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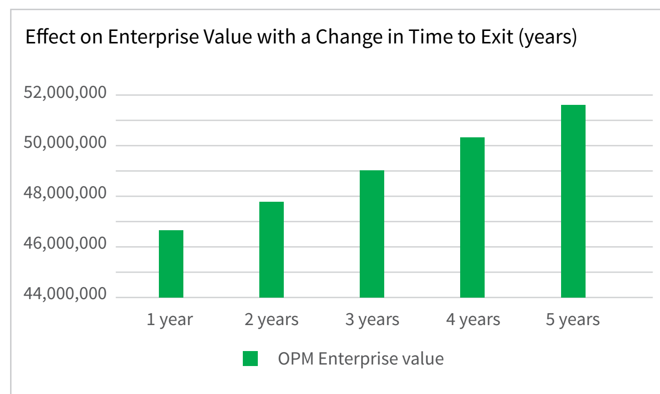
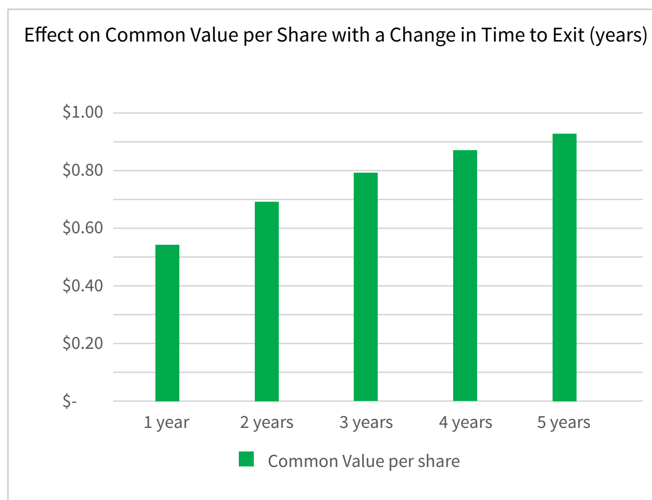
The Times They Are a-Changin' – Adjustments in the OPM: Time to Exit

As mentioned previously, the option pricing model (OPM) contains multiple inputs when completing the Black-Scholes calculation for allocation including time to exit. This input is not set in stone, and is dependent upon management indications as to when and how the subject company plans to exit.

When comparing the resulting enterprise value of an entity when a time to exit is adjusted, there will be more time for the company and common shares to accrue value given a longer time to exit and developmental stages being met. In a shorter time to exit, more of the available proceeds will go toward senior security series as there is less time for value to accrue. The time to exit selections will depend on each company's circumstances, including management's opinion on the perceived risk and the company's longevity up to an exit event. Again, potential decline for the company is limited by cost associated with the underlying security series, and potential growth has an unlimited range.

The OPM takes both optimistic and pessimistic scenarios into consideration while going through the calculation, considering each security series as a call option on the enterprise value. While there is an unlimited amount of possible growth, decline is always limited to cost. Potential growth is partially dictated by the time to exit indicated by the subject company's management team. There is a direct relationship between the time to exit and the company's potential for future growth.





These diagrams illustrate the changes in the enterprise value and common value per share once the time to exit is changed. These changes in value are based on the following:

- Time allotted for the company to continue to build prior to an exit,
- Common shares and the company both have more opportunity to accrue value over time, and
- Lowered risk and lessened uncertainty based on continued efforts within the company's operations and management team to progress forward.

While there is no perfect allocation for every value determined for a private company investment, the option pricing model is best suited for the uncertain circumstances that each venture stage company faces as it forges ahead into sometimes volatile markets.

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