

The Art of the Term Sheet

Building a great company requires capital. That money frequently comes from a professional investor who wants that money used well and returned with predictable profits. Understanding this simple concept lets you negotiate terms you and your investor can thrive on.

It's simple really. All the terms offered for investment center around getting a needed ROI, step in and control rights if you're not delivering that return and information flow so they know if you are on track. The art is putting it all on canvas. Start with the form and bold shape.

Just like any artwork, a successful term sheet piece starts with preparation and planning.

Chris Hibberd, CEO at Astute Medical and Greg Wimmer, CFO with Skinit just offered their insights from completing new rounds of financing during CONNECT's FrameWorks Workshop. They agreed, you will only have a successful funding if you start by taking a step back to develop the whole picture before you start asking for money.

Research your target investors. Don't just ask your resources for names, instead ask about the VC, the firm and their partners. How do they support you? What happens when times are tough? Visit people who know them to get the real scoop.

Talk to VCs early, before you even have a completed your pitch. This puts you on their radar. Just like the artist goes to events to create buzz and anticipation for the new exhibit before opening night.

Background checks are not out of the question when you realize this is one of the most significant "hirings" you will do for your company.

Setting up your canvas and easel

Wrap up the Due Diligence package early. Once you are on the road raising money, you can't afford the time to stop everything to prepare for the next set of documents. This is a long process, so plan for 6 or more months of cash and open calendar time.

Get your own expectations clear early so you know when you have the right deal. This avoids missing the good ones because your vision is bigger than the market or just taking anything that comes along because you think any money is good money.

Approach

You absolutely need a warm introduction. Use your network to approach any investor. Not using a trusted source can send your deal straight to the rejection bin. Your best introductions come from professionals who don't take a piece of the action. Lawyers, CPAs, other VCs, CONNECT, and portfolio companies make great introductions. Later rounds might involve investment bankers.

The gentle approach is far more effective. A simple, quick, short, touch works better these days.

Then follow up with your executive summary because they now want to look at your opportunity.

Negotiating the pièce de résistance

Negotiations start early. Let's be clear the VC issues the term sheet. Not the entrepreneur. But, if you wait to discuss the terms until the term sheet is in the mail, you'll be lucky to have the best of terms. Discuss your critical, must have points early. You want to be in alignment before the term sheet is issued and the main deal points are locked by the investment committee. You'll find it very tough to make major changes later.

Valuation is most likely the critical issue to get worked out early. Yet, be sure to give and trade or you'll end up spilling your paint cans and your deal, too.

Fine brush strokes offering the finest technique

Once your investor offers you a term sheet you can be sure you are nearing the money. Yet, all of those strange terms which seem to make up the bulk of the offer are there to provide... well you remember... predictable ROI, transparency to track progress and control if you're hopelessly painting out of the lines.

Those details carry a long term effect you can't see. The solution is simple, really, get a venture experienced lawyer involved early. Details can be negotiated and the best advice comes from your attorney. As entrepreneurs these are out of our daily experience and no successful entrepreneur has time to stay up on the constantly changing fine print.

If the following list of detail areas, suggested by co-presenters at t, Nate Jensen and Matt Steiner from Morrison Foerster, doesn't scare you to use professionals, an investor just might not like your lone wolf attitude and drop your deal.

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Valuation	\$	Antidilution
\$ Option pool	\$	Redemption
\$ Ownership preferred rights	\$	Protective provisions
\$ Maximum return	\$	Founder distributions
\$ Dividends - yes, no, non-cumulative or cumulative	\$	Board representation
\$ Sunset provision	\$	Proxy and board control
\$ Liquidation preference	\$	Drag along triggers
\$ Participation rights	\$	Preemptive and refusal rights
\$ Conversion	\$	Milestone payments
		Clawbacks

Finally, don't forget raising money is like opening a whole exhibit, so you must work on multiple deals at the same time. Bringing every potential investor along at the same pace increases your value and demand.

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