Get a Good Legal Head Start(Up)
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Case Studies

These case studies are works of fiction. All names, characters and incidents are products of the author's imagination. Any resemblance to actual events or persons is entirely coincidental.

Case Study #1: Before You Start

Lindsay, Joe and Trevor work as senior software developers in Goggle Inc.'s Vancouver office. They have been brain storming for months about launching a startup in a similar space. After numerous pitchers of beer and hundreds of e-mails and texts among the team, they decide to move forward with the new venture in the spring of 2012. Given that there are no funds for salaries at the outset, the partners elect not to resign from Goggle and commence the project on evenings and weekends on a part time basis.

Discussion question:

1. What should the team be concerned about prior to launching their venture?

Case Study #2: Incorporation Decisions

The team is excited about the market opportunity in the mobile search space and wants to catch the wave of frothy valuations in Silicon Valley. They have received some advice from a fellow entrepreneur that they need to incorporate in Delaware in order to attract U.S. venture capital in the future. They also read a blog post written by an accountant recommending that the company's intellectual property be spun off into a subsidiary in Barbados for tax reasons. While they are deliberating, development is ongoing and the founders are funding the initiative personally, while also bringing in a few of their former colleagues on a contract basis to write the software algorithms. One of their former SFU classmates tells them that it is easy and cheap to self-incorporate a company.

Discussion questions:

1. What would you advise the team about corporate structure?
2. Should the founders have done anything differently?

Case Study #3: Founder Agreements

With the company now incorporated as "SearchMob Technologies Inc." and development of the prototype well underway, the team is working around the clock to be ready to demo the product at the Mobile World Congress tradeshow in February 2013. The founders are good friends and decide to divide the equity pie equally, with each founder receiving 1,000,000 common shares at a price of $0.0001/share. The team decides to put on the back burner negotiating a shareholders agreement and other founder agreements until they meet their development deadline. All 3 founders are elected as directors of the company but no officers are appointed.

Six months later, the team is on the verge of burnout after numerous all nighters. The founders have maxed out their credit cards and have tapped out their friends and family for an initial seed round of investment of $100,000. Trevor has still not paid off his SFU student debt and is increasingly under financial pressure to make ends meet. Patience is running thin as the team is on the verge of missing its deadline. Personalities are clashing under the weight of this pressure and Trevor starts considering other job offers in order to pay his rent.

On a rainy November morning in 2012, Trevor tenders his resignation and tells his co-founders that he is joining MicroSift as a Product Manager.

Discussion questions:

1. With Trevor leaving the company, what happens to his shares?
2. How can this scenario be addressed more proactively?

Case Study #4: HR Agreements

It's now March 2013. The dust has settled on Trevor's departure and the team managed to pull off a successful demo at the trade show. The company is now in recruiting mode, and is seeking to build out the team with software developers, community managers and sales and marketing talent. These hires are partially funded by an IRAP grant and in anticipation of receiving a $150,000 SRED tax credit from CRA. Lindsay, who now occupies the CEO role, and Joe in his capacity as CTO, also think it would be a good idea to document the employment and contractor agreements for the existing 6 team members who have been with the company since the early days. Lindsay finds what looks like an applicable contractor agreement on a U.S. web site and gets to work preparing contracts for the team. In parallel, Lindsay and Joe want to incent the team with equity since they have all been making below market salaries during SearchMob's 'bootstrap' phase.

Discussion questions:

1. How should SearchMob devise and execute its HR agreements and incentive programs?
2. What should SearchMob have done differently?

Case Study #5: Intellectual Property

The mobile search space is heating up in mid-2013, with a handful of upstart competitors in the Valley raising substantial rounds of VC financing. Twitter is all abuzz with rumours that Goggle is about to launch a mobile search product that could be a competitive threat to SearchMob. At the same time, SearchMob's product launch at Mobile World Congress created some buzz with prospective customers. The beta is live and the company is achieving good customer traction in the consumer space. Lindsay and Joe are told by a prospective investor that they need to pursue patent protection for their product in order to attract investment and prevent competitors from blocking their entrance into the market.

Discussion questions:

1. What should SearchMob do to protect its IP now?
2. What steps should SearchMob have taken from day 1 to develop and execute its IP strategy?

Case Study #6: Financing your business

Heading into Q1 of 2014, Sales are growing and the company's new Director of Finance has developed pro forma financial projections showing hockey stick revenue growth from $250,000 in 2014, growing to $10 million by year 3. The product is stable and customer demand is strong. However, the company's burn rate remains at $75,000 per month and the company only has 6 months of financial runway left. Lindsay and Joe huddle with the management team and decide that it is time to pursue external financing to give the company the necessary runway to expand and the working capital to fund the company's burn. The company's board of advisors is divided on whether the company should seek Angel financing or Venture Capital financing. Management believes that the company needs a cash injection of $3 million to execute the business plan. The founders are concerned about dilution and are worried that the company's valuation will not be attractive while Sales are at modest levels. Blog posts on both sides of the border are engaged in a raging debate over the merits of raising convertible debt, "series seed" equity, "convertible equity" and straight common stock. The founders have never raised institutional financing before, and are intimidated by the process.

Discussion questions:

1. What type of financing should SearchMob raise?
2. How can the company get in front of the right investors?
3. How will SearchMob set its pre-money valuation?
4. How much money should SearchMob seek to raise?
5. What does the company need to do to get ready to raise capital?

Case Study #7: Selling Your Company

The M&A and IPO markets are heating up in the Fall of 2016 and SearchMob is on fire. Having completed a $1 million convertible note financing in Q2 of 2014 from Angel investors, the company used the additional financial runway to enter the European market. What followed was a $5 million Series A preferred share financing in 2015 led by Sandhill Road-based Sequooya Capital with participation in the VC syndicate by Kleener Parkins and Vancouver-based Gastown Ventures. Lindsay has now moved to EVP Corporate Development and Trevor now occupies the CIO function. The board of directors consists of the new CEO (based out of the company's San Francisco offices), Lindsay representing the founders, 2 VC nominees and an independent director from the industry. Having achieved customer traction and increasingly on the radar of channel partners and competitors alike, the board of directors is at a crossroads: should SearchMob continue to grow organically and attempt to become a billion-dollar company? Should the company instead take advantage of the IPO window and go public on NASDAQ and/or the TSX? All the while, prospective buyers continue to come out of the woodwork with overtures to acquire the company. A board of directors meeting has been called in 2 weeks' time to explore the company's strategic alternatives.

Discussion Questions:

1. When is the right time to pursue an exit for SearchMob?
2. Are there strategies and tactics that SearchMob can employ to maximize its valuation in an M&A transaction?
3. What are the pros and cons of going public versus an acquisition?

SFU Workshop Pre-Reading

http://www.marsdd.com/articles/sample-funding-documents-for-ontario-entrepreneurs/

http://www.marsdd.com/articles/co-founder-agreements/