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Unexpected Lessons Learned in the Hot Seat

The 'hot seat'--most entrepreneurs dread the focused attention and extra scrutiny that accompanies every decision made in it. Joe Heitzeberg, co-founder and CEO of Snapvine, which was recently purchased by Whitepages.com, knows the angst. His experience in the Snapvine hot seat was fast, furious and—*familiar* to many with a sizzling product in a hot market.

Snapvine helps users communicate in online communities with their own voice. In just three short years of founding, Heitzeberg and others raised series A and B financing rounds; saw sales surge due to their distribution success; were quickly acquired, and are now leveraging the power of a larger company to further their success.

While leading Snapvine through the whirlwind, Heitzeberg learned many unexpected lessons. At a recent Northwest Entrepreneur Breakfast meeting he shared his most surprising:

1. When raising Venture Capital, company valuation is an output variable.

   In determining valuation, logic dictates that if a company is worth $5 million, a 20% slice of company pie would be valued at $1 million. Interestingly, it didn't work that way for Snapvine. In fact, Heitzeberg contends that VC's don't really care about the valuation you place on your company because there are only two variables that matter: 1) VC's want a 30-50% ownership, and 2) they want to invest $4-5 million. Company valuation becomes a variable of that starting point. Using that math, for a VC deal to work Snapvine needed to raise a minimum of $5 million and sell a 40% stake, putting their minimum valuation at $7.5 million (regardless of true worth/valuation).

2. Valuation is only one key of the term sheet terms.

   Although valuation is important, there are other equally important terms. Heitzeberg credits his attorney for teaching him about liquidation terms. For example, in a series A round where company value is split 50-50 between the entrepreneur and VC, many would conclude that the entrepreneur would get half of the company when sold. That would be an inaccurate conclusion with liquidation preferences. Liquidation preferences are often set at 2-3X. When there is a sale, this enables the investor to get 2-3X their money invested *out first,* before the entrepreneur. So with a 50-50 split and a 2X liquidation preference, the entrepreneur would be left with zero.

Executive Insights

Cheryl Isen

3. It's impossible to read a Venture Capitalist.

   In the money raising process none of what Heitzeberg heard and saw mattered. Case in point: at a critical VC meeting where the outcome expected was a term sheet, most partners showed only moderate interest between reading/sending text messages; 15 minutes into the presentation, one partner left the meeting; a minute later another departed; at the one hour point only eight of the 14 were left and within 30 more minutes everyone was gone even though the presentation wasn't done. Heitzeberg concluded they had bombed. However, soon after he received a partner email saying how much they loved the pitch and that a term sheet was in the works.

4. Retaining more expensive start up specialists actually saves money.

   Heitzeberg found selecting the best, regardless of price was important across the board, especially with attorneys. Even though paying $600.00 per hour vs. $300.00 for legal advice hurt on the front end, it paid dividends later. For example, term sheet advice was crucial to getting a good deal. Also, hourly rates are a misnomer if a term sheet comes to fruition because its common practice to set caps for legal fees in the terms.

5. Lawyers will work for free.

   If VC funding is part of your growth plan, a clean incorporation is critical and requires a good attorney. Yet many early stage companies don't have the funds to pay. Interestingly, with a good pitch and upfront discussions about fees, many lawyers will work on deferral, without an equity stake. Heitzeberg attributes it to a Silicon Valley ethos—if they get your concept, they will take a chance. However, you may have to search beyond just the Northwest to find the right fit.

6. It's easier to not hire than it is to fire.

In tech companies most hires are based on an assessment of skill tests, with little discussion about responsibilities or expectations. This leads to many miss-fits that start ups don't have the bandwidth to tolerate. To avoid the pain of firing, Heitzeberg's team focused first on cultural fit and a prospects aptitude for working at a start up. The realities of start up work weren't veiled. Job descriptions and expectations were explicit and candidates were encouraged to opt out if the fit wasn't right.

7. Establishing core values gets everyone on the same page.

   As a young company Heitzeberg says, "We knew that one bad apple could hurt the whole business so we developed a prescribed recruiting process, defined our culture and specified the tactics needed to achieve it." Taking the time to define and build core values got everyone on the same page. Every team member felt destined for success. The values created unity, avoiding an us vs. them atmosphere. This enabled friendships to form, while everyone worked hard and had fun.

Regarding his leadership role in the hot seat at Snapvine Heitzeberg acknowledges, "It was awkward at times and certainly a personal challenge, but people want a leader and stepping up to the challenges provided wonderful learning opportunities."

These "Executive Insights" are based on monthly presentations provided by leading entrepreneurs at the Northwest Entrepreneur Network (NWEN.org), a non-profit organization dedicated to helping entrepreneurs succeed. The column is written by Cheryl Isen, founder of Isen & Company, a strategic marketing and public relations firm that helps emerging companies increase corporate visibility and brand awareness Contact Cheryl at (425) 222-0779, Cheryl@IsenandCo.com or on the web at www.IsenandCo.com.