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Raising capital: The startup journey

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Raising capital: The startup journey

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Make sure you get a lawyer to read your term sheet, and keep talking to VCs and other founders

When **Simon Schillebeeckx** co-founded impact-as-a-service platform Handprint, he and the two other co-founders raised over US$600,000 through SAFE (simple agreement for future equity) notes from friends and family. When the time came to approach corporate venture capitalists (VCs) for growth funding, the startup managed to raise US$1.4 million.

Then came the arduous legal formalities.

“The term sheet was 16 pages long. The actual contract, which includes the shareholder agreement, partnership agreement, disclosure letter, warranties etc. is probably about 350 pages,” observes Schillebeeckx, who is also Assistant Professor of Strategic Management at SMU’s Lee Kong Chian School of Business (LKCSB). “We signed the term sheet after going through it with the VC and said, ‘It looks fine’ without talking to our lawyers because we didn’t have one at that point. That was a mistake.

“No matter how much the VC and the startup want to make it work, when it comes down to negotiating a legal relationship, there are diametrically opposed interests. Generally, your interests may be aligned but they would likely want more control than you are willing to give up, or they are willing to give up less money than what you are looking for etc.

“So, bring in a legal expert before you sign any kind of term sheet.”

He made those observations at a recent SMU Business Innovations Generator (BIG) fireside chat on fundraising, which also featured **Gaurav Nagar**, Co-founder & CEO of enterprise IT security startup Evren and a graduate of the BIG Incubation programme. Nagar echoed the assessment of SAFE notes being the most suitable fundraising method for young startups where “you don’t have to deal with [the hassle of] due diligence, and with SAFE notes it’s as good as: two guys sign a three-page document, wire the money, get back to your work”.

For Nagar, who had a working product and some market traction before approaching VCs, it was about having leverage during funding negotiations.

“When you have a good product, investors will want you more and you would have the upper hand,” Nagar points out. “We went with VCs whom we thought would be fast movers so we can get on with the job at hand instead of raising funds, which becomes a full-time job.

“We looked at how much money we would need in the next 12 months to achieve some kind of growth so we can approach VCs and raise a bigger round. We came up with a figure of US$500,000 so I said, ‘Go for US$700,000.’ We ended up raising US$800,000 at the valuation we wanted.”

FINDING THE RIGHT VC

Looking ahead 12 to 18 months in terms of costs is more important than any other financial projections, says Schillebeeckx. He adds that it is crucial to not just map out the likely expenses such as salaries and equipment, but it should be done with the assumption of zero revenue.

But how does a founder know what kind of costs he will encounter? And how does he or she find the right VC?

"The easiest way is to talk to other founders and pitch them the idea of what you're doing, and they will ask you questions that a typical VC or investor would ask," Nagar offers. "But different founders have different needs. Some founders like myself can make the product themselves, some don't.

"But also, talk to VCs. Talking to VCs doesn't necessarily mean you want money from them. Talking to VCs gives you a good grasp of what they think about your business and how much they actually know about your business. You don't want a VC sitting on your board telling you what is or isn't working when they don't understand what you do."

He adds: "Look at what you need, and ask the VC, 'Can you help me with A, B, and C? Because I need help with A, B, and C.' The answers they give you will help you determine if this is the right VC for you. Also, ask for references to founders they have invested in and worked with for a few years. Then talk to the founders, who will most likely tell you the truth."

If a startup is viable enough to reach Series A funding, heavy hitter VCs come into the picture. That is also when the question of share dilution come into the picture.

"How much share dilution are you willing to accept for the amount of money you want to raise?" asks Schillebeeckx. "It's about how much money you actually need and how much you are willing to give up at this stage. The more your startup grows, the more expensive that equity becomes.

"As a founder you want to have as much ownership before you get to Series A or whatnot but when you get a big-time VC on board, it doesn't matter what percentage the VC buys up; he'll get control of a lot of things anyway. They will ask for veto rights on this, that, and the other. You either accept it or walk away."

Simon Schillebeeckx and Gaurav Nagar were speakers at the SMU Institute of Innovation and Entrepreneurship (IIE) Business Innovations Generator (BIG) fireside chat on fundraising that was held on 23 February 2022.

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