KODA

SEIZING THE OPPORTUNITY: A Technology Entrepreneur's Perspective

Wealth Management After A Liquidity Event

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The sale was a very emotional process and it was the period afterwards that was probably even more traumatic. Over 10 years we had taken a team on a roller coaster journey and built something we were very proud of. Pre exit, as founders, our identity, our ego, our place in society, was very much wrapped into the business and it's like ok, I am now going to swap all that for some cash. So it then becomes, how am I going to fill that hole in my life to get fulfillment?

Tech Founder – App Development

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In 2016 and 2018, Koda Capital published 'Seizing the Opportunity', a series of insights uncovered through interviews with current and former business owners across a diverse range of industries.

The research highlighted common wealth management concerns shared by entrepreneurs following the sale of their business. Importantly, the critical role of specialised wealth management advice in addressing these concerns and providing peace of mind as a business owner entered the next phase of life emerged very clearly through these interviews.

Following a series of recently completed interviews with technology entrepreneurs, *'Seizing the Opportunity – A Technology Entrepreneurs Perspective'* extends these previously identified themes and focusses them on the unique needs of the *technology entrepreneur*. Tech entrepreneurs are in many ways defining the trajectory of our society. They are clever, decisive people who are seeing future industries in a way the rest of us haven't yet: much like Steve Jobs who turned portable music devices, tablets, phones, TVs, watches and even online payments into gadgets and experiences so ubiquitous and seamless that it's hard to imagine a world pre 'iDevices'. This research examines the balance a tech entrepreneur tends to seek as they embark on the next stage of their entrepreneurial and life journey. While there may be a brief pause following the sale of their business a key theme to emerge from all who were interviewed is a drive to continue on. This 'continue on' trend was a clear difference to the 'non tech' entrepreneurs interviewed in 2016 and 2018, who were often 'done' in terms of commencing another start up. In contrast, largely driven by the younger average age of the tech entrepreneurs (typically late 30s early 40s), we observed a higher level of energy and passion to go again combined with a community/peer group *expectation* that they continue on and aim to turn another idea into a successful business.

Executive Summary

The total or partial sale of a privately held business, also known as a 'liquidity event', is usually the culmination of years of hard work, considered risk taking, determination and tremendous energy. In many circumstances, the proceeds of the sale may be enough to provide long term financial security to not only the founders and their immediate family but also the next generation. It is also often a time of powerful emotions.

Financial security does not always mean financial peace of mind. Just ask any billionaire! It is for this reason that many entrepreneurs seek specialised, independent and dispassionate advice that focuses on both the rational *and* the emotional aspects of the journey. Entrepreneurs in particular have often been successful in part because they are the expert. They are the ones with the answers. Having the trust in a financial adviser to let them drive, or at least act as co-pilot, does not come naturally or easily to many successful people. But it is in this trust and rapport that the advice relationship delivers the most value.

The common goal sought by entrepreneurs is a well organised advice framework that protects a substantial portion of the sales proceeds while also allowing the flexibility to commence a new business in areas of the tech founder's strengths and interests.

Finding and partnering with the right trusted adviser will lay down the foundations of confidence which, in turn, allow the entrepreneur to pursue their other passions as they enter the next stage of their lives. To reinforce the unconflicted nature of Koda's business model we offer clients the choice of a fixed fee or variable fee.

> So I wanted to project myself forward to age 80 and say, Okay, now I'm looking back on my life. I want to have minimised the number of regrets I have. I think what you do is think about the great expanse of time ahead of you and try to make sure that you're planning for that in a way that's going to leave you ultimately satisfied. This is the way it works for me.
>
> **Jeff Bezos, Amazon**

Key Insights from our Research

The four key insights provided by the tech entrepreneurs interviewed fell into one of the following categories:

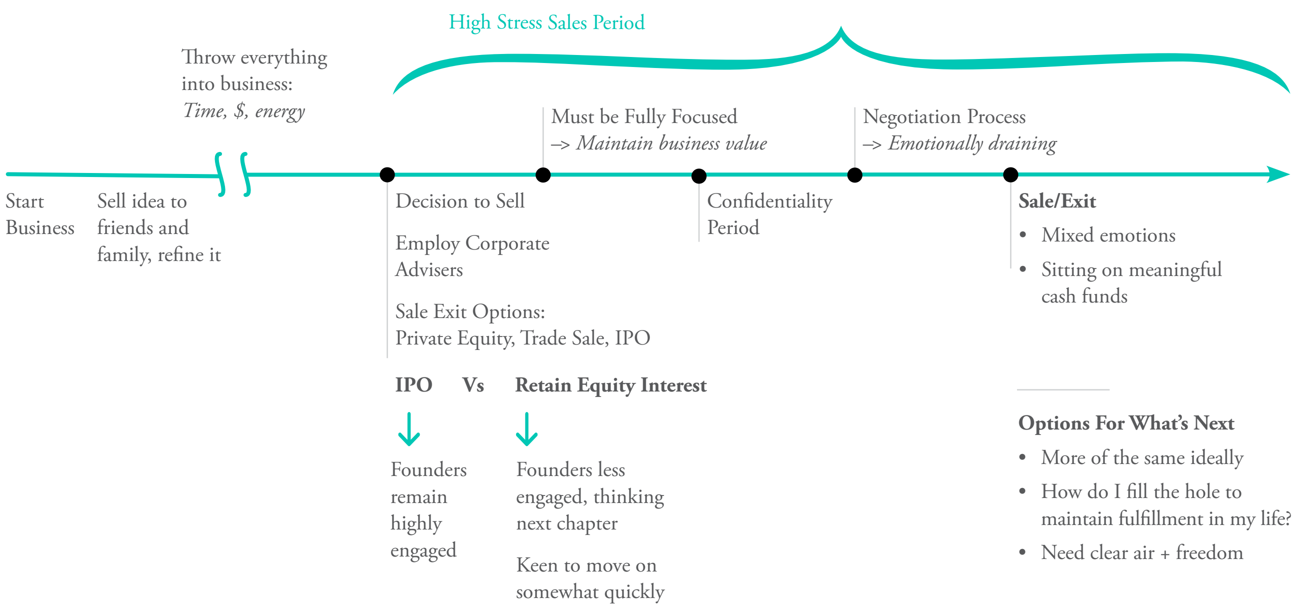
> **Insight 1 – Guidance:** I might be pausing but I am not stopping. Partner with me through the next stage. I want guidance and a framework that allows me the freedom to build/invest/co-invest in other start-ups or elsewhere.
>
> **Insight 2 – Time Poor:** I have no time. I am not a professional investor. I need to get financially organised and want to know that things are taken care of.
>
> **Insight 3 – Framework:** I need a plan that helps me avoid mistakes. Give me structure, discipline and governance so I don't blow what we have made or what we are about to make.
>
> **Insight 4 – The Risk Flip:** Start up risk tolerance versus personal affairs. While I might have been highly risk tolerant with by business venture, I now want to be reasonably conservative and well organised in my personal affairs.

Insight 1 – Guidance

The first key insight we gained from our interviews is that the emotional intensity of the road to liquidity affects the tech founder's approach to their next life stage and, in particular, how they want to manage the wealth created by the liquidity event.

The typical journey to liquidity can be illustrated through the time-line chart below. This timeline, which is not to scale given the build business phase is significantly longer than reflected, provides some insight into the demands associated in successfully selling a tech business.

The Entrepreneur's Liquidity Journey



The key point is that at the point of the exiting, **the founder values near term risk mitigation by putting aside a sensible portion of the funds, while ensuring sufficient capital to fund the next entrepreneurial chapter**. All interviewed recognised they don't need more tech genius; they need solid financial advice customised to their plans and personality.

> Success is a lousy teacher. It seduces smart people into thinking they can't lose.
>
> **Bill Gates**

Gates' cautionary comment above aligns with the research that shows success can be a curse, in that a founder, following their successful exit, often feels invincible. In turn, they roll dollars into new start-ups where losing money is a real risk.

At a more local level, the following cautionary tale from an Australian based entrepreneur and Koda client was offered:

> My advice to other tech entrepreneurs from my experience is this: create a forward hedge that gives you flexibility in the future should the product-market fit, timing or just lack of luck not allow your next idea or ideas to flourish. There are enough stories of entrepreneurs blowing $10m on start-ups and ending up in consulting roles 10, 15 years down the track wondering what on earth happened.

The guidance Koda offers is one of conducting a discovery process to identify what is important to the entrepreneur, both now and into the future which shapes a planning framework that a) ensures their life's work is protected b) their financial house is placed in order and b) creates scope to allow for fun, new projects and new ventures.

Insight 2 – Time Poor

Often the sale of the business is not in one instalment, meaning the founders must remain working for the new entity in order to receive the second/third tranches of the proceeds of the business sale.

This period, often termed an 'earn out period', requires the founder to steer the business, post-acquisition, to achieve performance thresholds in order to receive the final tranche(s) of the sale price. This means serious on-going time and focus from the founders as they remain heavily involved in a business which is now owned by others.

As explained by a tech founder currently fulfilling a 2 year earn out period:

> Because I have an earn out, I must carry on working. That next day to pause never really happens but I need our capital to go to work in the meantime. We need someone we can trust to put the money in the right place.

By investing the time required to truly understand our client's goals we learned that the founder wants to get financially organised, have a plan, invest and be given the freedom to move ahead, knowing things are taken care of.

Koda's role (*remembering Koda is an indigenous term meaning friend or ally*) is to act as a personal CFO to the entrepreneur following the liquidity event. By project managing all aspects of the financial and administrative aspects of our client's lives, we provide both financial peace of mind and free up much desired personal time.

Insight 3 – Framework

Good advice is not just about returns. Good advice and the greatest return on investment can very often involve being steered away from where not to invest so as to avoid losing serious money. Losses when they occur, often are a result of a post-sale pattern that looks something like this:

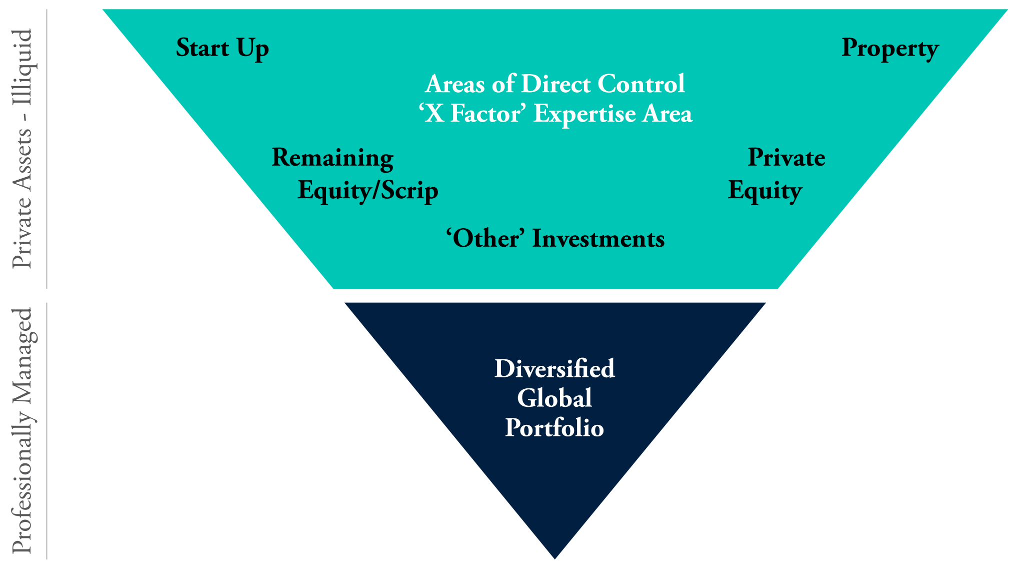
1. Exit liquidity event.
2. The exit hits the press.
3. The founder is inevitably approached by friends, family members and even strangers, to invest, to back ventures, to loan, emerge.
4. In the event loans are made, IOUs often turn into gifts.
5. Friendships can deteriorate as loans or investments don't turn out as hoped and/or loans are not given in declining the loan/investment.

As explained by a leading corporate adviser:

> What we often see is an entrepreneur's idea of investing, post liquidity, is they will tend to meet someone at an event, at a function, overseas or in various social settings and the strategy tends to become one of allocating quite meaningful amounts into investments that have not been well researched as to suitability. Quite quickly, before they know it, the individual holds a series of unstructured investments with an unclear understanding as to investment time frames, risks, liquidity, income expectations and how the investments dovetail with an overall plan. Post exit, entrepreneurs can still freewheel but they need to have a clearer framework.

The individual ends up with a portfolio of good ideas rather than a good portfolio as per the diagram below.

A Portfolio of Good Ideas

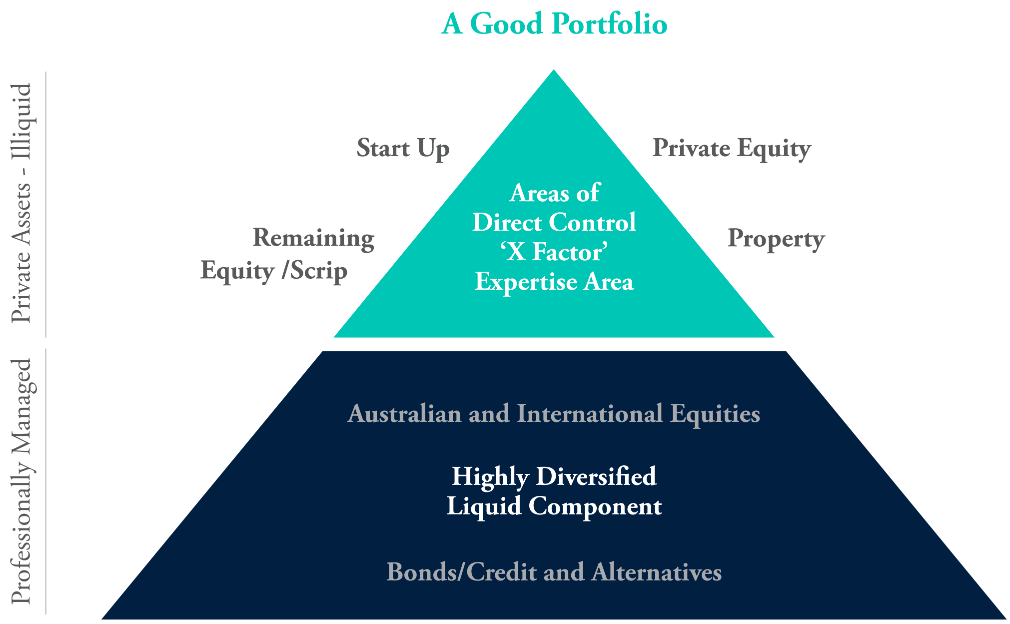


A Structured Approach *With* Flexibility:

In our view, the preferred approach has a level of governance designed to deliver a sense of purpose and structure to the investment activities, while ensuring an appropriate amount of funding for entrepreneurial endeavours. Importantly, this structured approach to governance helps all stakeholders (founders, spouses and other family members) be on the same page about how the money is going to be allocated – avoiding future relationship tensions and providing purpose to the sale proceeds.

An adviser provides a layer of delineation between the free-wheeling entrepreneur and the need for disciplined, *ongoing* investment rigour through the presence of a framework. A good framework includes an agreed vetting process through which to filter opportunities, and to allocate them to the 'entrepreneurial' pool or the 'investment' pool.

This process ensures private, growth focussed investments have a place in the entrepreneur's portfolio – but does not overwhelm the portfolio. One doesn't need to go from building a private company, having a liquidity event and then suddenly only invest in liquid public assets and leave the private world. Great opportunities to invest and co-invest in the private world exist, and the optimal portfolio is a tailored blend between public market (liquid assets) and private market (typically illiquid) assets.



Outcome: Using a structured approach to wealth management where the right questions have been asked delivers four key benefits:

1. Control is maintained.
2. The assets are appropriately managed.
3. Emotional pressure is removed.
4. A bigger picture plan is in place for growing multi-generational wealth.

> I am a serial entrepreneur. I am not a professional investor. I turn crazy ideas into reality – that's my thing in life, it's what I want to do more of and why I need to sensibly deploy our capital, put it to work, so I can focus on my next venture.
>
> **Tech Founder – Hospitality**

Insight 4 – The Risk Flip: A shifting in attitude towards risk

Our final insight category relates to our observation of a shift in focus as entrepreneurs move on to the next chapter of their lives. It is evident founders have been very comfortable with risk, having often spent the last period of their lives risking everything on a business, with their fortunes linked to a single asset being their (successful) business.

Once the business is sold however a very clear transition occurs in the thinking of all founders interviewed. They have typically built their wealth in a concentrated manner (one business) and, importantly, now wish to preserve that wealth through diversification. Essentially a decision to 'de-risk' their financial situation is made by selling the business for the security of cash. While funds are set aside to fund a new typically high risk venture, there is a strong desire to preserve the bulk of the sale proceeds to ensure financial security can be maintained regardless of the outcome of the next venture. The entrepreneurs interviewed confirmed the value in the peace of mind that comes with sound governance, confident key matters are taken care of meaning they are free to continue the next stage of their individual journey.

> Messy and agile and fighting fires daily was great as we built, but I don't want that on the personal side now. You could say I have grown into governance and recognise a solid plan is important.
>
> **Technology Entrepreneur - Health Sector**

The Koda Client Experience

With the four key research findings listed in this paper, the following section is a brief overview of how Koda manages our clients' financial affairs:

1. **Start with the right business model** – The Koda business model is founded on a clean and simple principle: our clients come first. As an independent firm, we do not manufacture investment products and we are unconstrained in the investment universe we can access, which means we provide the full range of wealth advice, free of conflicts and uniquely tailored to each client's needs. Put simply, we are entirely focused on providing great *advice* to clients.

2. **Financial peace of mind** – By conducting a broad discovery we have listened and understand what is important. We then prepare a plan, commence the journey as a guide, project managing the financial lives of our clients. In doing so we keep the entrepreneurs financial house in order, year in, year out.

3. **Patient capital** – Our view is that long term wealth creation and capital preservation is best achieved by targeting portfolio participation in 80% of market upside in exchange for less than 50% of the market downside.

4. **Fees** – Our fees are for advice. They can be fixed or variable. We do not manufacture any financial products meaning we are not conflicted in the advice we provide to our clients.

Conclusion

By investing the time it takes to understand what is important to our clients following the sale of their business, we are consistently refining our advice and improving on our ability to deliver on what is important to each client's unique situation.

The latest round of founder interviews confirms that great advice results in:

1. Clarifying the issues

Clarifying the key issues that need to be considered given the range of options available, a technology founder, having been so focused on building their business, will generally not know what issues need to be considered from a private wealth management perspective. On the topic of portfolio management, they simply don't know what they don't know. Accordingly, good advice will succinctly lay out the issues that need to be considered both immediately and for the longer term.

2. Investing wisely

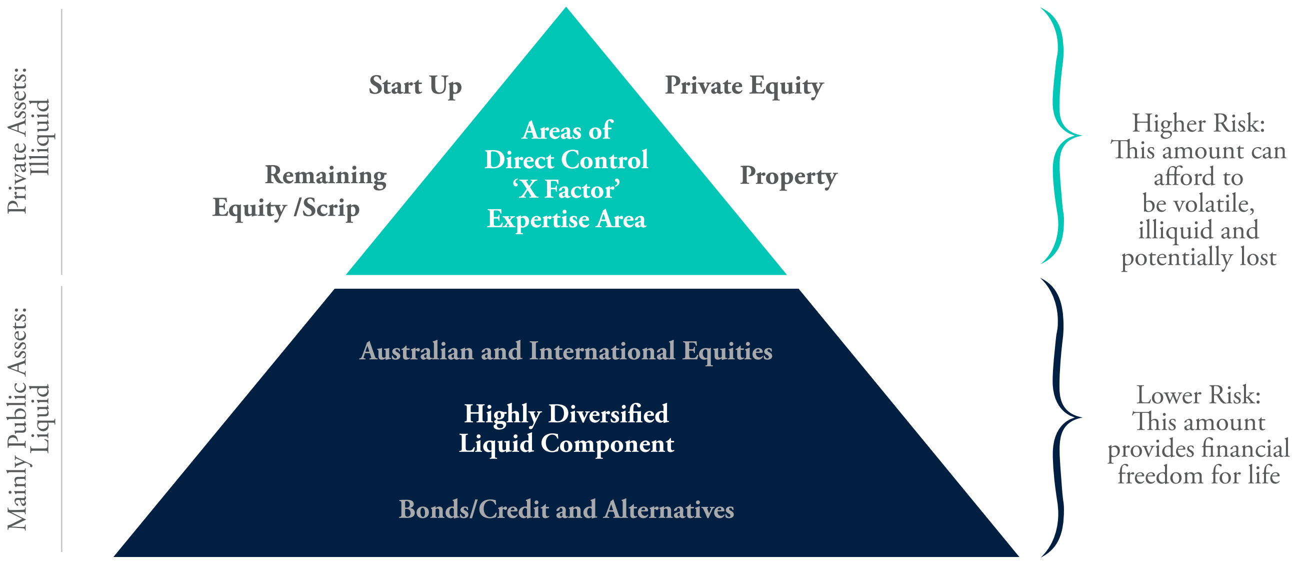
Following years, if not decades, of first building the value of the business and then completing the sale transaction, the focus from a wealth management perspective becomes one of the sale proceeds is put to good use and is underpinned by an appropriate risk/reward approach.

> As entrepreneurs, we have always felt we were always only ever two phone calls from oblivion so the fear of losing what we have built plays heavily on me. Protecting and growing what we have made, and passing what we can to the next generation, means a lot to us.
>
> **Digital Creative Agency Co-Founder**

The sale of a business means Koda clients have created their initial wealth. Data, and basic mathematics, conclusively shows that avoiding large negative losses or 'drawdowns' is the most effective approach to protecting and growing wealth at a reasonable rate. Our investment process is first and foremost focused on protecting and growing wealth while avoiding unrewarded risk.

We understand entrepreneurs will and should continue to be involved in other businesses or personal investments. These areas can include investing in start-up businesses, venture capital opportunities or commencing new businesses which, if unsuccessful, should not compromise the core family wealth and therefore the family's ongoing standard of living.

The 'Smart Money' Personal Balance Sheet – After A Liquidity Event



The key value in Koda's role is not targeting returns similar to the founder's (often leveraged) operating business returns, but rather the provision of discipline to keep to the agreed framework, to only take as much risk as is required to meet required return objectives and to keep a client's financial house in order so they can focus on turning their next idea into reality.

> I'm convinced that about half of what separates successful entrepreneurs from the non-successful ones is pure perseverance.
>
> **Steve Jobs**

Koda's Commitment to Clients

Koda commenced in 2014. With a 20 year average industry experience per Partner, Koda is a disruptor to the wealth management industry. It is an open source financial advice business which sources best ideas for its clients. It has no parent ownership and does not manufacture financial products. It is a purely advisory firm built by its Partners. The business delivers fearless, unconflicted wealth management advice. The client experience is one that supports the tech founder to 'go again' while also protecting and growing the proceeds of their life's work to date.

Appointing a firm to take on the role of managing a family's wealth can understandably be a difficult decision for the entrepreneur. Trust is critical and precedes the requirement to prove capability. Our commitment to clients highlights what we stand for as a business and ensures we deliver on our promise of Koda's name, an indigenous word which translates to 'friend or ally'. Our independence is core to our promise to clients, to the profession, and to ourselves.

In summary:

1. We will always be independent and free from conflicts of interest that affect our advice.
2. We will always put our clients' best interests first – across the full range of investment, execution and advice services we provide.
3. We will agree, in writing, the services we will provide and deliver those services to the standards we promise. Our clients will have access to the best solutions available - not just a list of products restricted by commercial interests.
4. We will only earn fees which are paid directly and transparently by our clients, and if we were to receive any commissions they will be fully rebated to our clients for their benefit. We will detail the basis on which the fees are charged and will discuss them with clients at any time. Clients have – and will always have – full discretion to choose the type of fee structure that works best for them: be that on a fee for service basis, transaction basis, or asset basis. We believe that as advisers we should be rewarded according to the quality of advice and services we provide, not by our ability to promote specific products.

Sean Abbott
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Sean Abbott is an Adviser and Partner of Koda Capital. He has been a financial adviser since 1998. He holds a Bachelor of Business, Finance Major (UTS), and a Graduate Diploma in Financial Planning (SIA), an holds the Financial Planning Association peak international certification of Certified Financial Planner.

Sean has a comprehensive knowledge of wealth management from an investment, structuring, asset protection, and estate planning perspective. Sean is a strong believer that sound planning, structuring, and patience are the keys to ensure clients make the most of their personal circumstances.

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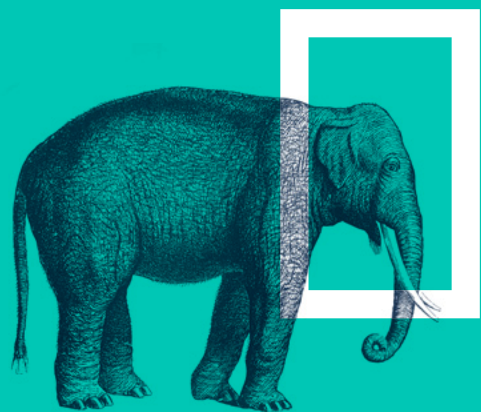

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