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THE LEGAL PROCESS OF RAISING INVESTMENT FOR YOUR STARTUP

A step-by-step guide for raising money

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INTRODUCTION

You have a great idea, a strong team, excellent product-market fit, and all you need is an investment to develop your idea further and eventually scale your startup.

Before you start approaching investors, there are certain things to keep in mind. An investor is unlikely to invest in you on a hunch and is more likely to be expecting a detailed explanation about your business.

We have put together an information package with references to the main steps to be taken and relevant documentation needed to raise your first private investment from an angel investor or a venture capital fund.

Here you will find:

- A step-by-step process of raising your first investment
- Documents needed for successfully securing your first investment

Note that it is always essential that legal advice is sought to get things right from the start.

STEP 1

Preliminary steps to be taken

PRELIMINARY STEPS

When it comes to getting investment, a business plan and other documents are essential ways to communicate your company as an investment opportunity investors shouldn't miss out on, particularly as they will be inundated with requests for investment.

So, what should you prepare before you start to approach investors?

- **Establish a legal company**

You can't give away shares in your business in exchange for investment unless you have a legal entity with shares.

- **Founders' Agreement**

A founders' agreement is a legally binding contract, usually in writing, that outlines the roles, rights, and responsibilities of each owner in a business. The agreement sets the terms if one founder decides to exit the business. Furthermore, it shows investor that you have a serious business.

- **Business plan**

You will need a detailed case for your business that includes the market research, traction to date, financial forecasts as well as the amount of investment being sought and for what.

- **One pager**

Prepare a short summary of what you do.

- **Pitch deck**

Prepare two versions of it – one that could be sent out as a reading material and other that you can present standing in front of an investor.

- **Share capitalisation table**

You may need to seek some help from a lawyer to help prepare your share capitalisation table. This will set out the structure of shares for your company before and after the investment.

- **Create a list of target investors**

This is for your own, not for investors' benefit. Research the investors you are going to approach and create a list of your ideal investors, to whose criteria you could tailor your documentation.

- **Network**

This is not a legal part of the process but it is an essential aspect of getting an investment. Try to reach out to connections in your network who may either be able to introduce you to potential investors, or who will be able to advise you on the process along the way and review your documentation. Find a lawyer who will have lots of contacts with experience in the various elements of investment, so you should see how they can help you beyond assisting with the documentation.

Read more on Linkilaw website.

Source: Linkilaw website

STEP 2

Due Diligence

DUE DILIGENCE

After you have found an investor who is interested in financing your project, you need to ensure that the funds actually reach your bank account and that the investors will be happy with their decision.

What is due diligence?

Due diligence is an investigation, audit, or review performed to confirm the facts of a matter under consideration.

Here you will find a short summary of what your startup should know about due diligence as well as some unspoken rules that will help you build good relationships with investors.

What is analysed during due diligence?

- Your business (product, technology, market, go-to-market strategy, risks, team, traction, exit strategy, financing round)
- Your finances

The list of the documents you will need to provide to the investor varies depending on your stage, but this is a required minimum:

- Executive Summary/One-pager;
- Pitch Deck;
- Pre-shareholder agreement and cap table;
- Technology description and detailed "how it works";
- Competitor analysis;
- Sales strategy/Go2Market strategy;
- Roadmap: product and business development;
- Cash flow/Profit and loss statement: past periods and forecast (2-3 years);
- KPIs and metrics dashboard;
- Detailed use of funds.

DOs and DON'Ts

+ Have all the necessary documents at hand
+ Be proactive, fast, open, polite and positive
+ Use simple language
+ Ask for feedback
+ Keep calm and be wise (never start arguing)

– Don't hide anything
– Don't show internal/working documents
– Don't leave questions without answers
– Don't take it personally

Source: Finance PM

STEP 3

Term Sheet

TERM SHEET

Term sheet is the first formal – but non-binding – document between a startup founder and an investor. A term sheet lays out the terms and conditions for the investment. It is used to negotiate the final terms, which are then written up in a contract.

Here you will find the elements of a good term sheet.

- **Valuation**

  Before you can negotiate terms, you have to know what you're negotiating about. On a term sheet, you're going to include both pre-money and post-money valuations. Pre-money is what your startup is worth before investment, while post-money is that amount plus the amount invested.

- **Option Pools**

  An option pool is a block of stock reserved for employees or future employees. On a term sheet, you might need to create an option pool or expand on the one you already have. You're also setting the terms for how stock gets diluted as more stock is issued.

- **Liquidation Preference**

  Liquidation preference is a safety net for investors who are getting preferred stock. In the case of your startup failing, liquidation preference gives the investors a possibility of getting at least some of their money back.

- **Participation Rights**

  Participation rights give investors two benefits: A return on their investment before any other investors and a percentage of whatever is left. While investors might push for participation rights, they're not a standard part of term sheets and you should feel empowered to push back.

- **Dividends**

  Dividends are, at the most basic level, distribution of profit between a company's shareholders.

- **Board of Directors**

  While the concept of a Board of Directors may seem ludicrous to an early stage company, it's an important part of any company as it grows.

- **Ownership Percentage of Share Classes**

  While a company's board often determines big decisions, some decisions will be made by a shareholder's vote. Your term sheet should include a section about ownership percentage of share classes — i.e. what percentage of the company each person/group holds.

- **Investor Rights**

  The rights listed in the term sheet can vary pretty widely. Therefore, it is a good area to consult with your lawyer in order to make sure you're getting a good deal. Investor rights are usually specific actions that investors have a right to take or expect.

Read more on Startups.com website.

Source: Startups.com

STEP 4

Documents

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DOCUMENTS

After the terms have been agreed on and due diligence has been completed, a lawyer, either your's or investor's, will start to prepare the documentation that will fix the arrangements for the investment.

Here is the list of the documentation that is usually needed.

- **Shareholder's Agreement or Investment Agreement**

This will set out the agreed terms in the term sheet in more detail. Future investors may want to see this agreement to know how much control other investors have in your company.

The agreement will:

- set out the shareholders' rights and obligations;
- regulate the sale of shares in the company;
- describe how the company is going to be run;
- provide an element of protection for minority shareholders and the company; and
- define how important decisions are to be made.

- **Vesting Provisions**

These may be drafted into the shareholder's agreement. Vesting provisions are usually designed to protect the investor or major shareholders from key members of the founding team leaving the company soon after investment, meaning that certain shares will „vest" over time or upon meeting certain milestones.

- **Subscription Agreement**

This agreement is the promise of your business to sell a certain number of shares to the investor at a certain price, and the agreement of the investor to pay that price. The subscription agreement regulates the terms of the investment itself, what happens in connection to the investment and what warranties the founders give to the new investors.

- **Articles of Association**

The articles govern the operation of the company once it has received the investment.

Source: Linkilaw website

FINAL STEP

INVESTMENT

Once all the conditions have been met, documents prepared and terms agreed, a closing date will be scheduled.

After that, you have successfully secured your first round of funding!

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LEARN MORE ABOUT TETRA PROJECT AND OUR PROGRAMME ON [HTTPS://BUSINESS.NGI.EU/](https://business.ngi.eu/)

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