ANGEL ASSOCIATION NEW ZEALAND

Better Exiting Failing Investments

Lessons Learned From Expander's 'Negative Exit'

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This is the second in a series of articles exploring in-depth lessons of early-stage investments into companies that did not result in a successful exit for founders or investors. They are based on detailed interviews with founders and investors, summarising a company's trajectory before- and after- funding, & drawing specific insights which we can build on for future investments. Whilst much of angel investors' focus is pushing towards positive outcomes, there are still solid lessons to be learned from those that did not come to fruition. We thank the contributors for their honesty, candour, and willingness to share these insights back into the community.

This is the story of Expander, a labelling and software technology to help large enterprises manage traceability and reduce counterfeit products in the supply chain using a unique QR labelling solution.

The venture was led by founder Ollie Langridge, an expert in the creative design field and specialist in custom-designed QR codes. Prior to Expander, Ollie had set up a very successful creative-services business selling custom designed QR codes to many big brand labels across the world like Coca-Cola, Warner Brothers, and Luis Vuitton. In selling these into Japan he started to think they would be the next big packaging innovation, and soon after, a large milk producer in NZ ordered two million codes for their packaging, asking if they could make them unique to each product.

This was around the time that the New Zealand dairy industry was embroiled in the Chinese milk scandal which tragically led to babies dying, and many more getting sick from contaminated milk powder. Ollie, having lost his own child, understandably had a very emotional hook into seeing this problem solved. On the back of his recent experience, he saw a great opportunity to use unique QR codes to prove authenticity of dairy products and aid traceability across the supply chain. Thus the idea for Expander was born.

After being successfully accepted into the first Lightning Lab accelerator programme, Expander built an alpha version of their product and were successful in getting a few trials underway with medium-sized exporters.

They completed the programme after three months and raised $500K from local angel groups and supported by SCIF. But the startup journey was different to the types of services companies the founders had run before, and with the pressure of startup uncertainty and slow progress, began to falter, completely underestimating the length of the sales process, and the complexity of the solution selling into larger NZ enterprises.

Ollie, knowing he was a better starter than CEO, stepped down early in the company's life to let another, more capable, leader take his place, but by the time the team found that person, there were other problems that made it hard to execute.

Compounded by the lack of sales; their inability to find the right team; and lack of deep market understanding; the investors naturally focussed their energies on more compelling investment opportunities elsewhere, so ultimately couldn't support the team with the amount of capital they really needed to take advantage of the opportunity.

After two years in and still no significant progress on the horizon, the board resigned to on-sell the company to an interested party, which resulted in returning at least some, albeit, a fraction of funds back to investors.

For investors, Expander is a good story of a relatively fast-fail for an early stage investment, but a disappointing end for founders who believed in the idea.

This article will explore some of the insights and lessons, from both founders' and investors' perspectives to surface some learnings that others can take away to help through their early stage investment and company-building journeys.

Early-Stage Acceleration

The Lightning Lab accelerator came around at the right time for Ollie. Whilst he had good successes running more traditional service-oriented businesses, he realized that this product-business would need a different type of team and solution than he had built before. At the time he didn't really know how to build that team, didn't have the domain knowledge in building a tracking system in dairy or IT, and didn't really understand high-growth startups. Understandably this was both a major opportunity, and a major challenge!

Ollie came into Lightning Lab as an individual late into the process and was offered a conditional place on the basis of him finding the right technical co-founder. He found that person, and accepted the offer, but the day before the programme was due to start, he lost him and had to scramble to find another tech founder in time.

His other more operationally-focussed co-founder, Paula Nightingale, had worked with Ollie in his previous business, but only remotely, so along with their new tech co-founder, Roman Kudiyarov, the team really was nascent when they came through the 'Lab. After being accepted into the the programme, the team made good progress in their product-thinking, but the Lightning Lab was an incredibly intense environment for a brand new team. It's pressure-cooker style environment was the wrong way to build a team as there was no 'getting to know you' part - it was full pressure from day one. The co-founders had to learn on the job, going through 'forming, storming, and norming' under intense pressure and the heavy workload that such environments demanded.

Early stage investor, Susan Iorns, who ended up becoming Chairman of the Board reflected that fundamentally team-fit was a problem from the outset - she didn't think Ollie was fit for this type of intensity and pressure during Lightning Lab and so lots of things ended up being rushed.

With neither Ollie nor Paula being technical, the team really struggled with the product vision. Their CTO and third founder, Roman, was a good workhorse and had access to an army of talented developers in Russia, but leading a technical product vision that comes from an innate understanding of the needs of the market was a something that none of the three co-founders had.

Ollie quickly realized his gap in both the dairy and enterprise sales fields and sought the help of Heath Milligan, an early stage investor and mentor at the Lightning Lab programme who was well networked and experienced in selling into large enterprises.

By the time the end of programme investment showcase, 'Demo Day', had come around, Expander had managed to get a handful of early customer trials with a test version of their technology using a simple hand-applied label, and more medium-sized exporters in the sales pipeline. But the push and intensity of the short accelerator programme, really left them with so much to do with a small team.

Despite this Ollie did an incredible investor pitch - emotional and really played on the fear of the current environment around milk powder contamination that captured investors. Compared to many of the other investment opportunities on the night, this one clearly had a passionate founder, solving a big problem, ripe for disruption from New Zealand.

But whilst they were ready for the end of the accelerator programme, it turned out they weren't really ready for investment.

First Fundraise

Expander managed to gather a group of interested investors around them during this time, enough to start going through the due diligence process, led by Richard Laverty for AngelHQ.

Richard remembers there being a lot of buzz in the press about this space with the China scandal, which added some extra 'social proof' to investors. But upon reflection, Richard's thoughts were that the team and investors were overly reliant on blind faith that the Government would step in and create a market for them by regulating the industry, and that never came to fruition.

Richard had to step aside as lead investor due to a conflict of interest in his work with NZTE, so Susan took over the lead. Susan reflected that there were lots of different opinions on how investors read the founder capabilities at the time but does remember that the severe lack of domain knowledge on the part of the team, and about enterprise sales, was likely misread by investors, or swept under the carpet with blind faith.

Susan remarked that as investors' we should be more critical of the founder's ability to reach into that market; experience selling into that market; and networks required to turn that into a business; and then be critical on their real commercial experience, particularly enumerating their skills required as a founder and demonstrable points so far. She also commented that investors tend to evaluate the venture and market more so than the team's ability to execute on it.

Expander was formed in the early days and inception of the Lightning Lab so the Expander deal lacked the due diligence that investors might have been used to, making it harder to evaluate. Much of the early due diligence, turned into deal development more so than checks-and-balances, showing that Expander really was too early for investment and should have been sent back to do more work.

Accordingly, the due diligence and fund raising process ended up taking a lot more time than usually seen in an early stage investment. Again the founders complete lack of experience in this process, and shortness of time given the accelerator programme, really made the process difficult for them.

Ollie had almost burned out after Lightning Lab and took a vacation abroad at a crucial time, leaving co-founder, Paula, to pick up much of the due diligence during that time. Whilst under-resourced, and all the focus being on deal development, little business-as-usual happened, and much of their sales pipeline decayed. Ollie remembers the due diligence process pretty much killing them, slowing them down so much that they lost any momentum in the deals they had, which was a real setback.

Susan also commented that in the due diligence process, many investors followed others they viewed as experts in the field, like Gavin and Sarah Hodder of Labelling firm Saito who were also investing - their view was technology like this could be the future of this industry.

During the accelerator programme, there was some push to choose someone to ultimately lead the venture, but neither Paula nor Ollie wanted to be CEO. Ollie eventually settled on that role and took the pitch since it was his vision, but Susan remarks that should have been more of a red flag.

It's often hard to be objective in the due diligence process - as angels, our commitment to helping see founders be successful can often blind us to whether or not they have the markers for success in building a company requiring outside investment.

Early stage investor Heath Milligan comments that some angels' due diligence process can be 'too nice and supportive' and investors have to be harder, to ask the tough questions, especially around the founder's ability to execute. Heath says that the process can easily become about ticking boxes on a due diligence checklist rather than being based on evidence and real proof points of building a business that someone actually wants. He wonders if sometimes the lead investor bias, and social proof that comes with it, is often the same as the founder's own subjective bias.

Eventually the team did close $500K in that first fundraise allowing them to execute primarily on the product build and looking for further enterprise sales.

Post-Investment

During the lead up to the first investment round, there was some confusion over Heath's role as either a co-founder or a sales employee. Heath had offered to help the team more so than just a mentor, so signed a deal with Expander which he thought was a co-founder agreement. Heath had agreed to work as other founders at no cost until funded, but like other sales roles, took a commission on successful introductions through his network which turned into sales, a vital role given the team's lack of capability in this space.

But Heath failed to get resolution on this role on the lead up to investment, pushing for closure before the pitch, which was misread by investors, who ultimately decided to exit him (and his investment) before closing the investment round, leaving the team with no other sales capability.

It's not specifically down to this decision, but this lack of sales capability became a persistent issue that plagued Expander going forward, with none of the team managing to convert interest into meaningful sales over time.

Whilst Ollie agreed to be an early stage CEO to galvanize the idea and get investor support, he understood his time was limited. A few months' after Demo Day Ollie talked to Susan about handing over the reins to someone else, but understood that investors were backing his vision and leadership and stepping down too soon wouldn't be a good idea.

Ollie stayed for six more months before stepping down and the team started looking for a new CEO, but upon reflection he left too soon. With Ollie leaving, it took a lot of passion and vision away from the team. And although he sat on the board, the team never really found anyone, whether on the board, or in subsequent CEOs, who could drive the day-to-day vision like Ollie could.

Susan reflected that Ollie really needed a CEO coach rather than replacing, which was clear early on, but never happened as Ollie never really wanted the CEO role in the first place. Ollie remarked that he didn't really know what he should be doing or what was expected of him from investors at this stage as this was so different to building a revenue-led services business that he was more familiar with.

Paula looked back and remarked that there was no real conviction in the team for what the team needed to look like and there was no real leadership. They all knew they didn't have the right CEO, but didn't have a plan for that, and the pressure of Lighting Lab made them make wrong decisions and get up in front of investors too early.

Another factor not helping the team was that they physically split up after demo day with Paula heading back to Auckland, and Ollie staying in Wellington; with Susan commenting that this didn't help their focus. As a new team, it was imperative that they stayed together and were closely connected, both to motivate and push each other forward, but this never happened.

After Ollie left, the board brought on a new CEO, but his unrealistic plan was rejected by the board as it needed significant capitalization and resources that the team didn't have, and the new CEO didn't stay much past this.

Eventually, they found a new and capable CEO in Erwin Versliejen, with Ollie remarking that Erwin was a great CEO, but was too little, too late as he didn't have enough runway to make any new plans work.

Disillusionment

Erwin came into a hard situation. He was basically recruited into a failing company with no sales, and asked to turn it around with a three month runway before they'd run out of cash - not a great position to start from!

After starting his role by revalidating the market due to poor validation extant in the current company, Erwin realized the product wasn't right in terms of how it needed to integrate into customers' ERP packages, line printers, and their other operating environments; and their pricing didn't work for customers at a price per unit construction either (sometimes three times the price of an existing solution for particular verticals like the wine industry for example).

After going back to the board with a new strategy, but again being rejected for lack of capital to make it work, progress just came disappointingly slow. Erwin reflected that he came into a process that had already broken down at a board level. His first board meeting saw no alignment in the board, with no-one having a solid idea of what the strategy needed to be, and everyone on different pages.

His view of the board at this time was that they had become disillusioned with the opportunity, and this showed in their lack of participation and his failed expectations around their roles. Whilst the board did well trying to manage a difficult and drawn out process, Ollie's reflections also point to a mismatch of expectations of what the board's role was, especially since he'd never had a board before.

Both Ollie and Erwin felt they needed more domain expertise and enterprise sales expertise on the board, but Erwin's attempts to put such a person on the board was rejected due to their lack of startup expertise. Board chair, Susan, did recruit follow-on early-stage investor David Akers onto the board after Erwin came on board to help with a more startup perspective moving forward.

David remembers being on board for about a year and said that in that time the company still never managed to get any sales, because they were dealing with very conservative customers whose timelines were painfully slow. David reflected that whilst the idea sounded good, in reality the product was too hard to integrate into the value chain, and because of this could never get enough sales to prove the model.

David wonders if they had the market wrong, wondering if selling to consumer retail markets that were high targets for counterfeit goods such as Gucci, would have been a better direction, but he felt the team and progress to date had wedded them to that market and strategy.

Marcel van den Assum, early investor too, also reflected that Expander's value chain was too complex, commenting that "if you add up all stakeholders in the value chain, their ability to influence it was nil - if the retailer loved the product, but couldn't sign others up in the chain, then the whole thing falls apart, being only as strong as it's weakest link". If Fonterra, in the dairy vertical, or the Government, had mandated solutions like Expanders' as a standard for example, then the change would have filtered down and sales would have been easier to close.

David also talked about validation being very hard to read. He remembers being in a sales meeting with Turners and Growers and whilst they were saying all the right things, they just ended up underestimating the length of sales cycle and integration issues (e.g. vendors didn't want to write drivers to integrate with different printing machines), so the process just became larger and a more complex set of moving parts than it looked on the surface.

Second Round Investment

At the end of his three month runway, Erwin came back to the board with a new plan, and started subsequent capital raising to execute on it. The team raised another $300K, from existing and new shareholders, but Erwin remembers the process being fraught.

During this second fundraise, Erwin commented that a significant syndication by Enterprise angels fell through because existing shareholders wanted to rely on existing due diligence from the first fundraise rather than do any more (possibly feeling the pain of the deal development which they had the burden of during the first raise).

It's an interesting point that a few of the shareholders talked about: as investors, we often do due diligence at the first round, but because subsequent capital calls are often done under duress or towards the end of cash runways, we don't do as much (or any) 'progression due diligence' as we should.

Erwin reflected that he'd wished he'd pushed harder on the board to be involved more in the fund-raising process where they never really helped. Ollie commented that investors had become weary at this point, and were looking for a way out rather than seeing Erwin's appointment and new plans as a great opportunity to reboot the company, so maybe that lack of faith meant they didn't want to push too hard on their networks?

It's a fine balance how to manage progressing a 'final chance' for new hope versus calling it a day. Marcel commented that knowing when to pull the plug and how to do it is a good lesson to take from Expander's journey.

The company was successful in raising a small second round of funding, but never enough to allow for the product redevelopment or the length of the sales cycle. As shareholders realized this, the board started to look for options to sell on the company so they could return some value back to investors.

Exiting

A number of options were followed up to find a buyer for the remnants of Expander as there was still developed intellectual property in the idea that would be useful to other interested parties.

Erwin had previously talked to a potential buyer who he tried to get to invest in their second round and who ended up being the final purchaser. Unfortunately Erwin had declared some degree of conflict of interest due to an existing friendship with the potential buyer's brother, so his involvement with the deal wasn't ideal and Susan led out the exit negotiations.

The other potential buyer they talked to turned out not to be a fit, thus really only leaving Erwin's lead as the only viable option on the table (other than winding up the company).

Susan commented that the weakness of having a lead investor without a lot of skin (or passion) in the game was again apparent with the demands of a hard negotiation and contract-writing far outweighing any conceivable personal return. She already saw the reputational damage as a sunk cost and a loss to shareholders was inevitable.

So with no other options, Expander sold the company and assets, returning around 12 cents in the dollar based purely on dollars invested. David Akers commented that at least there was some positive upside for investors, and whilst it probably wasn't the best deal, there was little way to rescue the company - the ideal outcome would have been to sell to a large packaging manufacturer like Tetra Pak who could just back the technology as a loss leader for 5 years until mainstream adoption and consumer awareness was more prevalent, but that was never an option in NZ.

Richard Laverty also commented that the sale didn't leave a lot of room to negotiate, especially given the progress and lack of runway. He reflected that it was a shame there was no ownership in the final technology to allow them some upside in what still was a huge opportunity, even today. Soon after the sale, Expanders' largest competitor, an Israeli company, backed by $2.4MM of seed capital, announced a deal with Chinese eCommerce giant, Alibaba, to integrate its similar QR code tracking technology into all of its online merchants.

Conclusions

What to take away from Expander's journey? There's certainly many lessons and insights particularly around the importance of the right team and the need for good governance.

There were obvious problems with the company from inception onwards, but many of these were overlooked by investors in lieu of the market opportunity.

Certainly the company raised money too early, but we also get a sense that the founders didn't live in the traditional angel investors' world so had little expectations of how it was supposed to work and how to really build an investor-led product company with an enterprise sales focus.

Did the support system let the founding team down? Should we have known better to set the team up for success and fill in the gaps of what they 'didn't know that they didn't know'? There's no easy answer here, as we also have to maintain a balance between the role of a board & investors versus the vision and direction of the entrepreneur and management team.

Whilst there was premature push from Lighting Lab's side to see both that and Expander succeed, investors were probably overconfident backing the company so early without seeing further proof points of both the newly formed team and the customer need.

In a company like Expander where enterprise sales are critical, the importance of pre-sales leading validation is clear, as investor Serge Van Dam points out. Being involved in many enterprise sales deals, he knew that it would not have taken long to reach the right people and test whether they were willing to pay, but having so little enterprise sales experience in the team was an obvious warning sign, although the early success with trials may have sent them off-course.

As investors we should question how much of our early stage investing is led by a robust validation process, particularly around the founding team's capabilities and exposing any shortfalls. Do we fall victim to the same bias as founders in leading our deals as Heath points out? Do we follow social proof too much, like industry experts Gavin and Sarah Hodder, without qualifying those opinions with data?

Expander's journey does present an interesting question about when enough is enough and how to manage exiting a company gracefully for all parties. Expanders' appeared to be one of frustration and tiredness of the board having negative impact on the team, albeit, rightly so due to lack of progress.

How do we better identify what the criteria and milestones are for success and hold the team accountable, even if it means giving up your investment? Ollie commented that investors and the board had a lot of emotional equity tied into their decision making. Should we have fewer investor representatives and more independent representatives in early companies? Is there a solution here to let others in the angel community replace investor representatives and 'cross-sit' on others' boards as objective investor reps instead of investors, to remove the emotional capital?

Whilst investors should have a say in the governance of the company, at what point do we need more externals than investor representation? Alongside founders, Expander had at least two investors on the early board, with an investor-chair, so certainly the board was driven heavily by investors. Once Ollie left, but stayed on the board (as shareholder and investor in the second round), this moved to a majority of investors on the board.

In terms of capitalisation, it was clear there was never enough capital in the company to execute an enterprise sales strategy like this. Is there a better way to support companies like this with longer sales cycles through early investment? Dave Moskovitz says Expander's lesson is that 'as a community we often under-resource our teams with predictable results', but what's the alternative in our capital-constrained early-stage environment?

On team capability, Serge also suggests that for new teams like this where there are so many unknowns, other approaches could be considered like committing larger sums in the fundraise, but having an investor's 'test' after six months, similar, but different to a tranche whereby investors get a call if they've made enough progress based on evidence to unlock the remaining funds; or alternatively an administered approach where an external (or investors) hold the raised funds and administer them to the company, signing them off at the start of each month (assuming these processes aren't overly burdensome).

What expectations should we be giving our founders about running investor-led companies? Clearly a part of Expander's failure was down to the founder leaving too early, taking a lot of energy and vision out of the day-to-day operations and team, an issue which the company never really recovered from alongside their lack of sales.

How can we collectively make sure our founders know what the journey will entail, and what we expect of them? How can we do this due diligence sooner rather than later, not necessarily killing the deal, but supporting that team to put the right people in place and prove the team out before taking investor money?

Ultimately, Expander failed because of the lack of sales, and it's a good reminder that you can't do anything without sales. Investors will inevitably lose support if they are the only ones contributing cash to the company with nothing coming back the other way.

David Akers talks about doing better due diligence as investors, saying that we need to have better diligence around why things are working or not. We need to ask the right questions - for Expander, we'd already lost the game before it started as we were asking the wrong questions. How as a group; board; and individual shareholders; do we quantify and qualify when to throw in your hand? Has anything proven this in NZ before? Where's the evidence?

He questions how to get more support around the board and team, from the angel group for example. David says that we have a lot of faith in people, and that the team can execute. Whilst there's something to faith, what about actual proof?

The team never had real validation. David says they could have asked, 'how are we really going to do this? With the people in the value chain, can we actually do that?' He wonders around validation, can angels frame the validation piece more onto startups to use a framework similar to: "Directors and shareholders and the angel community are here to support you to do the job, but we're not going to do it for you - your job is proving the model is here. If you don't prove it by the 3rd round, no-one's going to give you more money.

David also talked about founders not feeling the fear of failing to make payroll enough, like many successful entrepreneurs have. He sees founders equating investor cash in the bank with income and it's definitely not the same.

Marcel questions in hindsight why did we follow on and not address the fundamentals which were probably inevitable? At what point do say time to move on? What's the trigger? Team? Funding ran out? Red flags from due diligence? When is the point of no return?

Whilst the board did a good job of finding a suitable buyer for the company after a long and frustrating journey, the bigger part of this story is one of learning when to wrap it up from the investors' side and on that basis, knowing what the options are: to sell back to founders; to look for buyers sooner; or just wind up and return funds back to investors faster. Either way, we've got to make the call sooner, and make a plan for doing that in a clear way for all parties.

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