How to kick off investor negotiations

By Adrian Dommisse

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It can take months of pitching before you find the right investor for your business, but finalising the deal can be tricky.

Finding an investor can be a difficult and time-consuming process and once you've found one with the right strategy and values, you may be tempted to rush through negotiations to access the promised cash injection. However, there can be serious ramifications if the details of the deal are not negotiated on level playing fields.

Here are some issues for you to consider:

- ## Ask for a term sheet early

  A term sheet is simply a summary of the deal in a few pages. It exposes the bare bones of the fundamental commercial terms of the investment and because it is so concise, you are less likely to miss some essential detail, as you tend to do when faced with pages and pages of legal documents. The term sheet can be an invaluable document because each board member or founder can get to grips with it quickly, and give input from their unique perspectives.

- ## Compare deals

  Always compare the terms on which different investors would invest. Don't be tempted (or persuaded) to commit to one investor unless they offer a genuinely better deal. Often an entrepreneur is focused on the valuation of the company, hoping for a higher valuation and, therefore, a higher investment. But don't forget other important points - there may be a significant "negative" value such as founder restrictions, share claw backs, rights of investors to sell (their shares and yours!) and other terms that come along with a higher valuation.

- ## Determine which terms are binding

  Before you put pen to paper on the term sheet, be sure to understand which parts are binding. Although the terms of a cash injection will not be binding until set out in comprehensive documentation, the investor may require you to commit to an exclusivity period, in terms of which you undertake not to negotiate with anyone else for a set period.

- ## Always check the fees

  Once the investors instruct their attorneys to draft the investment documents, they will expect those fees to be for your account - usually deductable from the investment amount when it is advanced to you. However, what if there is a genuine disagreement on a fundamental term of the investment? Who pays those fees if the investment never closes? Make sure that you hash out all the details prior to signing and make sure that the legal fees are capped so that they won't drain your investment funds.

- ## Determine if there are "arranging costs" involved

  "Arranging" costs can be significant. If you are negotiating directly with the investor, this fee may not apply. You could argue that the investor's profit will be from their investment (exit profit or distribution of profit), not from the company's balance sheet at the commencement of the relationship. Having said that, it is not uncommon for investors to take a fee from the proceeds of the investment. There can be valid reasons for this, such as where a complex deal requires unique, expert skills to arrange, but you should investigate any such term in discussion with the investor to understand why they would rather do that than invest those funds with you. Check to see if this is common practice - again, by comparing deals.

Following the above process will help avoid disappointment, or even avert a failed deal later down the line, at your cost.

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