GONZALEZ & FERRARO MILA

ABOGADOS

Advising the entrepreneur who seeks to raise capital
pitching interviews and term sheet negotiation

When advising entrepreneurs who are seeking to raise capital, we cannot look at it solely from a legal perspective, but we must look at it from a business perspective as well. In most cases, venture capital investors will first look at the economic aspects of the target venture, and then hand the reins to their attorneys in order for them to look at the legal aspects of the transaction. Therefore and from a purely business perspective, most investors will look at things such as management, valuation, return on investment, liquidation preference and lastly, an exit strategy.

Inexperienced entrepreneurs tend to put a lot of emphasis in business plans that are full of charts and references to comparative businesses, but fail to nail down the true and particular advantages of the business they are trying to pitch. Hence the importance of a well thought and drafted executive summary, where the prospective investor can look at the basics of the target business, without getting distracted with irrelevant comparative information. Therefore, entrepreneurs should be aware of these material issues that investors will be looking for.

This is also true when it comes to term sheet negotiation. Most investors are not willing to just hand over large amounts of money to young people with smart ideas without any type of restrictions. They want to have a certain control over the use of the money (commonly known in term sheets as "Use of Proceeds"), as well as the possibility of including negative covenants in the contracts, in order to restrict the entrepreneurs' ability to run the company at pleasure.

Another important issue during term sheet negotiation is board representation. In most cases, majority seats are appointed depending on how much control the investor is paying for. So if the investor is becoming the controlling shareholder, he will require to have the majority of the seats of the board. Once the seats are allocated, then the focus will move to which decisions require either a unanimous vote or a supermajority (normally through a shareholders' agreement). Again, entrepreneurs should look at these decisions in terms of what the investor is looking for, and in most cases it basically refers to decisions that are material to the status and survival of the company (i.e. mergers, consolidations, sale of substantial assets, etc.).

Finally, another important issue is information. Entrepreneurs must be willing to share information with their investors, and in most cases, term sheets will include provisions that allow investors to seek information from the management of the company, and in some cases, perform audits of the company in order to obtain such information. It is a healthy habit for entrepreneurs to deliver quarterly and annual reports to their investors in order to fulfill this requirement.

Last but not least, entrepreneurs should keep in mind that most investors are looking to achieve win-win situations, which basically means that the management has enough freedom to run and grow the company, while at the same time investors are able to obtain information on how their money is being used and are made participants in the relevant decisions that have to do with the governance of the company.

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