.

“C” Remedy 13:

This is part of a personality defect that causes paranoia giving the principal founder false impressions about conspiracies against him/her as plotted by their subordinates. If the founder feels that he/she has mistreated these subordinates then such feelings that counter a false sense of loyalty tend to surface. If founders treat their subordinates respectfully and well, they have no reason to become suspect in this way.

“C” Example 14:

Managers appear to be too overly dependent on the founder to the point where the founder may be manipulating control over such subjects. Plus it becomes apparent that the CEO or founder attempts to dictate control in the personal lives and associations of subordinate managers and rank and file employees.

“C” Remedy 14:

Founders should not interfere with the personal lives of their employees, managers or not, as an employer, and should not take advantage of the fact that certain of these employees are substantially dependent upon their company for survival, etc.

General Point of Failure “D” – Management’s Lack of Sound Planning:

VC detects that there is some uncertainty about your sense of direction and ability to plan for the future. How might this happen. Here are some examples:

“D” Example 1:

You appear to be confused or too variable about your absolute funding needs as evidenced by your requested amount fluctuating up and/or down continually.

“D” Remedy 1:

The amount you need to fund your venture should not change invariably from week to week or person to person. Any such change should only be considered when your projections are altered by newly discovered facts that have significant impact on your corporate capital needs. Otherwise, this figure should stay consistent and definite. Constant changes are a sign that you don't know what you want and do not even have a sound method for determining what criteria to use to determine your capital needs.

“D” Example 2:

The amount that you are requesting is too low or too high off from a realistic target.

“D” Remedy 2:

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Being too low means you will be undercapitalized and being too high means that you will have a higher cost of capital for an overage of un-deployed funds. You need to determine your capital funding requirements based upon a timeline Use of Proceeds Statement that also allows a reasonable cushion for burn rate coverage into profitability.

“D” Example 3:

You are not sure where your projected break-even point is in the post funding cycle or the assumption factors that you have used to determine this are inadequate and unrealistic.

“D” Remedy 3:

You need to be able to narrow this down to the month based upon bottom up projections.

“D” Example 4:

You continually adjust downward on the amount of your request thinking that it will be quicker and easier to secure a lower amount, not realizing that the dollar volume of financing is not the impeding issue.

“D” Remedy 4:

This is just another variable of how a company’s capital funding requirements seems to keep changing. Lowering the dollar amount has no impact on the chances of getting funded.

“D” Example 5:

Management appears not to be on one accord about the plans for the business which is evidenced by managers contradicting each other while in interview sessions together or while being interviewed one-on-one where their answers and statements made to the VC do not coincide, let alone not help to support the notion of there being any good chemistry among the managerial team composition.

“D” Remedy 5:

Hold briefs and information meetings to keep everyone abreast on all official corporate developments and to insure that everyone has the same version of all stories relevant to such developments. This will prevent contradictions as a group or as separate interviewees.

“D” Example 6:

Management fails to set aside equity for employees, either because of oversight or because the founders have a problem sharing equity with lower subordinates, thereby indicating by attitude that founder places a low value on investing in good personnel and staff, a most critical area.

“D” Remedy 6:

Most VC’s prefer to see that the management has set aside at least 10% of its capital stock for its non-founder employees. A staff of dissatisfied employees who are working without adequate incentives can cripple a business no matter how powerful the marketing concept. They must

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have a sense of ownership too to give their best and feel good about it because they are also working to contribute to the value of their personal stock in the company.

General Point of Failure “E” – Management’s Lack of Discretion in Business Dealings:

VC believes that your ways and presentation style are too pretentious and lack sound business and psychological judgment and social tact, or display characteristics that are annoying and insulting to listeners, leaving them resentful. In general, such display of bad character and undesirable traits are harmful to the sound management of a business they might consider investing in. How might this happen? Here are some examples:

“E” Example 1:

You use obvious and cheap salesman tactics to sell the deal (instead of dropping the sales pitch and selling yourself and your management team).

“E” Remedy 1:

Don’t sell your deal, sell yourself. Talk about your deal and present it in a way that shows that it is open to modification wherever needed. But do not make insulting limited time offers or any other amateurish sales tactics.

“E” Example 2:

You engage in flagrant name dropping, especially in making such references to people whom you have had no personal relationships or dealings with.

“E” Remedy 2:

Avoid name dropping and only use names of people that you will actually involve in what you are doing.

“E” Example 3:

You attempt to speak heavily and unnecessarily in the jargon or highly technical lingo of your business or industry using words, terms and expressions that the average businessman would not comprehend or attempt to converse back in.

“E” Remedy 3:

Talk professionally but do so in plain English not your industry jargon. If you do use such words, acronyms and terms not commonly understood outside of your industry, to clarify with definitions and explanations. The same goes for written communication as well.

“E” Example 4:

You repeat yourself a lot on points made and fail to summarize all of your points.

“E” Remedy 4:

Analyze your dialogue to eliminate redundancies and summarize all of your points made towards the end of your presentation.

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“E” Example 5:

You put the name of a venture capitalist’s or investment banker’s on publicly distributed materials without their permission.

“E” Remedy 5:

This can cause you more trouble than the potential benefits you may have leveraged.

“E” Example 6:

You make unwise or fabricated statements to others about your dealings with a venture capitalist or investment banker and such statement get back to them, as they sometimes are associates of the VC or IB you are referring to.

“E” Remedy 6:

Be discreet in all of your communications.

“E” Example 7:

You make presumptuous gestures such as inviting a VC you do not really know to take a seat on your board of directors, or accept some other honorary type of designation from your company which is in reality an obvious tactic to gain leverage from using their name in association with your company as well as a familiar but insulting closing tactic to commit them to funding your venture.

“E” Remedy 7:

Don’t enter this type of dialogue unless and until you have received a firm commitment from the financier to finance your deal, and even then, such arrangements such as a board of directors seat will be set up automatically and need no prompting on your part as to when, how many, etc.

“E” Example 8:

You attempt to finish a sentence that the VC has not yet completed either out of bad conversational etiquette, or to prove how in sync your mind is to the VC’s expression of thoughts.

“E” Remedy 8:

Be courteous and respectful and never interrupt someone who is speaking or making a point with an attempt to finish their sentence. This can backfire on you and do the exact opposite of what you might hope it would have done by exhibiting you intuitive prowess of forecasting sentences.

“E” Example 9:

You fail to make the points of your presentation clear and without using well laid out PowerPoint-type exhibits.

“E” Remedy 9:

Constant dialogue will start to sound like a jumbled up set of sentences after awhile and a PowerPoint exhibit will give you the advantage of staying focused and on track with the subject while narrating details and examples.

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General Point of Failure “F” – Management’s Lack of Personal Commitment:

VC does not believe that management has a significant stake in the business, or a long-term commitment to the venture and may walk or quit. How might this happen? Here are some examples:

“F” Example 1:

Management has very little or none of their own money invested and at risk in the venture and therefore do not have much to lose.

“F” Remedy 1:

All managers should have a significant personal financial stake in the business and have much to lose if it does not succeed.

“F” Example 2:

The absence of employment contracts and non-compete agreements applying to all executive management personnel including founders.

“F” Remedy 2:

Execute all relevant executive and employee related agreements to contractually lock everyone in to their positions of commitment. It gives you company a tighter more reliable structure.

“F” Example 3:

Financier discovers that founders and other top management have not nearly exhausted their other affordable resources to commit as their personal investment in the venture.

“F” Remedy 3:

Executives need to be able to show that they have made personal sacrifices and deployed much of their personal financial and other resources into their company.

“F” Example 4:

Financier discovers in your corporate books that your articles and/or bylaws as amended are laden with “poison pills” which are in the adverse interests of existing and future shareholders.

“F” Remedy 4:

Poison pills are provisions within the corporate articles or bylaws that make it very uncomfortable for someone who wishes to invest in or buy a large interest in your business because their buying will trigger the execution of some clause in the corporate books to cause a serious incident of dilution or some other change in the disposition of stock equity in the way it is owned and distributed. Unless such clauses are amended or rescinded, an investor will stay far away from such companies. Such clauses are usually orchestrated by general counsel who is

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familiar with securities and corporate law and agreements. Some are even actually placed by founders who have improperly placed them there without compliance to corporate or securities law or regulation on proper notice procedure, and without adequate knowledge and consent from fellow shareholders. The most popular type of poison pill was something called a “golden parachute”, which is a severance package for executives that were activated upon the event of a hostile takeover of their company that would cause their termination as managers in the corporation. The severance terms were often significant enough to cripple the company financially if a big enough exodus was to happen with incumbent management.

“F” Example 5:

Comments in your conversation reveal a disregard for shareholders and their concerns.

“F” Remedy 5:

Always speak in terms of building shareholder value as your number one goal in the corporation.

“F” Example 6:

Members of management are hesitant or reluctant to sign employment and non-compete agreements.

“F” Remedy 6:

Do not deal with managers who will not sign such agreements if they claim to be committed for the long term.

“F” Example 7:

Managers seem to be more concerned about their own personal post-funding salaries and bonuses than other corporate financial issues.

“F” Remedy 7:

Insuring your stake in a venture is acceptable behavior, but being obsessed with such details to the exclusion of other mutual concerns will raise a red flag about your true priorities when the issue of shareholder value is to be considered.

General Point of Failure “G” – Management’s Exhibit of Haste, Desperation and Anxiety:

You appear and act desperate and overly anxious or too eager to close quickly. How might this happen? Here are some examples:

“G” Example 1:

You attempt to impose a time limit on the VC to make a decision by presenting an ultimatum for timing.

“G” Remedy 1:

Never present an ultimatum for time unless you are past the due diligence stage and have entered the post-negotiation stage. You will only cut your own throat and kill a potential advance in the deal.

“G” Example 2:

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You attempt to negotiate the terms of an offer before passing the due diligence review.

“G” Remedy 2:

Trying to negotiate a deal anytime prior to due diligence is totally inappropriate and premature.

“G” Example 3:

You attempt to negotiate the terms of an offer before establishing an objective valuation on your business.

“G” Remedy 3:

Trying to negotiate a deal prior to establishing some objective valuation will cause you to negotiate in the blind and have no true justifiable basis from which to suggest how much of your company should be given up for a particular dollar amount invested. Establish this valuation first and then attempt to negotiate.

“G” Example 4:

You attempt to offer or make the VC a “bargain deal” that he cannot refuse if he agrees to act “now”.

“G” Remedy 4:

Don’t impose such limited time offers. This is a cheap salesman’s tactic that will cause you to lose much credibility.

“G” Example 5:

You try to play the VC against another, real or imagined, in a horse race game attempting to give the impression that they are under pressure to act promptly or miss out.

“G” Remedy 5:

Do not ever attempt this type of ploy, whether it is real or fabricated. This tactic will cause resentment and can have you end up being blackballed in the industry.

“G” Example 6:

You farm out your business plan materials and at some point of saturation, “over shop” your deal on the “street”, that is, in the venture capital market.

“G” Remedy 6:

Spreading your presentational materials, i.e. your business plan, all over the financial community develops negative “branding” for your deal and your name. It is best to be discreet about who you give your materials to and to privatize the matter instead of publicize it.

“G” Example 7:

You offer your personal founders’ stock as “collateral” for an equity investment.

“G” Remedy 7:

In a venture capital investment, “stock” in your company is *NOT* collateral.

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Management Team Composition

You must assemble a management team that is **well balanced** in terms of their varied fields of expertise and experience used to properly carry out all the operations that apply to your particular business. In most development stage companies there is a proliferation of imbalanced management where for instance you may have four technology/engineering people, one bookkeeping person, two administrative people, one creative design person, one research person, one telesales person, one paralegal person, maybe a customer service person and no one else in other departments with other top level backgrounds that are needed for proper administration. If the business is technology oriented, then perhaps having several technology people may be warranted, but not at the expense of lacking in other critical areas such as accounting, finance, marketing, operations, legal & regulatory, personnel, etc.

Corporate administration should be built from the top down, not the bottom up, but in most startups it is usually and typically the other way around because most founders find and recruit people with substandard credentials to operate their growing companies with various overlapping functions that will eventually evolve into departments or divisions of the company, and due to complacency with the processes, they simply neglect to bring in highly competent people of executive stature to administrate these functions in a more organized way of corporate style planning and management familiar to larger more established organizations.

At a minimum, most every business that plans to accelerate its growth and become a serious competitor for investment funding needs a core management structure that consists of competent executives in the fields of **general management & leadership**, the **operations specific to the industry or line of business**, **accounting and financial management**, **corporate and other applicable business law**, **administrative office & personnel operations**, **marketing & sales**, and any **applicable technology or other technical matters that are also specific to the industry or line of business**. Certain other functions such as shareholder relations, human resource and employee benefit administration may be initially outsourced until the company grows more able to retain competent managers to set up and run self-contained departments and divisions. Also, at first, upper management will closely assume the roles of middle-management department heads until such accommodations can likewise be made in the growth and further development of trained personnel.

Determining Managerial Needs

The first order of business is to candidly assess your management needs as if you had no management personnel at all, and then size up your current management structure to match existing personnel into appropriate roles. There will be much overlapping of such roles due to managerial talent deficits that will be force you to make hard and fast decisions about what roles are necessary and which people are best suited for such roles, whether it be incumbent managers or persons recruited from outside your existing personnel ranks.

You must first fully consider the parameters of certain discipline groups that should be represented to make up a sound and complete corporate management roster. In doing so, it is always important to keep in mind that when you attempt to staff and run a company that is in search of avenues that will allow for continued access to permanent financing, you are in business first and foremost to make a profit, you need a vehicle to equitably distribute such profits while also strategically taking in additional investment funds, and you need even another type of vehicle to streamline your corporate fundraising needs on a regular and continued basis which is accommodating to the liquidity concerns of all investors and shareholders. In other

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words you must consider that you are running or at least aspiring to run three (3) unique entity types at once:

- **Number 1** - you are running a **for-profit business enterprise** which is something you should be most familiar with as a business manager.
- **Number 2** - you are running a **state chartered corporation**, which is a unique vehicle in and of itself with its own special legal and financial structure requirements and highly technical problems and solutions.
- **Number 3** - you are running a **public company** or a **company that aspires to become public** for all the stated obvious and not so obvious beneficial reasons, which is subject to special reporting requirements and more intensive regulatory oversight among other things that are peculiar to managing a reporting publicly traded versus privately held concern. Even if you aren't public, it is best to practice running your company as if you were to avoid being resistant to and apprehensive about change due to sudden corporate culture shock when the public offering induction process actually transpires.

Introduction or Re-Introduction to Management Oriented Corporate Structure

To properly administrate your management structure to prevent complicated and time consuming restructuring later, you must first properly structure the aspects of your corporation that cause management to legally exist to begin with in a way that is validated by procedural compliance to regulatory mandates.

A corporation is made of three components consisting of shareholders, directors and officers. It is vitally important to distinguish the roles, relationships and differences of these three components and to comply with such knowledge, otherwise like the vast majority of startup businesses you will have an invalid and faulty management structure that has evolved from an invalid corporate structure. Corporate capital structuring and restructuring is a very complex matter and it is not the purpose of this section to explore it in detail, but merely to reference key points that directly affect the management structure.

In most startup and development stage corporations **Shareholder ship** is established by a mocked up subscription agreement and **Directorship** is established by word of mouth from the CEO and **Officer ship** is established by word of mouth following an informal meeting of company founders (with no articles, minutes, resolutions or other documentation) and perhaps even a boilerplate employment contract and some printed business cards and stationery with their name and title along with a private office. If you are serious about cleaning up your management structure to impress upon financiers that you are familiar with running your operation as a corporation, all of this must change. Surprisingly, even entrepreneurs with credentials in business administration fail to accept and practice these maxims.

* Customized stationery such as business cards and letterhead, having a picture in the company brochure or website and name mentioned throughout company literature, having signatures endorsed on company documents whether or not stamped with the corporate seal, a personalized name plate on your desk and on the door to your private office, a parking permit card for your office building, a private secretary, and other typical executive office trappings does not validate any appointment as a corporate executive. Such attributes normally associated with executive office positions will not standup in any legal arena when the validity of a company actions or contracts signed or approved by such persons is being contested or tried.

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What You Need To Know About Compliant Corporate & Management Structure

Assuming the corporation is in good standing and the Articles of Incorporation as amended allow for all normal operations of distributing shares to founders with a stated per share par value, the first way to establish management is to be named in the Articles of Incorporation when the corporation is formed which may even be preceded by a Pre-Incorporation Agreement which summarizes such details of ownership and initial management appointments. Here are the basic rules regarding corporate structure as it relates to proper management structure:

- Shareholders and directors are initially established in the Articles of Incorporation or Amendment to the Articles of Incorporation. Additional shareholders cannot be admitted until directors are appointed to carry out the planning of the corporation. Additional directors cannot be admitted until the shareholders conduct a vote to appoint such directors.
- Any person can be a shareholder and/or director and/or officer of the corporation. Only a natural person can be a director or shareholder. But a legal entity including a natural person, an institution or organization, can be a shareholder. The three capacities do not overlap as far as being a combined function. They only overlap as far as one person being able to operate in any or all capacities with clearly separate functions for each at different appointed times.
- Shareholders cannot manage the corporation as a shareholder. They must hold a vote to establish a board of directors and must then trust these directors to properly administrate the planning and operations of the company, who will in turn appoint officers charged with the daily operations.
- Directors acting as directors do not manage the day to day operations of the corporation unless they do so in the capacity of an officer. They set policy and plans and appoint officers to carry out the executive functions of the company. Officers acting as officers do not participate in setting such global policy and planning unless they do so in the capacity of a director.
- Shareholders can elect and remove directors and directors appoint and terminate officers. Shareholders do not directly elect, appoint or terminate officers; they must trust the directors that they appoint to do this.
- In a corporation, shareholders are the owners, directors are the master planners and policy makers and officers are the executives that carry out the plans using strategies of business management to build value for the shareholders. You must invest to be a shareholder, and you must be appointed to be a director or officer
- A **Corporation** cannot legally exist without a **Certificate of Good Standing** from its state charter, **Shareholders** cannot legally exist without the corporation which is established by the **Articles of Incorporation** (or **Certificate of Incorporation** in some states), **Directors** cannot legally exist without the approval of **Shareholders**, and **Officers** cannot legally exist without the administration of and appointment by **Directors**.

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- Following the **Articles of Incorporation** and accompanying **Organizational Minutes** which serves to account for the formation of the corporation, all subsequent corporate-level actions that concern or require the approval of shareholders, directors and officers must be preceded by a **meeting for discussion** and a **motion for decision** or **voting session** (if applicable) to eventually arrive at a **conclusive decision** which is all accounted for in the **Corporate Minutes**, **Corporate Resolutions** and any related **binding agreements** (if applicable), all drafted and executed in appropriate language and form.
- With the exception of voting on actions that have a direct effect on the corporation's capital structure and appointing and removing directors, **Shareholders** merely invest and take on a passive ownership role, while **Directors** take care of all **corporate functions** and **Officers** take care of all **business functions**.
- For any corporation vote to be legal and valid, **bona fide notices** of the meeting must be properly served upon the parties and a **quorum** (the minimum amount of voters that need to be present to uphold a resolution decided by majority vote) must be present as prescribed in the **Bylaws of the Corporation** that serves to regulate such matters.
- A **quorum in a shareholder vote** can be satisfied by shareholders that are actually present as well as absent. This is done by a statement of **proxy** (a duly authorized substitute representation made by a delegate assigned the right to vote on behalf of a named shareholder in their absence).
- **Shareholder votes** may be conducted in one of two ways. Such shares may be voted either in **cumulative (block)** or **non-cumulative (one vote for every one share)** form if allowed by the Articles of Incorporation under authority of the State of its corporate charter.

Non-cumulative voting is a simple task of adding the amount of shares that are voted a particular way to tallied up a total based upon one vote for every one share.

Cumulative or block voting on the other hand, provides a formulation for several shareholders with less shares to band together to represent a more significant voting interest than if they were to simply have their total share counted in a vote. This formulation allows them to actually multiply the amount of shares they own by the amount of shareholders voting on a similar persuasion to arrive at a cumulative total for voting purposes. It is allowed as an option in some states and mandatory in certain other states. Many states leave the discretion of allowing or disallowing cumulative voting to the corporation which is effectively administrated within the Articles of Incorporation as amended.

- A company's **Capitalization**, in short, the value of its **outstanding shares of common stock** multiplied by its **price per share**. If the company is **Privately Held**, the **last issue price** (which should also be the highest issue price) is valid as a price per share for determining capitalization. If the company is **Publicly Traded**, the **current market value** or price per share as of the last closing bid on its exchange is valid as a price per share for determining capitalization. The unadjusted valuation of public companies is quickly determined using this capitalization formula, but if the price per share is not justified by a reasonable price/earnings (P/E) ratio, such valuation is considered over-

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inflated. A stock's P/E ratio represents a multiple of its price per share over its earnings per share or likewise its capitalization over its total earnings for all shares.

- The **Capital** (sometimes used interchangeably and confusingly with **Capitalization**) of a corporation refers to its capital structure which is based upon the disposition of its **authorized common and preferred stock, issued and outstanding common and preferred stock, treasury (repurchased) stock** (common only), long term fixed liabilities such as **bonds and notes outstanding**, and **derivatives or hybrid securities** that may convert into shares of outstanding common stock if converted (in the case of **convertible notes/debentures** or **convertible preferred**) or exercised (in the case of **stock options**). Such options include **preemptive or preferential rights** which are issued to management principals as an equity incentive for joining the company at such an early stage **warrants** which is granted to outsiders who are not employees or part of the management team, which are options issued as a bonus attached to stock offerings bought for cash or as an incentive to broker/dealer underwriters that place or sell the stock to end investors, and **stock options** granted pursuant to a corporate sponsored Employee Stock Ownership Plan (ESOP) that includes a common stock option distribution.
- **Authorized Stock** represents the maximum shares that can be issued but is practically non-existent and inconsequential to any meaningful valuation or transaction ability until actually created and assigned or issued. The number of authorized shares of any given class of stock can never be decreased less than the issued and outstanding shares of the same class stock.
- **Issued Stock** represents shares that have been transferred to shareholders or shareholder accounts (such as escrows set aside for ESOP's) assigned from authorized shares. The number of issued shares of any given class of stock can never exceed the number of authorized shares of the same class of stock. The total amount issued stock is a sum of currently outstanding stock and stock repurchased into the treasury.
- **Outstanding Stock** represents the portion of issued shares that is still under the ownership of shareholders and has not been cancelled out by a repurchase from the company.
- **Treasury Stock** represents formerly outstanding shares which have been repurchased from shareholders by the company (for cash) and held in a special account (the corporate "treasury") to be used as an off balance sheet asset such as for acquisition currency or for ESOP's, etc.
- **Issued and Outstanding Stock** represents shares that are still in the hands of shareholders after being issued out. These shares are the difference of shares that have been issued fewer shares repurchased back into treasury.

When founders stock is initially authorized and issued, the action must at a minimum, be recorded in the original **Articles of Incorporation**, or an **Amendment to the Articles of Incorporation**. At this point it is important to select either a **par value** or **no par value**. These values relate to **authorized stock** and **issued & outstanding stock**.

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Par Value is a designation that means your capital stock has a “**face value**” per share and conversely **No Par Value** is a designation that means your stock has “**no face value**” per share. If a company is not concerned with taking in capital in the near future, no par value is usually the designation of choice. But if a corporation plans to issue shares to other people besides its founders, a par value is chosen. With this value will come a tax consideration based upon the issued and outstanding shares times the par value per share. This issuance is known as **founders stock**, which is so named because it is typically issued when the corporation is founded and includes the cheapest issue price the stock will ever be sold at, which is actually a nominal buy in rate.

The **per share par value** is usually kept down to a fraction of a cent to minimize a tax event upon issuance of such value. Common per share par value denominations typically range anywhere from \$.01 (*one cent*) to \$.0001 (*one hundredth of a cent*).

State charter annual taxes: If your aim is to minimize this amount of tax based upon your authorized shares of common stock, the amount of authorized shares can be kept to an allowed minimum depending upon which state the charter is in. Each state has a maximum amount of shares that can be authorized to minimize the annual tax portion of state incorporation fees. There are usually different rates for par value versus no par value shares and the rate varies widely from state to state.

Consideration, which includes cash or cash equivalents, tangible assets, intangible assets, or the value of services provided, must be recorded and exchanged for such stock issues. Stock bought in such a way is considered **fully paid and non-assessable**, meaning that there are no liens or encumbrances against the stock issued. If the stock is bought instead for a note, IOU or some other promise of consideration that has not yet been delivered as payment in full, it is considered **not fully paid and assessable**. This type of situation should be resolved and settled before attempting to issue more stock for subsequent rounds of financing.

- Each state has a statute that regulates the **minimum amount of directors** a corporation under its charter is allowed to have. The number ranges from either one director with no conditions to three directors unless fewer shareholders. In a practical situation these minimums will always be well exceeded in a sensible corporate structure and meeting this area of compliance is not a major concern to anyone who is actively involved in building a management team. The state statute is easy to meet. The requirement of investors is a much more difficult standard of compliance to meet, where the quantity of directors for corporate staffing is not so much regulated by corporate or securities law but by investor requirements.
- **Regulators** for corporate and inherent management structures include the state authority that issues the corporate charter. It may invariably be named the Secretary of State, Department of Corporations, Department of Business or some other similar designation. The body of law that it oversees the compliance and enforcement of may be entitled the Corporations Code or Act or the Business or Commerce Code or Act or some similar language that codifies corporation law in the statutes of each

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individual state that grants corporate charters or authorities to do business as a foreign corporation in such states. If you are engaged in stock offerings in such states, applicable regulators may also include the state Securities Department or a department of similar authority that regulates stock offering disclosures, investor solicitation and stock issuance activity within their states.

Now that you have been familiarized (or reacquainted) with the rationale and elementary ground rules of corporate capitalization, organization and administration, we can now get into the actual exercises of building a proper management structure from the foundation of a corporate structure that should already be acceptably sound.

The following steps outline simplified technical procedures and the usage of evidentiary documentation necessary to legally validate your corporate structure in a due diligence and management review. The chief goal of this restructuring exercise is to demonstrate that you have the ability to maintain the proper relationships between all shareholders, directors and officers, and are engaged in the regular practice of running your company as a legit corporation.

Step 1 – Establish Shareholder ship through Documentary Compliance

The admission of **initial founding Shareholders** is established by the **forming of the corporation** as represented in the **Articles** and **Organizational Minutes**. The admission of **additional Shareholders** is established by **execution of certain documents** that account for an outgoing transfer of **Equity** and an incoming receipt of **Monetary or Other Consideration** accounted for as **Paid in Capital**. These actions are officially recorded in one or more of the following corporate documents depending upon the underlying purpose(s) and point(s) of orientation:

- **Pre-Incorporation Agreement**
This is an agreement that is sometimes established by principals who desire to organize and operate as a corporation sometime in the near future.
- **Articles of Incorporation**
This is the first document filed with your state charter that reveals the founding shareholders. Its other purpose is to indicate that you have established a new corporate entity and have determined the general rules of what powers this corporation will have. Any changes can be made with an amendment.
- **Shareholder Resolution Approving Sale of Stock**
This resolution can refer to stock in general or to stock for a particular transaction
- **Minutes of Meeting of Shareholders**
These minutes apply to meetings concerning any stock transfers or sales
- **Shareholder Resolution Approving an Acquisition**
This resolution applies to acquisitions made by an exchange of stock out to the target
- **Shareholder Resolution Approving a Stock Option**
This resolution is only relevant when the options are exercised
- **Board Resolution Approving Sale of Common Stock**

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This resolution refers to the general offering of a series (A, B, C, etc.) of common stock

- **Transfer of Stock Agreement**

This agreement applies to any specific transactions where stock is transferred by sale, gifting, pledge or otherwise

- **Stock Subscription Package including Stock Subscription Agreement**

This is a package of documents that determines investor accreditation and suitability, provides instructions for a private stock offering, and presents a binding purchase (“subscription”) agreement to accompany a private placement memorandum to investors who purchase an interest in your company. The actual issuance of stock certificates can be affected later.

- **Corporate Stock Ledger**

This is an accounting or bookkeeping form that keeps track of all stock issued and cancelled by certificate number.

- **Stock Certificate**

This certificate is not evenly denominated like bearer bonds but is a registration that records the amount of shares held by the investor. The variable details such as the name of the shareholder and the amount of shares held is engraved and stamped by the Corporate Seal over a printed certification mark to help prevent the untimely events of fraud or counterfeit certificates surfacing.

- **Stock Assignment Separate from Certificate (or Certificate in Lieu of Stock)**

This is the best alternative of issuing a document to shareholders to certify their equitable interest of ownership in the corporation when you have not yet undergone the exercise of printing stock certificates.

- **Financial Books of Account**

This applies to appropriate sections of journals and ledgers that allow you to record the changes in **equity** and **paid in capital** accounts when capital stock is sold or issued.

Step 2 - Establish **Directorship through Documentary Compliance**

The appointment of a **Director** is established by a **Vote of Shareholders** and is ratified by a **Resolution of the Board of Directors** approving such appointments. These actions are officially recorded in one or more of the following corporate documents depending upon the underlying purpose(s) and point(s) of orientation:

- **Shareholder Resolution Appointing Directors**

This is the principal document used by shareholders to appoint directors to the board. Persons may be appointed simply as directors or specifically to a director office which includes the Chairman of the Board, Corporate Treasurer and Corporate Secretary.

- **Shareholder Resolution Appointing Director to Fill Vacancy**

This shareholder resolution is only applicable if a director is appointed to fill a vacancy

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- **Minutes of Meeting of Shareholders**
This document records shareholder meetings regarding director appointments
- **Action by Written Consent of the Shareholders**
This document is primarily used for other actions but can possibly be used to effect director appointments, but not always or necessarily
- **Board Resolution Approving Appointment of Directors**
This document is used by directors in approving the appointment of directors made by shareholders.

Step 3 - Establish **Officer ship through Documentary Compliance**

The appointment of a corporate **Officer** is established by a **Vote of Directors**. These actions are officially recorded in on or more of the following corporate documents:

- **Board Resolution Approving Appointment of Officers**
This is the document used by the board of directors to approve the appointment of each individual corporate officer.
- **Board Resolution Approving Entrance into Employment Agreements**
This document is used to approve each individual employment agreement that involves the appointment of an Officer. The corporate Bylaws however are used to provide blanket approval for all employment agreements in general with whatever conditions are additionally established.

Structure of Management Roster

The following guide will concisely explain the roles and titles of executives that you need to identify and put in place to properly build and restructure your management roster.

Management Titles/Roles for **General Executive Management & Leadership**

Officer Titles in this category include:

- **Chief Executive Officer (CEO)**
- **President**
- **Executive Vice President (EVP)**
- **Senior Vice President (SVP)**

Determining Head Executive Management Titles and Roles

Under this category of general management and leadership the head corporate officer is called the **President** or **Chief Executive Officer (CEO)**. If there is only one person among management who best fits the bill for this role, then that person should be the **President and CEO**. If there are **two** such people who closely fit this role and would otherwise be equal partners in the business, then the one in a position of stronger leadership with the best overall understanding about the company's direction, business offer, industry and market, finances and capital structure should assume the title of **President & CEO**, while the one in a more demur position of leadership concerning overall knowledge about these components of the business should assume the title of **Executive Vice President (EVP)**. There should only be one Exec

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VP and this person is ideally next in administrative power to the CEO or President, while the other **Vice Presidents (VP's)**, including **Senior Vice Presidents (SVP's)** and other **Vice Presidents (VP's)** with no seniority designation, are subordinate to the EVP.

Determining Ranks and Roles of Executives Subordinate to the President

SVP's and VP's in general are not and should not remain generic officer titles in and of themselves without a designated function that explains the general duty or departmental function that these officers are charged as being responsible for. The EVP is generally the assistant to the President/CEO but the SVP's and VP's are assigned as to a particular departmental function such as finance, accounting, marketing, operations, sales, personnel, etc.

Proper Positioning of Managerial Titles & Roles for Founders

Although most founders assume such head leadership roles, *Founder* or *Co-Founder* used as a stand alone designation is not appropriate as a title for a corporate officer. Although insistently commonplace, a founder does not have to, and sometimes should not always necessarily be, the President / CEO of the corporation, especially if their skill set and stature does not warrant being in a valid and convincing position to assume such a role.

Entrepreneurial protocol supported by a unanimous vote validates such roles where founders who are unfit for management roles assume the role anyway, but being *convincing* as a CEO is an entirely different matter that calls for an unorthodox approach. In cases where such a role cannot be justified by a person being genuine "management or leadership material", many founders are better suited for assuming the role of Board Chairman, or even sometimes "honorary" Chairman of the Board in cases where their executive management skills are severely lacking but their right to contribute to managerial input is preserved based upon their senior position as founder. Simply put, entrepreneurs who lack competent management skills are just not professionally fit to run the companies they have founded where their shareholders must trust that they have invested their money in a company that will be ran with competence. When you sell a piece of a company you have founded, it is no longer solely yours alone. You may be a majority owner, but you have to now consider and respect the concerns of other co-owners, especially the passive shareholders who have no control beyond election power inherent in their voting classes of stock and regulatory protections afforded to those who have purchased their stock through organized, well documented and semi-regulated mediums and methods of making a stock offering, such as a Regulation D private placement.

It has been a practice for two such business founders with strong leadership roles to divide their positions where one becomes the President with or without some other officer designation such as Chief Operating Officer, while the other person assumes a role as **Chairman**, (a non-officer, director position) and **CEO**. This practice has usually been made to compromise feelings of sharing power between two founders, but in a practical sense, no one should assume such role divisions unless their skills and backgrounds make them most appropriate for those job functions. Besides, in a corporate structure, with the role of a President being exactly the same as a CEO, it is simply inappropriate to have two equal heads of the corporation.

Management Titles/Roles for Financial/Accounting

Officer Titles in this category include:

- **Chief Financial Officer (CFO)**
- **SVP or VP of Finance**

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- Chief Accounting Officer (CAO)
- Chief Accountant
- Controller
- SVP or VP Investment Operations
- SVP or VP of Corporate Acquisitions
- SVP or VP of Corporate Fundraising

Management Titles/Roles for Operations/Departmental Management

Officer Titles in this category include:

- Chief Operating Officer (COO)
- SVP or VP of Operations

Management Titles/Roles for Administration/Back Office Mgmt. & Support Operations

Officer Titles in this category include:

- Chief Administrative Officer (CAO)
- SVP or VP of Administration

Management Titles/Roles for Personnel/Human Resources

Officer Titles in this category include:

- Chief Personnel Officer (CPO)
- SVP or VP of Human Resources (H.R.)
- SVP or VP of Benefits Administration

Management Titles/Roles for Legal/Regulatory/Compliance

Officer Titles in this category include:

- Chief Legal Officer (CLO)
- General Counsel
- Chief Regulatory Officer (CRO)
- Chief Compliance Officer (CCO)
- SVP or VP Intellectual Properties

Management Titles/Roles for Technology/Information/Systems

Officer Titles in this category include:

- Chief Technology Officer (CTO)
- SVP or VP of Technology
- Chief Information Officer (CIO)
- SVP or VP of Information
- Chief Systems Officer (CSO)
- SVP or VP of Systems

Management Titles/Roles for Corporate Communications

Officer Titles in this category include:

- SVP or VP of Corporate Communications

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- **SVP or VP of Shareholder Relations**
- **SVP or VP of Corporate Publications**

Management Titles/Roles for Marketing/Sales/Advertising

Officer Titles in this category include:

- **Chief Marketing Officer (CMO)**
- **SVP or VP of Marketing**
- **SVP or VP of Sales**
- **SVP or VP of Inside Sales**
- **SVP or VP or Field Sales**
- **SVP or VP of Advertising**

Director Titles

- **Chairman**
- **Treasurer**
- **Secretary**

Comments about Principals of Management Failing Due Diligence Reviews:

Many entrepreneurs have learned to survive in a community of tough players, some of whom are scam artists and “sharks” of many calibers who operate with ill intentions, making others around them abrasive and insensitive to human issues that are key to establishing successful working relationships with legitimate players. Many misguided business owners have picked up on some of these “wheeling/dealing” habits that are sometimes hard to shake when they meet people in a different arena who are “*real*” (meaning legitimate in their capabilities and good intentions), and play on a different level. Exposure to the aforementioned type of unsavory environment breeds entrepreneurs who learn and apply substandard negotiating and sales tactics, pretentious exhibitions, double-talking and other amateurish fabrication techniques that financiers find annoying and even disturbing. The entrepreneurs who practice these harmful traits tend to view such carrying on as a survival mechanism, necessary to save face, especially if they feel that their image for being a non-victim or “hard-nosed” negotiator is at stake.

The closed-door conversations that VC’s have about wearisome due diligence sessions, concerning the managers of companies under review, are a lot more thorough and meticulous than what you would ever be allowed to know as the subject entrepreneur being discussed. Most of the time you can only guess what it was that caused your presentation for financing to fail, or even to know how far it may have gotten along before the decision was made to forego and pass on your deal.

Why leave anything to chance? Doesn’t it only make good sense to cover all bases? Why, of course. Is there really a way to cover absolutely everything? Probably not, but you can always cover all the recurring things that really matters most in every deal no matter what a VC’s personal criteria may be. This is your insurance to soar far ahead by putting the odds in your utmost favor to the exclusion of most others who are guaranteed not to be as much

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prepared for that moment as you are. One thing is for certain: If you fail to prepare in any of these areas, Murphy's Law will gain some ground on you.

Who's to say when a new industry boom might again suck many investors in to join the bandwagon ("get it while it's hot") on potentially unsound deals without enduring the otherwise normal evaluation procedure. You know the history. The Great Depression following the crash in 1933, the crash in 1987 followed by the consolidation of bank holding companies, FSLIC failure, S&L ("go-go thrift") crisis, high yield ("junk") bond market crash and chapter 7 bankruptcies of major corporations that experienced the unforeseen effects of poorly structured leveraged buyouts (LBO's), some of which were from hostile takeovers. The Internet boom and bust over the turn of the millennium was indeed the capstone to date.

Although many entrepreneurs who pitched unsound deals were poised for ideal timing in getting funds from seemingly carefree investors who were sold on the hype of a big and fast industry trend movement, most of them could not personally bail out of the bust due to built-in illiquidity problems such as stock lockup agreements and having too great a volume of stock to sell to a dwindling market of willing buyers who constantly lowered their bids (*the highest price an investor could sell off their stock for in the open market*) causing increasing downward pressure on market prices.

In the late 1990's, significantly due in part to the internet technological boom, the Dow, S&P 500 and other indicators seemed to be soaring on a one-way non-stop mission to the sky where any idiot could have just thrown their money at the indices and made a tidy profit provided they sold in time. This type of action does not change investment criteria or compliance rules. It does however tend to cause many money managers to compromise sound investment principles for the sake of being in vogue with investor demand in pursuing popular market trends. The most popular ones are of course are the ones that are making the vast majority of the investing public the most money.

In the American economy, due diligence is not a novel concept. It has been aptly applied for decades. People just tend to forget and compromise their safety net now and then when markets start to rally at unsurpassed levels from uncontrolled buying causing investors to buy overvalued assets for highly inflated prices (as could be seen in ridiculously high P/E ratios) before inevitably crashing. In these times people tend to ignore fundamentals and cling to riding the trend before the reality of a market correction kicks in causing a sell panic to ensue.

Don't ever count on slipping through the cracks this way. If history is of any consequence as a lesson, the days of throwing money at deals without proper due diligence are presumed to be over, at least for a good while. This even includes large established firms such as Enron and WorldCom, who shock the investment public even in this post- millennial age of well read and well informed investors who still got duped from cooked books from large credible accounting firms (imagine that). Governmental and self-regulatory agencies such as the SEC, NASD, SIA, SIPC, NAASA, Federal Reserve, IRS, AICPA's FASB, IASB, IBA, etc. have taken extraordinary measures to reinforce this. That is why total compliance is still

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more than ever the main key today for meeting investor criteria standards that VC fund managers must observe.

If you had a staff of experts in diverse fields who examined every aspect of your company with a fine tooth comb and as a result, brought to your attention a list of over 400 things that could go wrong if not resolved in the right manner, and then make a diligent effort to correct all 400 of these things within an incredibly short amount of time with minimal expense, and get it done to absolute satisfaction or even near perfection, what do you think your chances would be for winning when there are about 1,500 other companies you must compete against for VC attention, consideration and a closed deal for funding? You would shine like a superstar unless and until someone picked a critical area and decided to attract negative attention there. The place where you can do this best (actually worst) is in the area of managerial examinations, which is part of the due diligence review, where you are supposed to show and tell what you are really made of. Is there anything we can help you rehearse to insure that you don't blow it, or are we forced to have faith in you to pull through?

The final and most challenging area to concentrate on for your preparation is actually the first and most important one in your line of defense. This is actually the task of prepping you and your management team for the series of face-to-face presentations to be made to financiers. Your consulting team members (including firms such as ours) can only supplement this function for you up to a certain extent. Ultimately it is up to you to come forward and shine in all the right places.

We and others can present you and all the wonderful things about your management and deal in the best light. This is not merely because we want to see you succeed in getting funded, but because we want to and will be able to say this with full confidence, and with the means to back it up. This means that you must prove that everything your consultants said about you was right. The best way to insure this is to restructure and prepare your management to actually make it right. You must say and do all of the right things at the right time to the right people. You must demonstrate that you have all the right ingredients and teamwork chemistry for investors to put their trust and faith in your ability to execute a well thought out plan without them losing any sleep from recurring doubts about their decision to bet on you.

Being properly structured thoroughly prepares you to win in this area and you should not proceed forward until you are totally confident about your state of readiness. When it is your time to step forward, the ball will be squarely in your hands and no one cannot and will not control you with puppet strings. This is where you must perform and show the VC what you are really made of when this time comes. Quite simply, you should be focused on presenting yourself while your consulting team focuses on presenting the deal.

Your business structure and presentational documents can be flawlessly airtight. But the hardest thing to change and maintain at an optimum level is the exhibit of managerial competence, commitment, integrity, and other qualities sought in ideal investment candidates, which are funded by venture capital investors (VC's) and investment bankers (IB's).

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It will not suffice to patch this area up with bandages and attempt to push your way through a presentation while hiding unresolved due diligence issues under the radar screen. Everyone's reputation and credibility is always on the line when you are allowed to step forward. Possible embarrassment and avoidable criticism should not be an option, no matter how anxious you may be to move forward.

You must fix this area with permanent solutions as you would with any other area. This means that any coaching that you undergo is not for the purpose of memorizing lines or pitches or for coordinating speeches to be given or memorizing textbook answers to questions. It is for the purpose of reorganizing how you deeply think about your business and your level of involvement, commitment and responsibility in it. You must have a deeply ingrained grasp of your entire business model and plan, know it in your heart and in your sleep, and be able to give a clear and concise *ad lib* synopsis of what your company and its management is all about. And you must learn what you need to know about your other management team members to discover synergism and complimentary factors that solidify your chemistry in working as a well-informed and coordinated team.

Your attitude about all of this will tell anyone who's paying attention what you are really all about. It is not enough to wear a pleasant smile nor is it necessary to rehearse a sales pitch. Your outlook must be positive due to your newly found assertion of confidence in your ability to perform and come across like a winner. You will be held to a much higher standard and must honorably live up to it. This is purely a people management issue.

During many presentations to VC's or IB's most entrepreneurs essentially fail to secure their funding needs from these sources because they try too hard to sell the deal while attempting to hide themselves behind it. To win at this game you must reverse the order of things and sell yourself and your management team first, and the deal will virtually sell itself with much less effort required on your part to explain it.

Consider this. If you took away all the components that make up your business, you are the only component that cannot be readily replaced with money, notwithstanding key man insurance preparations having time to take effect. You are also the only component that has the ability to replace all of the other components. If you can be replaced so easily, then chances are that your business model and proposition really isn't so proprietary to be worth the attention of a VC to begin with.

A truly proprietary business model requires the vision of a founder/leader who is fully impassioned with the drive to make this vision a material reality. To replace such a person, much time is needed to groom a successor who must be infected by the same intense passion to keep the vision alive. Without this, the level of energy and enthusiasm rapidly dissipates, and so does the most proprietary merit of the deal. That is, a founder with a vision who knows how to lead by passionately selling other team members on this vision to make it a believable common goal.

Realize that you and your management team *are*, and *must be* what matters most in the deal. Other components of the deal can be more easily changed to fit a VC's requirements

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than a group of disorganized and dysfunctional corporate managers who lack basic but necessary characteristics that all investors desire in key people charged with managing a business enterprise fueled by their invested funds. These desired characteristics are reasonable things to expect of every corporate manager such as professional competence, leadership, commitment, honesty, integrity, tenacity, accountability, reliability or trustworthiness, humility, courage, flexibility, creativity, and the willingness to accept personal responsibility, delegate authority, adapt to change and work as team players.

Hopefully this guide has given you some insight and perspective that has helped you to better understand and appreciate the management review process conducted by venture capitalists, investment bankers and other professional financiers. It is advised that you use this insiders' perspective along with the Funding Roadmap™ SBA Loan Accelerator™ to complete and sharpen your presentation and be better prepared when such a time comes where you must perform. On this note: Good luck and best regards on your funding venture from the staff at **Unismart Capital Software LLC**.

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