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The 2024 Founder Playbook

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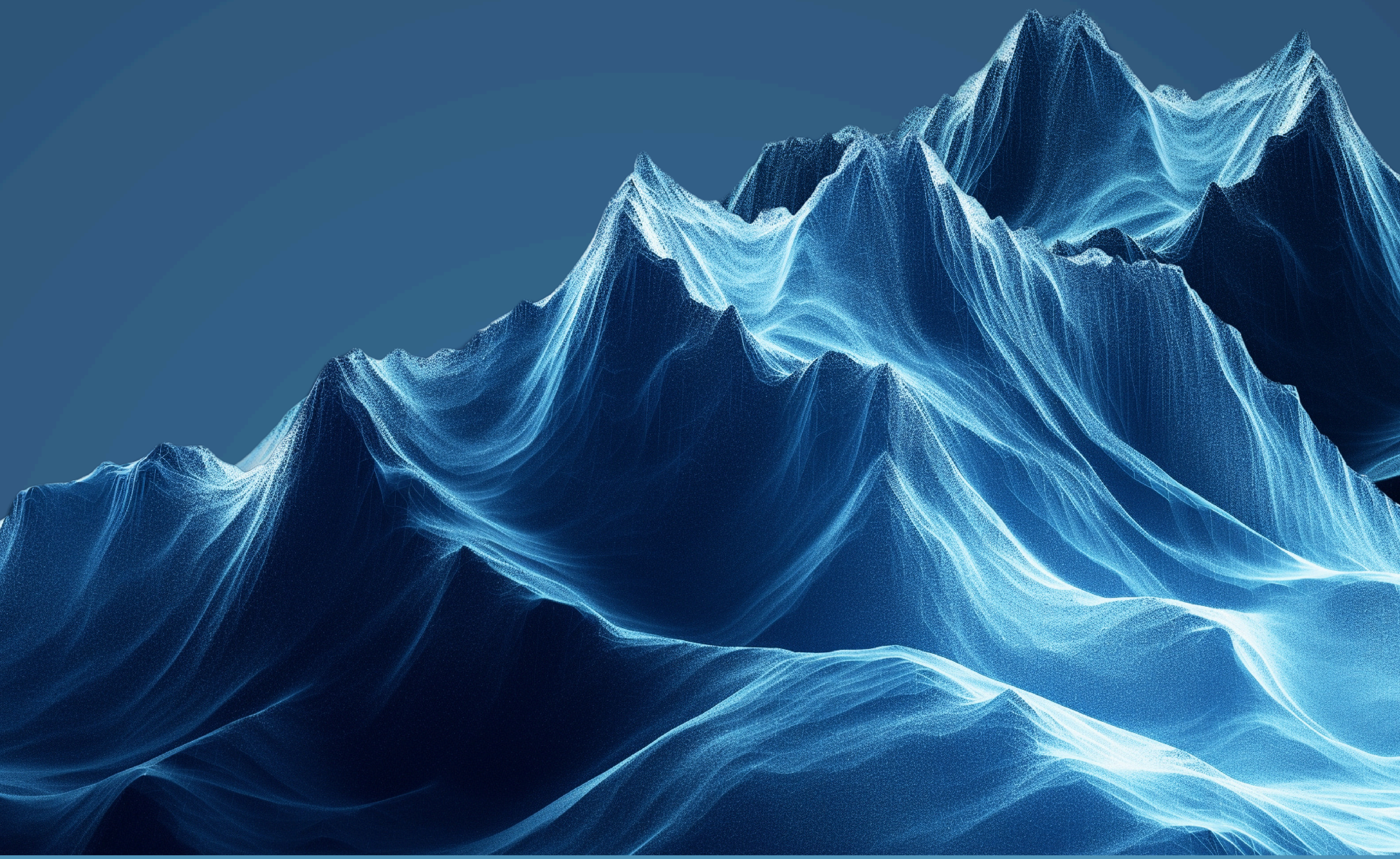
VENTURE VOICE

KOBI SAMBOURSKY
Co-Founder & Managing Partner



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Introduction

Welcome to the "2024 Founder Playbook eBook.” I’m pleased to share the insightful journey I've crafted as Co-Founder and Managing Partner of Glilot Capital Partners. With over twenty-five years of experience as a serial entrepreneur and leading investor, I’ve been fortunate to have made a mark on the technology and investment landscape, with a track record of twenty-two exits and a robust portfolio.

This eBook was created from my previous blogs, which I edited and updated to appear in the popular LinkedIn blog series, ‘The 2024 Founder Playbook,’ now combined into a comprehensive collection. In this series, I share my knowledge, delving into key insights, experiences, and lessons learned during my career as an entrepreneur and investor. Whether you're a seasoned entrepreneur navigating the startup world, an aspiring founder seeking guidance, or simply curious about entrepreneurship, this eBook is for you. Each chapter provides actionable advice, offering a roadmap to success in the dynamic world of entrepreneurship.

Get ready to level up your entrepreneurial game with the "2024 Founder Playbook.”

Kobi Samboursky
Co-Founder & Managing Partner
kobi@glilotcapital.com

LESSON 1

Reporting SAAS KPIs: CEO Do's and Don'ts

Over the past decade, Software as a Service (SaaS) has emerged as the de facto industry standard. As a result, key performance Indicators (KPIs) related to SaaS, have become the most important benchmark for evaluating startup companies with metrics such as Annual Recurring Revenue (ARR) turned into the perceived goal on a quarterly or yearly basis. Despite their significance, even basic KPIs are not part of formal financial reports and are not subject to official audits by the company auditors. This has created a problematic situation in which companies are using their own interpretations to gauge KPIs, resulting in an array of approaches ranging from highly conservative to ultra aggressive.

During 2023, we witnessed instances of failed due diligence (investments as well as M&A) resulting from overly aggressive SaaS KPI calculations. At the same time, CEOs approached me, asking for clear guidance. It's crucial to find a balance, being too aggressive, or too conservative puts your company at risk, falling behind competitors.

In this document, my aim is to offer straight forward guidance to CEOs. I explore potential friction points, common practices, and my recommendations to ensure that you are not misleading anyone or adopting an overly conservative approach. This paper can also serve as a valuable resource for investors and board members, aiding them in the due diligence process and providing guidance for their companies. Special thanks to Etti Hanochi, Partner at Nextstage, for her valuable contributions.

An important business note: many CEOs inquire about the right way to structure a deal to optimize the presentation of SaaS KPIs. In my perspective, the primary goal should always be the business aspect, structuring a deal that works for the client and optimizes the long term profit for your organization. The prioritization of the KPI presentation should come as a secondary concern. Accordingly, you can use the following recommendations to improve your strategies for deal structuring.

Multi-Year Deals

Issue: In some multi-year deals the price increases in later years. Which begs the question, which figures will you use in your ARR reporting? The price of the current year (typically lower)? The price of the last year in the contract? Or maybe the average? (I have seen it all).

Resolution: This is a good example of the difference between ARR and Committed Annual Recurring Revenue (CARR). One can use the later (higher) figure in their CARR reporting (as long as the ‘C’ isn’t overlooked). When it comes to ARR, I would recommend using the current, lower figure, unless opting out is not possible (a rare occurrence in SAAS deals). In such cases, an average could also be considered a viable alternative.

Free (or highly discounted) initial months/quarters

Issue: A similar case to the above, where the initial phase involves a free trial, or substantial discount. How should you handle reporting your SaaS KPIs?

Resolution: If it’s a try and buy situation, refer to the bullet point below. If the client is genuinely committed, I suggest using an average or simply using the current figure (i.e., start with a lower value and adjust as needed). I prefer the latter approach since, typically, there is no real need to inflate the numbers for such a short time frame, and it aligns better with a long term perspective. It is crucial to note the importance of consistency; whichever solution you choose, maintain consistency in all future deals.

Trial and Buy / POC

Issue: How should you report trial and buy scenarios or paid Proof of Concepts (POCs)? In software subscriptions, trials and actual usage are very similar. I have seen cases where individuals incorporate such figures in their SaaS reports.

Resolution: This one is simple in my view, adding POCs in a big ‘No’. It’s a classic example of reporting that can be highly misleading and should be avoided (and will damage you in the long run as some of the POCs will not convert and the result will be a high churn rate).

Deals shorter than one year.

Issue: How do you present short-term deals? Some choose not to include them all together, while others incorporate the monthly rate to the Monthly Recurring Revenue(MRR) thereby increasing the ARR beyond the actual contract value (i.e., a $50K deal for 6 months might be reported as adding $100K to the ARR).

Resolution: To me, if the deal is very short, let's say three months or so, it essentially functions as a POC and therefore, should not be included in the figure at all. For longer terms, like six months or more, incorporating the figures in your MRR/ARR metrics is acceptable. However, it is essential to recognize the risk. If the client does not extend the contract, you may face churn, which could be more damaging than having a lower ARR. Use caution when incorporating short-term deals into SaaS KPIs calculations, specifically if its impact is significant.

When is the deal 'done'?

Issue: B2B deals can take months to close, many times you know that a deal is 'done' before the actual contract is signed. When can you add a specific deal to your KPIs? Although accounting rules are explicit, they may not directly translate to SaaS KPIs. What should be done if the deal is confirmed in writing via email, but the contract isn't signed? Similarly, how should a deal confirmed before the end of a quarter, with the contract signed just after the quarter concludes, be handled in the SaaS report?

Resolution: The threshold for recognizing a deal should, at a minimum, be a signed agreement. Verbal commitments or unofficial non-verbal agreements are not sufficient. I recognize that some companies may consider a scenario acceptable where the contract is signed after the end of the quarter, but before the reporting date.

Non recurring components

Issue: How should non-recurring components, often integrated into SaaS deals, such as professional services, expense reimbursement, and training, be treated? Some incorporate these into their Annual Recurring Revenue (ARR) figures, while others do not.

Resolution: Non-recurring components should not be included unless the client is committed to them regardless of usage, even if historical data shows ongoing consumption. This is a great example of the need to use Revenue Run Rate alongside ARR and an alternative KPI (reserving ARR s for actual subscription cases).

Usage- Based Pricing

Issue: What should the ARR calculation be for companies utilizing usage-based pricing models (pay per usage, payment based on data etc.)?

Resolution: This is another great case for the use of Revenue Run Rate instead of ARR. I recognize that some companies present usage based pricing as ARR to meet investors expectations, it's crucial to maintain transparency and consistency. If you choose to report it as ARR, provide a detailed explanation for the presented data and make sure to be consistent.

LESSON 2

Sailing Your Startup Through Stormy Waters

Running my first company during the big bubble burst of 2000/2001 left an indelible mark on me as a young entrepreneur navigating through very stormy waters. These days feel similar, with a combination of financial, business and security difficulties, on a global as well as national and private scale, 2024 will likely be a difficult year for many companies. Yet, my experience is that if you maintain discipline, times like these can turn out to be very rewarding and educational on multiple fronts. I wrote this blog a few years ago, and given our current reality, its lessons remain highly relevant today.

The lessons you learn in bad times are far more valuable than the good days and therefore, the achievements you reach are far more satisfying. Below are eight tips to manage your startup in stormy waters and come out even stronger when the tide clears.

1. **Focus on your clients.**

Clients are always the most important aspect of your business. In tough days, even more so. When a client is happy, even in tough times, that's a great indication of a good company/product. Be in touch with your clients and ensure them you are around and thriving. These days are not easy for them either, so let them know you are there to support their needs. I'm sure you will benefit from this dedication in the future.

2. **Re-examine your strategy.**

During periods like these, it's easy to overlook that they not only pose challenges but also create massive opportunities. Re-examine your strategy. You may discover the need for a more pessimistic outlook on certain aspects of your plans. Surprisingly, you may find some new opportunities that emerge from a troubled situation. In times like this, the <u>daring and creative entrepreneurs earn extra points.</u> Don't be afraid to change your plans, and more specifically, don't be afraid to be more bold and to aggressively pursue new opportunities.

3**. Put your leadership skills to work.**

If you have what it takes, this is the perfect time to show it. <u>These are the days to show leadership and vision.</u> It's also the time to recharge your team, guide them and help them focus. Remind them of the long-term goals, rather than getting caught up in the noise and uncertainty.

Leadership is always important, but in quiet times, it's easier to be successful. In times like this, a true leader can shift the troops to becoming real industry leaders.

4**. Be extra careful with expenses.**

Look again at your hiring plans. Push back on hiring for any positions that are not critical. The same goes for other expenses; anything that does not contribute to the primary effort, should be postponed at least for a few weeks. Hopefully, by then you will be a bit more knowledgeable about the situation.

If your current company longevity is short (six months or less), you may want to consider more drastic measures. Consult with your investors to make sure you are doing the right thing.

A final note on expenses — even in the aftermath of a crisis, investors tend to be focused on efficiency KPIs. Being more efficient will help you even if you end up taking new money earlier.

5**. Communicate more often with your investors and employees.**

In tough days, everyone is more anxious. Your investors and your employees understand that the company is dealing with a special situation and they should know you understand the issues and are handling them in a smart, calculated way. You cannot make their fears go away, but you can make them feel better, knowing that the wheel is in good hands. Make sure to talk more often with them, even if you can't provide specific updates.

6**. If you are in an active funding round, ignore small details and close it now.**

We have all been there; The deal is 90% done and yet the lawyers find plenty of stuff to argue about. This is the time to get involved. Stay focused on the big picture and close the deal.

have been involved in investment deals on both sides of the fence (as an entrepreneur and investor) for many years. I can tell you that, in most cases, minor details are not relevant. Closing a solid funding deal in challenging times is a huge boost for any company, extending beyond just financial aspects. Focus on that.

7. **It's time to remember your vision**

Moments like these are the right time to go back and revisit your vision, and the core beliefs that shape both you and your company. Reflect on what is important to you and consider the priorities of your loved ones.

If you still feel strongly about your vision, now is the time to execute. Now is the time to establish a lead over your competitors. History repeatedly shows that great companies emerge in tough times. This is when it's easy to show the gap between the men and the boys, and the women and the girls. If you are skeptical, just ask the founders of Airbnb, Github, Slack, and Pinterest, all of whom started their companies during the financial crisis of 2008. As smart people say: "don't let a good crisis go to waste."

LESSON 3

Managing Your Board: Streamlining Productive Meetings

To be honest, I am not a big fan of board meetings. They tend to be long and tedious, mostly not very productive nor creative. Still, board meetings are very important, it is a good opportunity for you to get feedback from your leading colleagues and investors, a good opportunity for you to share your vision and thoughts, and most importantly, a good opportunity to get the company's leadership aligned.

An aligned board is crucial for the company's long-term success. Amid the demands of steering the company, founders may find it challenging to effectively oversee their boards. To address this, here are ten practical pieces of advice to assist you in navigating board management:

1.**Board Structure: (compact & professional)**

If possible, keep it small, ideally, only founders and main investors. However, it is advisable to include an additional expert to ensure that the board has at least one member with a distinct professional perspective.

2. **Scheduling**

Plan to schedule board meetings once a quarter, ideally during the second or third week of the quarter. Since operations are organized on a quarterly basis, meeting once a quarter is practical. Meeting mid-quarter or before its end, may leave you unprepared to discuss results. Conducting meetings early in the quarter, armed with the latest data makes a lot of sense. Aways schedule board meetings for the entire year in advance.

3. **Prior to the meeting**

Make sure to send the board deck (as well as the quarterly summary, if applicable), at least 3-4 days prior to the meeting. When you do so, request that your BOD members read it and ask for clarifications prior to the meeting, this will save a lot of valuable time.

4. **Length**

I don't like long BOD calls/meetings. They tend to be a waste of time. However, when companies are growing, there are a lot of issues to discuss. For me, a two-hour timeframe works well for keeping the board meeting efficient. (Although I'm open to the occasional longer call or meeting, once per year, if needed).

5. **Virtual vs. Physical**

As someone who used to do all BOD meetings face-to-face, I fell in love with the convenience of virtual BOD calls. They just simplify things. However, make sure to have at least one face-to-face meeting annually. This provides an important opportunity to connect with people on a more personal level and offers a friendly environment for communication. It could also be a good opportunity to extend the session, add a dinner, event, etc.

6. **The Good and The Bad**

Some CEOs tend to talk only about the positive aspects, pushing any negative news to the background. Don't do that, make it a point to address your hardships along with the positive things. Personally, I like board decks that start with one slide summarizing the good and the bad of the quarter. When you openly acknowledge the difficulties and challenges it builds trust in your leadership and lets the board know that you are transparent about the realities of the business.

7**. Define a main discussion topic, a schedule and (do your best) to manage the time**

Many board meetings are wasted on routine updates and on anecdotal questions from certain board members (likely not adding much to the meeting). Spend less time on updates. Prioritize selecting a subject to deep dive into during the board meeting, such as product strategy, go-to-market, or marketing. I have seen boards overlook these topics.

8. **Bring your top management, conduct open and closed sessions**

Board meetings are a great opportunity for the top management team to interact with the board members. Encourage your top executives to participate in relevant portions of the board meetings and lead discussions on topics related to their areas of responsibility. However, I recommend ending with a closed session, exclusively with the CEO, BOD members, and CFO, to allow an open discussion on all issues (including sensitive ones).

9. **Ask for feedback**

BOD meetings are your only opportunity to gather collective feedback from your BOD members. At the end of the closed session, request individual feedback. You will be surprised how effective this could be for you. Understanding what BOD members think about your work can provide valuable insights. Initiating this request sets the stage for an open yet positive dialog.

10. **After the call/meeting**

I am not a big fan of long and detailed board summaries. Still, to maintain a well-organized approach, be sure to distribute a board summary (along with other materials) after the call. This should include formal decision points and open issues to be addressed in the next meeting. Try to be fast about this. If you delay sending out materials for weeks after the meeting, people may forget certain details, leading to repetitive discussions on previously agreed-upon points.

Your board has the power to be a major headache, or a valuable asset. Investing in good board hygiene can play a pivotal role in your journey to success.

LESSON 4

Ten Things I Wish I Had Known
Before I Became an Entrepreneur

As far back as I can remember, I had always dreamt of becoming an entrepreneur. It wasn't about envisioning the creation of a giant corporation or amassing wealth; rather, it was the notion of nurturing an idea and transforming it into a living, breathing company that excited me. Times were different back when I started, and securing funding was almost impossible, so the dream felt very out of reach.

Almost three decades have passed, and the world of technological entrepreneurship has changed drastically in this time — globally, and particularly in Israel. There is now a greater abundance of investors, incubators, and advisors ready to help; however, the challenges and difficulties remain similar.

Following are ten things I did not know (and it’s a shame I didn’t) when I first started out:

1. **Don’t go at it alone**

Toward the end of my military service was when I began considering my first idea for a company. I felt pretty confident that I had the whole package of an entrepreneur: a strong technological background, managerial experience, and even a degree in business administration. I did not feel the need to look for partners. What value could they possibly add? After a few months, I decided to give up on the idea and move on. It’s possible that the idea wasn’t good enough, but I think I mostly needed someone there with me. Over the years, I have learned that successful entrepreneurship is a team effort. In every company I’ve been involved in, there were partners (yes, even Glilot, which in my opinion was just like a startup). You don’t need too large of a team; two to three people is enough. Establishing a successful company is extremely difficult — almost impossible — but with the right partner, someone who enhances your strengths and supports your weaknesses, your chances of succeeding increase significantly. Don’t search for a partner who is similar to you — find one who compliments you.

2. **There’s no instruction manual for success**

Many successful entrepreneurs share their success stories and provide lists of do’s and don’ts. It is always a good idea for an entrepreneur to read their stories in the beginning. However, you should not expect someone else, as talented and successful as they may be, to chart the course for you (this is also true of this blog post…). Over the years, I have learned that there are many different journeys to success. You could raise money from a VC fund and succeed, or you could not raise money at all and still succeed. It is possible to build a successful company based on an excellent technological idea and it is possible to build a prosperous company on a non-technological business concept. If there is anything guaranteed in the entrepreneurial world, it’s that whichever path you take will be unique and special to you. There is no guide, no instruction manual, to success. At the end of the day, you determine the fate and future of your company. No one else will show you a short-cut

3. **Find someone to advise you (one or two people, not too many!)**

I must admit — asking for advice is not something I excelled at when I was first starting out. I suppose revealing all your fears to someone takes quite a bit of confidence. If I openly share my fears with someone, it seems to make them more real, more palpable. Perhaps that means I don’t believe enough in my company? In my product? In myself? With time, I learned that asking for advice is one of the most important things you can do. Every entrepreneur knows to expect obstacles along the way. It’s always good to find someone more experienced who has traveled a similar path and can share their experience with you. Their advice may not always be right, but learning from their experience is guaranteed to benefit you. On the other hand, be sure not to have too many advisors; it’s a little difficult to make decisions when you are being drawn in different directions. Find one or two people whom you trust, then set off on your journey. However, be wary, there are numerous “mentors” and “advisors” who do more harm than good. (I’ll expand on that in another post).

4. **Be dedicated, and require dedication from others**

One thing is common in all the success stories I have experienced: total and complete dedication from the entrepreneurs. A real entrepreneur should feel that their entire world depends on the success of their company. In my experience, people who “try” entrepreneurship because it seems interesting or exciting will have a very difficult time in reaching success. I think this is one of the reasons why entrepreneurs who come from a relatively weaker economic background tend to have an advantage.

They have no choice but to succeed. Furthermore, your dedication and commitment must be contagious. Everyone — your partners, investors, employees — must believe in the company and be fully devoted to it.

5**. Your family is no less important than your company**

In entrepreneurship, as in other fields, the line is often blurred between your career and personal life. Over time, there is a clear connection between the two. You're going to be in this for the long run, and if you want to succeed, you must dedicate enough time to both. An entrepreneur must find the right balance between family and business, otherwise, it simply will not last. Make no mistake, your commitment to your company must be very strong, but at the same time, you must know how to balance your family life. As a young father, I would try to find time for lunch with my daughters, and nights relaxing at home were a vacation from nights at hotels abroad. After all, my family is the biggest reason for all my effort.

6**. Ignore the noise. Focus on your customers.**

I remember very well the day that my first company completed a major investment round. It was a monumental round. The company's name (and mine) made headlines — and the feeling it gave me, I must admit, was phenomenal. Throughout a company's life, there are many days like this: major investments, media appearances, big announcements, etc. But we cannot let these moments distract or confuse us. At the end of the day, there is only one thing that really matters: your customers. They should be satisfied and encouraged to buy as much as possible. Make sure to focus on sales, and the chances of your success will grow tremendously.

7. **Build the DNA of a winning organization**

That's the sort of sentence that didn't quite make sense to me 20 years ago. What does it even mean? What is a company's DNA?

Every company has its own characteristics: How customer-oriented are they? How hungry are they? How flexible or capable of changing? These qualities are established in the first year or two of the company by the founding team, and it is very difficult to change them later on. If you do it right, you'll reap the rewards of your company's DNA for many years to come.

8. **Create a long-term plan, but don't take it too seriously**

In the first company I built, one of the investors asked for a detailed business plan. We wanted it to be as professional as possible, so we recruited the help of professionals and worked on it for two whole months. That was the summer of 1999. Immediately after that, the tech market crashed and we threw the plan into the trash. Yes, it's important to plan for the future, but we live in a dynamic world, and conditions are changing constantly. Do not feel tied or fully committed to your long-term plans, as they are likely to change. What's more, if your plans don't change in the medium and long-term, you're likely doing something wrong. Check yourself again. It's called being agile, and it means that when the world changes, you know how and when to change with it. The ability to adapt to a fast-changing environment is one of the greatest qualities of Israeli culture — do not lose it.

9. **There's one thing you can count on — there will be difficult days**

When people see a successful entrepreneur, they tend to romanticize them, believing that they had it easy because they are very talented, or the idea was a guaranteed success, or they had a lot of luck, etc. In all the success stories I know personally, there are many tough days and sleepless nights. If one thing is guaranteed in entrepreneurship, it's that you will have some extremely difficult days. This is why one of the most important things that you must ensure when building your company is that you are building an organization that can thrive during difficult times (any organization can enjoy the good days…).

10**. The journey is long — enjoy it**

In the first year of building my first company, I worked like crazy, 'round the clock. Afterall, it was my company, so I had to work much harder. There is some truth in this: an entrepreneurial team must work very hard to succeed. But you need to remember this is a marathon, not a sprint.

Entrepreneurs must learn to find a good work balance and try to enjoy the journey. Even after more than two decades, I still work very hard, but always remember to appreciate the journey I'm on. Had I not learned to slow down and enjoy it all, it would have been impossible to continue.

LESSON 5

Investor Approach: Do's & Don'ts

Behind every approach to an investor stands an entrepreneur full of hope and faith.

As an investor, I receive dozens of emails every month. There are always some that make my heart ache as I read them. Sometimes, it is an entrepreneur mass-emailing every investor they know with a generic pitch (usually something like "I have an amazing idea that will make you rich"). Other times it will be a poorly written message full of misspellings. I find myself thinking about all the hope and faith behind these emails, but I also realize that the die has been cast. The chances of such a message receiving a favorable response by a serious investor are very slim.

What should not be done when approaching investors for the first time?

1. **Never reach out to a group of investors collectively.** The investment journey is an intimate process between an entrepreneur and an investor. Investment deals (like any other multi-million dollar deal) do not begin via a spam message involving multiple people. Moreover, when you approach investors as a group, you cannot create a real dialogue with any of them. The chance that they respond is low, as is the chance of you learning anything from the interaction with them.

2. **Do not use intermediaries or agents.** If you have a friend who can introduce you to investors, great. If not, contact them yourself. Do not pay for an introduction and never give up a piece of your company for one. You must understand that venture capital funds, and other professional investors, invest significant capital in marketing and brand-building efforts so that entrepreneurs are familiar with them and approach them. Good funds value their ability to connect directly with companies and communicate effectively with entrepreneurs. Use of intermediaries may only be relevant in special cases, such as raising funds in remote territories and/or when aiming to raise funds from non-professional investors.

3. **Avoid having anyone else reach out on your behalf.** Some entrepreneurs think that it is better for their assistant or one of their employees to approach the investor. I have never understood this concept. In my opinion, the CEO or the entrepreneur is the only one who should approach the investor. Raising capital is a strategic process in every company – especially in young ones. Building a successful relationship between an entrepreneur and an investor relies heavily on personal chemistry. Delegating this interaction prematurely sends the wrong message to the investor from the start.

4. **Do not be argumentative, do not be patronizing, and do not hide information.** If the investor has questions – answer directly and concisely. Respect the process of the person you are interacting with. If the investor has a question, it must be important to them. Sometimes I come across entrepreneurs who try to avoid providing answers (on various pretexts), which obviously does not help them in any way.

5. **On the subject of confidentiality: A response along the lines of "it's a secret, I cannot answer," is very problematic.** An entrepreneur must be able to describe his company without being concerned. I do not mean a detailed algorithm ("how?"), but rather a description of the problem, the product, the customers, ("what?").

So, what should you do?

1. **If you can, talk to someone who has already done it.** Get advice from someone knowledgeable. The more prepared you are as you enter the process, the more likely you are to succeed.

2. **If you have decided to go for it, contact a small group of relevant investors.** (How do you know who is relevant? Simply choose a few companies that are in a field similar to yours, check where they got their funding from and right there, you have the perfect list of potential investors). Approaching a small number of investors will allow you to better control the process. You may find out after several conversations that you want to make changes to the company's presentation based on feedback from initial conversations. If you reach out to a lot of investors at once, it will be harder for you to do so. It is important to do your homework before each meeting: Learn a bit about the person who will be sitting across the table – what have they invested in? What are their areas of expertise? This can help you greatly in the conversation.

3. **The fundraising process will require valuable time – be prepared for it.** Interested investors will ask additional questions and ask to see materials. If you answer quickly and comprehensively, it will encourage them to move forward and even speed up the process. If you delay the process, you will be sending a very problematic message to the potential

investor. Prepare materials in advance. The materials should be professional and concise (no detailed business plans are needed). Professional investors see hundreds of teams a year, they do not have the time to carefully read each business plan. Within a few minutes, they need to understand if they want to meet you or not, that's it.

4. **Most importantly, be yourself! Don't put on an act**. If you make a mistake, acknowledge it. It's kind of like a marriage– if you try to "bluff," you will not get away with it for long, and even if you do, what are the chances of this relationship succeeding? Take advantage of your time with the investor to learn about them. What kind of people are they? Do you really want to work with them?

5. **Received a negative answer?** Not get a response at all? Ask the investor why they decided not to proceed with another meeting. You will not always get an answer, but from experience, if you do, you will learn a lot. This information will help you understand more about your business and, in particular, understand how investors perceive your business and what you can do to be more successful in the future.

I spent most of my life as an entrepreneur thinking I knew investors well, but the truth is that after a few years as an investor, I realized that wasn't the case. I did not understand how busy and burdened they were with their investments. I did not understand the importance of personal chemistry. Most importantly, I did not realize that, sitting in front of me, was a person who really wants to invest (just as I wanted them to invest in my company). As investors, we see hundreds of plans a year, meet with dozens of people, and all this to find the very few companies worth setting out on a wild journey with. Help us understand that you are the right partner for that journey.

Five things Entrepreneurs Must Know
About an Investment Contract

So you've found an investor who wants to invest in your start-up. Let's assume that this is an excellent investor who understands your company well, and has the power and know-how to help the company grow. Let's also assume there is chemistry between you, and that you will enjoy working together over time. Why is it necessary to pay close attention to the investment documents? What aspects should you be cautious of? As someone who has spent time on both ends of the table, I have some advice in mind.

In every investment agreement, the entrepreneurs tend to give most of their attention to the investment amount and the company valuation. Other details receive less attention, but can be more important in the long run, and can even have a significant impact on the distribution of funds when the company is sold or goes public. Additionally, you should know that later stage investors tend to request (at least) the same rights that previous investors received. So making small mistakes in early rounds could result in bigger issues along the way. Early attention, particularly starting from the seed round, is very important.

Here's a quick overview of the points you'll see in most investment agreements:

1. **Liquidation Preferences**

This section determines how cash will be distributed when there is a liquidity event, such as a merger, acquisition, or IPO. In certain situations (mainly exits with a relatively low price tag), the wording in this section can hold greater significance than the valuation of the company or its holding structure. The investors' line of thought is that, in the case of a very small exit, since they risked a great amount of money, they need to get their investment back before the entrepreneurs get a piece. I must say, in my opinion, this is a logical argument. (I do not think the situation would be fair if reversed — if the entrepreneurs make millions, while the investors lose money).

On the other hand, there are investors who ask for a large minimum repayment (such as double their investment) before the entrepreneurs receive any compensation. This structure is less common today, and I would not consider it unless there are large gaps in the valuation of the company or the company is a high risk investment.

2024 Note: With the changing market conditions, we are seeing these types of structures appear but mostly in later rounds, less relevant to early stage companies. In general, there are two types of distribution preferences:

Participating Preferred – A situation in which the investor receives the minimum agreed upon payout, and the remainder is divided according to the amount of shares held by each partner.

Non-Participating Preferred – The investor receives the larger of either an agreed upon minimum payout, or an amount proportional to their share of the company.

My recommendation: Non-participating preferred is largely accepted today and is used by most of the leading funds in first round investments.

2**. Anti-Dilution**

What happens if the company's valuation in one of the following rounds is lower than the valuation of the company today? Most investors will seek protection from such a situation. In other words, they say to the entrepreneurs: "Today you're valuing the company at X, and we accept it, but if in a year or two the share price is lower, we want our investment to be re-calculated as if we entered at the lower value." This condition makes sense, but it can also be destructive to the entrepreneurs and the company, especially in companies that have raised a significant amount of capital. In such a case, in the event of a Down Round, all previous investors will receive additional shares — diluting the entrepreneur's share of the company.

The accepted solution today is known as a "broad-based weighted average," which does not correct the full damage incurred from the decline in valuation, but it grants the investor partial compensation based on a formula that accounts for the number of shares prior to the funding round.

The key to addressing the risks associated with this issue is to exercise caution when raising large sums of money and to do so only when you are convinced that the amount and valuation are right for the company.

3. **Board of Directors Structure**

Who will sit on the board? What’s the division of the board between the entrepreneurs and investors? Naturally, entrepreneurs typically have more weight on the boards of young companies, and as the company progresses and raises more funds, investors are usually added to the board.

I have come across very few situations in which resolutions are decided by a majority vote of the board, so I think the importance of this clause is less than what one tends to think. On the other hand, the personalities of those on the board, the chemistry between them, and each member’s ability to help (or disturb…) the company, is very important. A bad board can spoil an excellent company, and vice versa.

My recommendation: It all depends on the chemistry and trust between the partners. If you get an investment from an excellent investor who adds value to the company, there is no disadvantage in having them join the board. If it’s not a good investor, simply do not accept the investment.

4. **Veto Rights**

Professional investors will usually require special veto rights for strategic decisions in the company and/or decisions that can change their rights. From the entrepreneur’s point of view, veto rights are likely to be perceived as aggressive. From the investor’s perspective, they make sense — ultimately, early-stage investors retain a minority ownership stake in the company, while day-to-day operations are managed by the entrepreneurs. Without veto rights, investors exert minimal control or influence over the company's direction. How else can a reasonable investor avoid unilateral/unusual moves made by the company’s management?

Giving investors certain veto rights — limited to matters that are critical to the life of the company (such as changing direction or strategy, selling the company, etc.) — is an acceptable and fair solution. With this right, a balance is struck between the company leaders’ desire to manage the day-to-day operations without disturbance, and the investors’ need for assurance that with significant issues, their opinion will be considered.

Note for further rounds: In more advanced rounds, as there are more investors around the table, make sure that veto rights are given to the majority of the investors, rather than to select groups of investors. A situation in which different groups of investors have veto rights at the same time can make it very difficult for the company to function.

5. **Vesting**

The meaning of this clause is that the entrepreneur’s shares will not be available to them if they leave the company soon after the date of the investment. I must admit that when I first saw this clause as an entrepreneur, I was very angry — why should my shares not belong to me in any situation? Over the years I understood the logic of the clause. In my opinion, it protects not only the investors, but largely the company’s managers as well. In the event that one of the entrepreneurs leaves the company shortly after the investment, the damage to the company can be fatal. The company will need to find a strong replacement that will take over the role of the departing entrepreneur, a challenging process. The company will have to grant the new leader quite a few shares — what makes more sense than taking shares from the retiring entrepreneur and giving them to the one who stepped into their shoes?

Moreover, how will an entrepreneur who stayed feel, knowing that their former partner, after leaving early on, holds the same stake in the company? Another issue that arises in the case of the departure of one of the entrepreneurs: If the one leaving continues to have a large holding in the ownership structure of the company, a new investor who enters the company will try to understand what happened — why did the entrepreneur leave? What does this say about the business? What does this say about and mean for the remaining entrepreneurs? From my experience, such a departure can weigh heavily on decisions made in further rounds.

My recommendation: Assuming that you, as an entrepreneur, do not plan to leave, it would behoove you to include such a clause. Try to construct a clause that will be fair to the partner who leaves, while still minimizing the harm caused to the company in the case of a departure.

This section is more important if the group of entrepreneurs is larger, and/or if the entrepreneurs did not spend a lot of time together in the past.

And finally, a word about the amount of funding raised and the valuation. It is commonly believed that it is always better to raise as much money as possible, for as high a valuation as possible. I will not go too deep into this, other than to say that I don’t see this to be true. In my opinion, an entrepreneur must think of the money they raised as if they must return at least three or four times the amount to the investor. Raising too much severely limits the entrepreneur’s ability to enjoy a future exit. Even a very high valuation can be an obstacle. Think about it this way: Each round must be worth significantly more than the previous round. If it is unlikely for the next round to increase by 2-3 times the post money valuation of the current round, you are putting yourself at risk.

My recommendation: Raise the amount you need, at a valuation you truly believe is fair. This will prevent trouble down the line.

I’m always happy to see an entrepreneur/investor who knows how to stand on their own, while continuing to consider the other side’s needs. Understanding the priorities of both sides and knowing when to compromise is crucial. I try to do it myself, and at the same time, evaluate whoever stands before me: Are they doing the same?

Have an easy and pleasant funding round!

LESSON 7

Dead Meat on the Cap Table

A question I always ask entrepreneurs in our first meeting is: “Who is on the cap table?” (For those unfamiliar with the term, the cap table serves as a comprehensive list of all equity holders in the company, including, founders, investors, employees, consultants, etc.) Many entrepreneurs find this question puzzling at such an early stage in the process. They often fail to grasp its significance, particularly before delving into details about the product, market, business model, and so on. So, why is the cap table so important?

A healthy cap table is one of the most important assets of any startup. In fact, a poorly structured cap table can be very problematic, and unlike other startup issues, fixing a flawed cap table is exceedingly difficult. This is one of the reasons why I prefer to be a company’s first investor - it provides me the opportunity to see that the cap table starts off clean and to make sure it stays that way.

What is a healthy cap table?

In my mind, a healthy cap table only contains entities that can support the company in the long run. These typically come in two forms:

1. Founders and employees who work day in and day out to ensure that the company is successful.
2. Investors who have added value and/or can continue to support the company on a long-term basis.

Let’s start with the first item: founders and employees. In a healthy, early stage, cap table, founders and employees hold a significant amount of the company. This is essential because they are the ones doing the real work, and they need to be highly motivated. When I am evaluating a potential early stage investment, I’m not just imagining good times (that is always nice), I am also trying to imagine the bad times. Do the founders have enough equity to make them want to stick it out during tough times? The same goes for key employees.

How much should founders and employees hold? This depends on the stage of the company. Let’s put some figures around it: When we invest in a seed stage company, we like to see close to 100% of the company’s cap table held by founders and employees. Sometimes we meet seed stage companies that have given big equity chunks to consultants, to founders that left, and so forth. They argue that they are okay with their current equity stakes and claim they won’t request additional shares. However, I disagree. Most people do not fully realize the size of the effort before them and the difficult days that may follow. Investing in such a scenario subjects everyone involved to an additional, undesired risk.

The second item: investors. A good cap table includes a small number of investors that have a real stake in the company. A long list of investors with very small holdings, tends to mean more headaches for management when trying to reach important decisions and in running the company. In addition, a large number of investors with a relatively small stake for each one of them, means less commitment. On bad days, you want to have investors who hold a big enough stake to want to work hard to make it work.

Another important element is the financial strength of the investors. Those who own significant portions of the company, but lack deep pockets, may struggle to support the company during tough times. Aim to have value-added investors and deep pocket investors seated around the table.

Occasionally, when I meet companies with a broken cap table, the response I receive is: “Give us an investment proposal, and we will discuss how to fix this.” In my view, this is not a good solution. Based on my experience, a broken cap table is almost impossible to fix; it is a tedious process, typically involving many emotional issues, and definitely not something an external investor should be involved with. My advice is simple: if it is fixable, do it before coming to the first VC meeting.

Your cap table is your most valuable asset, keep it healthy!

LESSON 8

Seven Things that All Great CEOs Do

Over the years, I have interacted with the CEOs of many startups — Some who were excellent and others, not so much. I have learned that there are 7 things that really good CEOs do:

1. **Be likable**

All good CEOs that I have met over the years are all very likable. They are the kind of people you want to be friends with. It might sound strange, but I've learned that one of the most important qualities of a good CEO is their ability to make a great impression on people, whether they're clients, investors, partners, etc.

2. **Sell, Sell, Sell**

CEOs have a lot on their plate. In mature companies, they typically delegate sales duties to a VP Sales or a CRO, along with a complete sales team to promote and sell the company's products. Still, a competent CEO will never stop selling. In fact, a good CEO consistently ranks among the company's top sales representatives. A CEO continuously sells the company's vision to clients, investors, partners, existing and prospective employees, and of course, the general public.

3. **Listen (not just talk)**

CEOs need to listen. They need to listen to their employees, listen to their clients and their partners, among others. Seems simple enough, right? Not so much! No matter how smart we are, the ability to embrace different perspectives, and acknowledge that wisdom can come from others is super important.

4. **Work hard. Lead by example**

When I was a young, I watched my father wake up at dawn and leave to start a hard day of work. Even in today's era of advanced technology, nothing can replace the value of hard work. All good CEOs I know epitomize this ethos – they lead by example. Startup teams are ready to work hard too, yet without a leader who sets the pace, this dedication may falter. (Note: make sure not to overdo it).

5. **Communicate challenges, not just achievements**

It's fun and easy to discuss achievements, but communicating challenges and failures is much more difficult and important. Everyone around a CEO (including management, employees and yes, even investors) understands that challenges and failures are a natural part of running a company, even for the best ones. There is everything to gain by openly discussing them. Keeping silent about these issues does a disservice to the CEO, as employees may think that the CEO either does not grasp the problems or does not trust them enough to share, which isn't beneficial. The best CEOs I know start every board meeting discussing "things we didn't achieve in the last quarter." That might be atypical, but in my view, it's the best way to start a productive board meeting.

6. **Ask for help**

When we think about leaders, we tend to think of the old western cowboy who was silent and confident, never expressing weakness and certainly never asking for help. In practice, it's quite the opposite. Great CEOs are very good at relying on others and asking for help and receiving assistance. Smart CEOs always use people around them who are willing to help, if asked the right way.

7. **Humans first**

The typical image of a successful business person is a cold-hearted individual, lacking emotional intelligence and moral standards. However, this stereotype couldn't be further from the truth, particularly among startups! In my experience, all good CEOs I know are **not only highly driven to ensure the success of their companies but also deeply empathetic individuals who prioritize the well-being of others.**

Seven Things To Do When You Get An Acquisition Proposal

You launched your startup a few years ago. The journey has been a rollercoaster, with its highs and lows. Amidst the excitement, there have been challenging moments that tested your resolve. Yet, through perseverance and determination, you've been gearing up to take on the challenge of building something truly remarkable.

Out of nowhere, you get a call from a contact you’ve known for a while. They’re from a big company that wants to buy your business.

What should you do?

I have been involved in twenty-two exits to date. Three as an entrepreneur and nineteen as an investor. I cannot count the number of times that I, or one of my partners/colleagues, was approached regarding an acquisition of a related company. So much has been said and written about running a startup — but hello? — what should you do when you get approached about selling your baby?

Here are seven things you should do when that call comes:

1. **Take a deep breath**

This is the time for introspection and to focus on the big picture. What are your chances of building a truly epic business? I’m sure you thought your business had the potential for tremendous growth when you started. With the accumulation of data on customer feedback, team strengths and investor capabilities, and the competitive landscape, what do you really think now? If you believe that your odds are better going for the long run, don’t let tactical issues sidetrack you. A typical example: if you are short on cash, that’s not a reason to sell your company — instead, approach your investors and ask to sell some of your shares in a secondary sale. Experienced investors will likely support you and help you complete a secondary transaction.

2. **Talk with your partners but keep things very quiet**

It’s not just about you, it’s about your co-founders and your key investors. You have to share the news with them. If you’re still uncertain of your own position, be careful not to send the wrong message. The last thing you need is your partners getting ready for an exit and you don’t want to sell. Strive to be informative and collect as many inputs as possible. At the end of the day, this is a team game and whatever your partners want will impact your decision. At the same time, don’t share the information with more than a couple of close partners. The last thing you want is rumors about an acquisition circulating as this could certainly damage your business.

3. **It’s not about the (first) specific proposal**

The (first) specific proposal may not be the right one for you but getting it is an opportunity to explore your own views on an exit. Experience has shown me that if you act right, you can leverage the first M&A proposal, to better ones. If you were able to approximately double the price and improve some of the other parameters, would you consider selling? If your decision is to not sell, communicate it openly with the other side. Do this in the right way and you’ll win lots of positive points that may serve you well in the future (saying ‘no’ to a lot of money displays a lot of strength and stamina). If the proposal is coming from a potential strategic partner, you may want to leverage these new scenarios to cement a partnership that provides you with value.

4. **Get help**

What if the decision is to go ahead and explore an M&A? In this context “go ahead” does not mean “sign a deal now.” It means, “Let’s look into this seriously” or “Let’s see how we can improve this before making a decision.” The first thing you need to do is to find someone to assist you. It’s always beneficial to reach out for help but in this case, it’s necessary for several reasons. First, you likely have not done this before, and you need the guidance of someone who has been through it. They have navigated the process and know what to watch out for. Second, if you do everything yourself, you might come across as overly eager or even dishonest. Third, you have a company to run (remember that?) You don’t want to lose focus on the business.

5. **Create alternatives**

The key to improving your position is to create alternatives. As long as you haven't signed a Letter of Intent (LOI) with a "no shop" clause, you can — and should — explore alternatives. Since time is a factor, it will likely be difficult to reach out to companies that you (or your 'help') don't know well already (hence the advantage of using well-connected assistance). Reach out to them directly, drop hints that you are considering a proposal, and get their reaction. If the feedback is positive, your life will be much easier.

A good alternative could be an upcoming round of financing. Your potential buyer knows well that if/when you close your next round of financing, the window of opportunity will close (or at least, the price will go up dramatically). If needed, leverage a potential financing round to improve your positioning.

6. **Optimize but focus on the important points**

Just like in every negotiation, you will never be able to get everything you want. Make a conscious decision; What is really important to me and what is just "nice to have?" Be ready to show flexibility to get something in return. Remember, selling a company isn't like selling a used car. You will likely work for the buyer for years to come and you'll have a business relationship forever, it's in your best interest to understand and be flexible in regard to their needs as well.

7. **Make your choice**

Undoubtedly, this is a life changing decision and far from easy. Not only is your career at stake, but also the livelihoods of your co-founders and employees. This is a critical decision for your investors and for the vision that got you started. Still, after the discussions, negotiations, and optimizations, you need to make up your mind. The worst outcome would be to continue deliberations at the expense of losing focus from running your business. As said before, this is a long, time-consuming process. Think what could happen if a few quarters go badly because you were distracted? What could happen if the rumor is out that you are for sale? This could lead to a much unwanted downward spiral. So, make a decision. And if you say 'no' and continue to run the company with your full attention, you are likely to get additional — most likely better — opportunities in the future.

Throughout my career I have seen many entrepreneurs face this dilemma. I have seen it all– from founders that say 'no' and regret it to founders that say 'yes' and wonder forever if it was the right decision. Regardless of your choice, my final advice to you when getting an acquisition proposal is:

Rejoice. Building a company isn't easy and the odds were very much against you from day one. You wouldn't have gotten the proposal if you weren't doing something right. That's a great reason to feel proud. Regardless of the decision you make and the eventual outcome, take pride in everything you've accomplished.

LESSON 10

Eight Lessons Learned
From Entrepreneurial Journeys

Each and every entrepreneurial journey is different. Having done it myself a few times and following portfolio companies journeys from the side lines, I have observed eight lessons that should be effective to most entrepreneurs.

1. **Exits Are Good (!)**

Writing this down, it seems like a complete no-brainer. It should be, but this is not always the case. I often hear people speak negatively about exits, but I completely disagree with them. Exits that provide investors a good return for their money and provide entrepreneurs with a great financial outcome for years of effort are not only good, they are essential. Investors need to make good returns; otherwise, they will simply stop investing. Entrepreneurs need a good outcome from their hard labor, otherwise they will stop making magic. Exits are the fuel that the innovation industry is based on. Without this fuel, innovation will flounder. Indeed, there are cases when companies are sold prematurely, when they still have the real potential to evolve into a larger company. However, in my opinion, these cases are quite rare.

2. **Companies Are Not Being Sold, They Are Being Acquired**

I apologize for using a cliché (not a big fan of clichés..) but sometimes, clichés are actually correct. Exits are important, but you cannot build a company with only an exit in mind. You need to build a real company, with real clients, real products, etc. Our experience is that when you build good companies, acquisition proposals will come to you . On the other hand, if a company is poorly constructed, even the best sales person will not be able to sell it.

3. **Exit Strategy, From Day One**

I believe that every company should have an exit strategy from day one. As with any strategic plan, it may change in the future but having one is crucial. At Glilot, we like to see two options: the main one is aiming for a big independent company (the IPO route), and the other fallback plan is an M&A deal. As you will see in the following lessons, the exit plan determines many important decisions in a company's life, like picking the right partners and the right amount of funds, etc.

4. **Find the Right Partners**

Different partners have distinct strategies and desired outcomes. A VC, for example, will typically shoot for a substantial outcome in the shape of a significant IPO or a big M&A. If your company's exit strategy realistically leans toward a more modest outcome, it is irrelevant for VCs. Bringing them on board will not only result in dissatisfaction (which is detrimental to a successful company – all partners need to be satisfied), but it also diminishes your chances of achieving any successful outcome, even a modest one.

5. **Raise the Right Amount, in the Right Terms**

This is a hard one… Most CEOs will opt to raise the largest amount possible at the highest valuation achievable. This may be the natural thing to do; however, it is not necessarily the smartest, and certainly not the best way to optimize your chances of creating a successful exit. Here is how you should approach it: For every $1 you raise, you should return at least $4 to your investors (startup investors typically aim for a 10x return, although many will be happy with a 3-4x return). Therefore, if you raise on a post valuation of $400M, you are essentially blocking the potential of a successful M&A. If this aligns with your thinking that's great. If not, rethink your fundraising strategy.

6. **Timing is Everything**

As said before, life at a startup is like a roller coaster ride; the environment – both internally and externally – keeps changing. A company can be worth $1B today and 10% of that tomorrow, or vice versa. What does it mean? It means that any proposal you get today may be irrelevant next year. I am afraid I have no specific recommendation here, other than to remind you to be aware of the importance of timing, and to not take anything for granted.

7. **Sales Tactics**

What steps should one take when navigating an M&A deal? What is the best way to drive up the price and increase the odds of closing a deal? Unfortunately, there is no clear answer here. Looking back on my involvement in numerous deals, I've observed that in the majority of cases, the acquiring company had an established relationship with the target company long before the M&A negotiations began. In contrast to scenarios where an introduction is made by a banker (or another entity) prior to the transaction. In fast growing technology fields, where the pool of potential players is limited, establishing a strong relationship well in advance of any transaction is crucial for delivering real value. However, I have learned that creating a competitive environment is very important to drive the best value of an M&A transaction.

8. **Be Patient**

Most importantly, be patient. Building companies for success takes time. It is a marathon, not a sprint. In addition, every good company I know faced many obstacles along the way. Even if you hit a wall, keep your eye on the ball, and focus on building exceptional products that your customers truly need. Build relationships with key industry players. By adhering to these principles and being patient, you will achieve your final goals.

Best of luck, enjoy the ride!

Thank You & Next Steps

Thank you for reading the 2024 Founder Playbook! I hope you found the information valuable. Now that you've gained these insights, are you ready to put them into practice? If you’re an entrepreneur with a unique idea, I’d like to hear from you. Our fund is always on the lookout for innovative startups to support and invest in.

Glilot Capital Partners is an early-stage VC fund in Israel, investing in exceptional entrepreneurs developing advanced technology in Cybersecurity, AI, and B2B software. Ranked among the top-performing VC funds globally, we provide hands-on, personalized support from seed stage to growth through our Value Creation team. Founded in 2011, we manage five funds totaling approximately $1 billion.

Kobi Samboursky
Co-Founder & Managing Partner
kobi@glilotcapital.com