



## The Perfect Storm – The Fiduciary Nightmare of Managing Shareholder Records

**Joe Maxwell**, seasoned entrepreneur founder of Investment Scorecard and current co-founder/CEO of CapControls, shares ten reasons why using Excel to track shareholder records can cause a perfect storm when it's time to sell the business.

## The Hidden Factory

Shareholder records are rarely a priority for an executive team immersed in building a business, raising funds, and managing a team. But come time for a transaction (money raise, recapitalization or sale) the CEO quickly realizes why meticulous record-keeping means the difference between a closed deal and a potential nightmare.

## The Perfect Storm

Round one typically involves friends, family and the company's founders. The executive team tracks all fundraising details in a spreadsheet – the number of shares, value of shares, transaction date, shareholder name, contact information – key components to the capitalization table. If venture capitalists are involved, they too, maintain separate records. Further, the start-up's law firm must also retain vital shareholder information and maintain a certificate ledger.

As the company grows, various employee ownership plans may be added to the mix. Round two of funding commences and more complexities are added to the cap table. All parties update their own spreadsheets with the new funding information. After a series of additional fundraising efforts and relevant events, the company has grown into a valuable enterprise – one being courted by cash-rich buyers ready to close a deal. Mission accomplished for the CEO, right?

Not yet.

When a company is ready to sell, the clarity and accuracy of its board minutes, shareholder documents, and cap tables becomes a top concern for the executives, attorneys, VCs and future buyer.

As discussions evolve with the buyer and the two parties agree on the terms of the deal, it's time for the company to track down each shareholder, vote, then announce the event and pay out earnings. The company learns that one investor gifted her shares to an ex in their divorce settlement and never notified the company. Another moved to Europe, and there's no record



of his forwarding address. A third shareholder – a team of consultants granted penny warrants – still has claim to its shares years after a consulting engagement. Oops, the CFO forgot to terminate the rights when the term was automatically renewed unless cancelled, only to realize the oversight now.

More confusion arises when the VC's records don't match the company's – there are a few conflicting data points, and those may be significant. The law firm kept track of the basic information it received when the company was founded seven years ago and subsequent certificate cancellations and issuances – but some updates are missing. At this point, the company's series of spreadsheets is so extensive and complex that finding the inaccuracy is like finding a needle in a haystack.

Meanwhile, the company is mired in detective work, trying to track down each shareholder. Legal fees mount as the company tries to reconcile its shareholder records. What should have been a dream deal has turned into a costly, time-consuming nightmare for the executive team.

It's a common story. Companies are often dominated by the tyranny of the urgent, and between starting a company and various major events, housekeeping details get lost.

Most first-time CEOs and CFOs assume that Microsoft's Excel, Word and Outlook can sufficiently track the company's shareholder records, and their core focus should be building the business, not managing the cap table and shareholder communication. They later learn (after it's too late) that Excel was not built for sophisticated data capture, financial modeling and reporting, and that these records required much more ongoing maintenance than they realized.

It can get really messy – and really expensive – fast.

At the end of the day, everyone's nervous. The company is burdened with an extensive clean-up job, knowing that VCs are quick to discover sloppy record-keeping and rushed updates. What's worse, the potential buyer may lower the purchase price - or pull out of the deal altogether out of fear of a potential shareholder lawsuit.



And the kicker is that the entire disaster is preventable.

Unlike Excel, a new, automated services and products such as CapControls, my company, manage shareholder records in one central, secure, Web-based location. These tools resolve many of the weaknesses of Outlook, Word, Excel and other desktop programs, with the added benefit of modeling capability so that CEOs and VCs can evaluate and forecast the impact of future events.

It's a huge win for the business owner, shareholders, auditors, the VC, and the law firm – they only need one centralized scorekeeper, and they only want one scorecard.

While veteran CEOs know the issues all too well, new executives are often unaware of the many threats Excel-based solutions present to the accuracy of their records. Here are the **top 10 headaches** reported by business owners, attorneys and VC who used spreadsheets to manage shareholder records.

## 1 Formula Errors

An Excel user can enter any data into any cell, and complex calculations can quickly lead to formula errors and compromised data integrity. In fact, research studies\* estimate that 94% of spreadsheets contain errors, and 5.2% of the cells in unaudited spreadsheets contain errors.

To protect against this, these services offer an automated tool with repeatable computations. The software enables the user to enter data only in a central, secure location, and the Cap Table is tied to a transaction ledger to help reduce the likelihood of errors.

## 2 Versioning Errors

Excel lacks a central repository of normalized data, leading to multiple versions and conflicting information between employee, investor and business owner. Without a transaction ledger, the business owner has no way of knowing who made changes to the spreadsheet, and when the changes were made. A Web-based software program like CapControls gives all parties real-time access to the latest information, and prevents versioning errors by multiple users.

## 3 Lack of Security & Confidentiality

In today's digital world, security and confidentiality is more important than ever. Companies should limit the number of individuals who have access to sensitive information, and protect that information from outside parties. Some companies store their cap tables on a local drive, which operates with simple password protection and is susceptible to crashes. What's more, the creation of numerous spreadsheets increases the potential of security breaches and lost data. Services such as CapControls, host all data on a Web server with three separate levels of security.

## 4 Ineptitude With Complex Modeling & Reporting

Spreadsheets were not made for complex modeling. Such calculations require detailed layouts and complex algorithms in each cell. Also, for institutional investors to view composite reports for all of their holdings – across all funds and portfolio companies – they must either maintain their own ownership record spreadsheet(s) for each portfolio company or rely on the numerous spreadsheets provided by each company, which likely vary in format.

In either case, the spreadsheets need to be manually reconciled and aggregated to provide composite reporting. To address this challenge, services allow institutional investors to view their cross-company holdings from the same centralized repository of data.

## 5 Unnecessary Operating Costs

Depending on the amount of investor activity, the costs associated with ownership tracking and cap table management in-house typically exceed those of outsourcing. It makes sense. Companies often outsource payroll, acknowledging that it's not the best use of their time and expertise; why not do the same with ownership tracking?

## 6 Knowledge Silos & Single Points of Failure

As proprietary spreadsheets become larger and more complex, the company is forced to rely on a few individuals within the organization to interpret the data. Staff turnover and human error make this an incredibly risky bet. To eliminate this dependence, services should offer one point of entry and the seamless transition of record management from one individual to the next.

## 7 Lack of Expertise

Most CEOs are not experts at every financial aspect of the company, much less whizzes in Excel. If they are, you may want to seriously question the soundness of your investment.

## 8 Time Management

Given the long list of responsibilities facing each CEO, data entry and spreadsheet management rarely rise to the top. Simple changes in Excel often require a large numbers of manual cell-level operations, a tedious and error-prone process. There are only so many hours in the day.

## 9 Stressful Audits

While CEOs generally claim that trust the accuracy of their ownership records, the word “audit” is quick to elicit second thoughts. And with FAS 156, the new accounting standards, compliance is now equally as critical a private business as to a public company. CapControls software eliminates the frantic rush to gather records, and the fear of inaccuracy. All data is properly reconciled and organized in real-time.

## 10 Legal Woes

Inaccurate reporting often results in sky-high legal fees during the reconciliation process. Further, because it’s very difficult to determine who made revisions to spreadsheets, and when, regulatory compliance can be called into question. In the worst-case scenario, these issues could lead to charges as serious as fraud.

\*Source: R Panko. What Do We Know About Spreadsheet Errors? Journal of End User Computing, 10(2) Spring, 1998.



## About the Author, Joe Maxwell:

Joseph E. Maxwell serves as President and CEO of CapControls, LLC. Maxwell is the founder (1995) and former Chairman and CEO of Investment Scorecard, Inc (sold to Informa Plc. April 2007). Maxwell is an active member of the Young Presidents Organization (YPO) and serves as a member of CapControls, Beacon Technologies, Independence Trust Company, Interactive Advisory Software, Ardea Capital Management, and Mobular Technologies Boards of Directors.

Maxwell earned a BA from Denison University and an MBA from Vanderbilt University's Owen Graduate School of Management. Maxwell lives in Brentwood, Tennessee with his wife, Juliana, and three sons, Wyatt, Rudy and Hadley.

Maxwell is a veteran speaker and has presented to many audiences on topics of wealth management, leadership, and entrepreneurship.

Maxwell can be reached at [jem@capcontrols.com](mailto:jem@capcontrols.com) or 615-377-3538 ext. 2