



2017 Venture Capital Due Diligence Survey

Alternative Investment Forum, LLC/KCSOURCELINK

STANDARDIZING DUE DILIGENCE

Regional venture capital funds, high-net-worth investors and family investment offices believe it would be helpful for the venture stage investment ecosystem to have a standardized due diligence process as part of their investment review and investigation. A recent study conducted by the Alternative Investment Forum and KCSOURCELINK found 62 percent of those responding thought standards for due diligence would be helpful.

The study also found that most of these investors (85 percent) are spending more than 20 hours conducting due diligence for each venture stage investment opportunity they consider, with 36 percent spending more than 60 hours on each opportunity. Survey respondents are spending less than 5 percent of the amount they invest to conduct the diligence.

A vast majority of the firms surveyed use professional internal staff to conduct this work and there are clear similarities in the processes used for conducting due diligence for the investments they consider. The investment community is interested in out-sourcing some of their due diligence work for more common and standardized issues. Based on the results of the survey, a standard reporting process will be drafted to share with the venture capital community as well as the larger early stage investment ecosystem.

BACKGROUND/METHODOLOGY

In the fall of 2016, the Alternative Investment Forum, LLC partnered with KCSOURCELINK to conduct a survey with fund managers and investors in the Midwest region. This survey was a follow up to an Alternate Investment Forum/KCSOURCELINK survey done with individual investors earlier in the year who reported ignorance of proper due diligence processes as a barrier to investing in early venture-stage companies. The objective of the current survey (the "DD Survey") was to better understand how due diligence was conducted by professional investors, if there were standardized process professional investors use and whether there were opportunities to collaborate or learn from each other.

A link to the DD Survey was distributed to 96 high-net-worth investors, family investment offices and individual venture capital funds from about a 200-mile radius of Kansas City (including St. Louis, Wichita, Omaha and Columbia). Forty-one surveys were completed for a 43 percent response rate. Thirty-one of the 41 respondents were well known venture capital firms, seven were individual angel investors or angel funds and

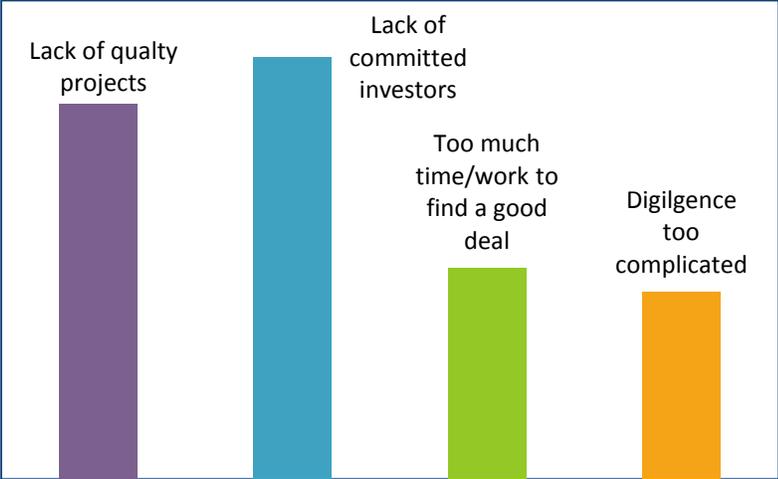
three were prominent family offices. More than half of those responding had been involved in early-stage investing for 4-10 years, and another 32 percent had been involved longer. Almost 75 percent of the respondents had conducted a substantial number of diligence reviews.

KEY FINDINGS

The DD Survey included 32 questions which were designed with very granular multiple choice responses. Ten questions related to the background and business of the respondents, four asked for their opinions and 18 related to the actual tools and steps that the respondents utilize in their due diligence process.

SUMMARY OF BACKGROUND AND BUSINESS RESPONSES FROM RESPONDENTS

Barriers to entry in the venture space



- Lack of quality projects: 47.1%
- Not enough committed investors to invest with: 52.9%
- Too much time and work to find good deals: 26.5%
- Diligence too complicated: 23.5%

Investment stages of deals they invest in



- Priced Rounds: 64.3%
 - Series A Rounds: 59.5%
 - Convertible Notes: 54.8%
 - Follow-on Rounds: 52.4%
 - Series B Rounds: 40.5%
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- Half of the responders reported interest in a company generating \$1MM or more in revenue and half would consider business with less than \$1MM (responses not mutually exclusive)

General Due Diligence Feedback

- Time spent on diligence:
 - 20-60 hours: 50%
 - More than 60 hours: 36%
- Dollars spent on diligence:
 - Less than 5% of investment: 78%
 - 5% to 10% of investment: 20%
- Source of diligence:
 - Internal staff: 81%
 - External consultants: 38.1%
 - Volunteers: 38.1%
- Use of outside specialists every time: 43%
- Use of outside specialists more than half of the time: 74%
- Collaboration with other firms more than half of the time: 64%

SUMMARY OF THE DUE DILIGENCE TOOLS AND STEPS USED IN THE DILIGENCE PROCESS

Management Team Review

- More than 80 percent review resumes, check references, review org charts and/or discuss with other investors and board members.
- About 60 percent do background checks and/or review social media sites.

Market and Business Model, Market Strategy Review

- Almost 98 percent review the business plan, the financial statements and pro forma projections and/or conduct an industry review of the proposed investment.
- Almost 98 percent analyze customer acquisition.

Product and Technology Review

- More than 80 percent review product or service competition, IP, patent and trademark protection, license agreements and/or product demos.
- Almost 98 percent analyze competition and half of the respondents use third party research.

Financial Analysis

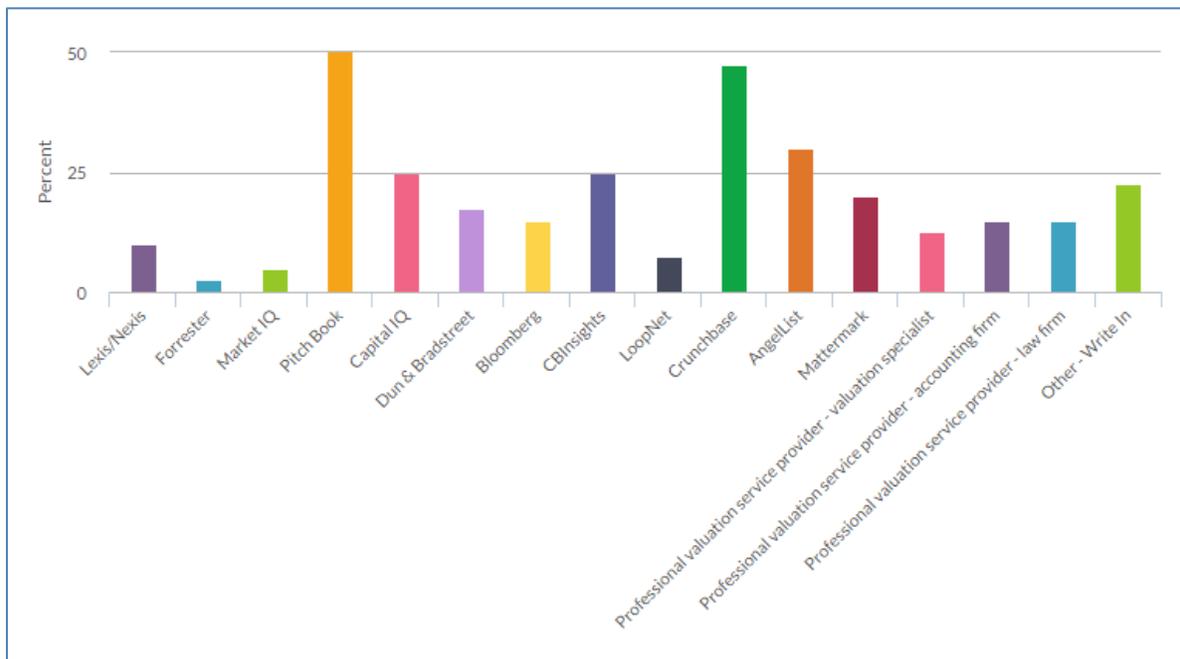
- More than 80 percent use financial tools including use of funds, pro forma cash flows, IRR calculations, velocity schedule for spends and/or funding forecasts.

Document Review

- A review of 18 document categories and specific documents within the categories was analyzed. Respondents reported a high level of reliance on many of the documents cited. More than 80 percent reviewed nine of the documents (board structure and litigation getting the most review); eight other documents were reviewed by at least 45 percent of the respondents.
- More than 65 percent of all respondents review 10 common deal terms in the documents as part of their review, with 95 percent requiring a pitch deck and investment summary.
- Almost 70 percent of the respondents prefer the use of the National Venture Capital Association document packages for venture investing.

Diligence Reports and Tools

- Almost 70 percent of the respondents create an executive summary report for a selection committee or a board; 44 percent provide a full detailed report with documents, findings and recommendations; 49 percent have an internal grading system; and 49 percent use a series of reports and different levels of review.
- Of 15 outside services Pitch Book and Crunchbase are used by almost 50 percent of respondents (not mutually exclusive).



- Less than 30 percent use third party data room services to maintain diligence files and research.
- The respondents were interested hiring third parties to secure diligence reports for eight categories of information:

Hiring Third Party Services

- 80% for background checks
- 63% for Intellectual Property review and report
- 50% for collecting and reviewing approved lists of legal documentation
- 50% for collecting market analysis
- 23% for financial analysis
- 13% for FINRA level review
- 13% for deal point analysis and reporting
- 10% for business valuations

SUGGESTIONS FOR USE OF SURVEY REPORT AND DATA; DEVELOPMENT OF A STANDARD REPORT

From a careful review of the data, we believe that the creation of a Standard Venture Capital Due Diligence process and production report can be created for use by the venture stage investment ecosystem. Part of the promise to the DD Survey participants was to deliver each of them a copy of this report. In that effort we intend to provide a proposed standard process and report format and we will ask the participants to consider endorsement of the standard. By adopting a format report process, entrepreneurs, attorneys, accounting firms and capital consulting organizations can develop products that incorporate the standard. AIF will also endeavor to contact educational organizations for feedback and to encourage use of these findings in training students, entrepreneurs and those in the venture capital community.

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Participating Respondents (partial list):

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|--------------------|----------------------------------|
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| iSelect Fund | GXP Investments |
| Arboretum Ventures | Fulcrum Global Capital |
| KCRise Fund | Illinois VENTURES |
| Northland Angels | Adventur.es |
| Brown Cow Capital | Jordan Kanuff Investment Bankers |

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Cultivation Capital
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