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VCs Intensify Focus on Founders' Background Checks to Help Mitigate Risk

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Recently, it seems that for every startup that fulfills its unicorn potential, there is another that flames out amid high-profile controversy. Further, those flameouts are often accompanied by pointed media commentary asking how the signs — so obvious in hindsight — could have been missed. This has led to increased scrutiny by venture capital firms' decision-making and risk-management teams.

In this environment, VC firms are judiciously doubling down on due diligence prior to investing. However, there are challenges to doing so. More VC firms chasing fewer viable deals means compressed deal cycles that give less time for not just formal diligence processes, but for simply developing a comfort level with the founders. After all, it's long been an axiom in the venture capital world that you're not so much investing in a startup as you are investing in the leadership, judgment and integrity of its management. This axiom is reinforced by the fact that a startup's financials and projections, are, by definition, less robust than that of a company with a developed product and a track record of meaningful revenues. There is, in other words, less material on which traditional due diligence can be conducted.

What a Background Check Includes

These constraints make comprehensive background checks on founders and key management more important than ever. If done correctly by an experienced team of investigators, background checks can be more than a box-checking exercise — they can provide a pathway for a deeper understanding of the management team. These insights can be useful not just when evaluating the investment, but in helping build a productive relationship with founders and management post-close.

Background checks conducted by Mintz Group of startup founders and key management typically includes:

- Involvement in any civil, criminal, tax, or bankruptcy litigation.
- Enforcement actions taken by regulators or inclusion on global sanctions and watchlists.
- Controversies or other risk-relevant information in the media and on all corners of the Internet, including through AI and manual searches for any contentious publicly available content.

- Details regarding the founders' track record and performance of their other business ventures.
- Background information about the company in question, including details to compare against the material provided by the founders to the deal team.
- Verification of prior employment and credentials, including degrees and professional licenses.
- Controversies associated with prior ventures (which may not necessarily name the founders).
- Relationships that founders have had with other investors and venture capital firms.
- Instances where the founders may be involved in many ongoing projects.
- Feedback on the product or service by users or consumers, if applicable.
- Whether the founding team has had experience working together in the past.

Putting Background Checks to Use

Depending on the nature of what is uncovered, investigators may suggest expanding the scope of the background check to gather further context and resolve uncertainty. When background checks identify potential red flags, the VC firm can then assess the findings and factor them into their overall decision making on the deal. Note that background checks merely uncover information and context — how to act on the findings is left to the firm. Because of this, those vetting the investment should go into the process with a sense of what their deal-breakers are.

The extensiveness of the above list suggests that background checks have a usefulness that extends beyond verifying information and identifying potential red flags. The information uncovered also provides useful insight that can help the VC firm better guide the management team post close. For example, the management team's history (or lack thereof) working together may not constitute a red flag, but it may influence the type and level of oversight the team should have.

Managing investment risk is high on the agenda of the entire investment community. Thorough background checks on founders and key management of potential target companies provide the information essential to mitigating that risk.

ABOUT MINTZ GROUP

For corporations, investors and the legal, financial and talent advisors who need actionable facts to assess risks, protect reputations and win disputes, Mintz Group is the partner of choice for due diligence, investigations and background screening anywhere in the world. Since 1994, Mintz Group has developed a uniquely transparent and practical approach to fact gathering before hires and transactions, during disputes and after allegations of corruption, fraud or workplace misconduct. We provide impartial facts that are comprehensively researched, properly sourced and stand up to the toughest scrutiny in the boardroom or the courtroom.

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