Note on Managing Investor Due Diligence
When Raising Capital for an Early-Stage Business

Raising capital for a startup business is a well-understood process that follows a fairly predictable pattern very similar to that required to sell big-ticket products or services to businesses. Therefore, it is instructive for entrepreneurs and startup teams to approach the capital-raising process as a business-to-business sales process – understanding, and planning for, the predictable sequence of marketing-and-sales steps necessary to generate interest among investors and to educate, screen, qualify and close those “sales” (investments in your startup). Think of the fund-raising process like this:

• A startup first develops a list of potential investors (in sales parlance, “unqualified suspects”).
• Next, the entrepreneur tries to reach these potential investors and generate interest, typically through presentations to potential investor groups and/or by providing them with an executive summary (sales managers would view this as “preliminary lead generation and qualification”).
• The startup then arranges meetings with investors who express interest (“qualified prospects”) during which they meet the management team and view a company presentation and possibly a product demonstration.
• After the preliminary meetings, those investors still interested will typically enter due diligence. This process entails performing detailed research on your company to either validate their initial positive impressions, or alternatively to uncover reasons that might make your business a less attractive investment. This process typically takes several weeks.
• Assuming encouraging results from due diligence, the investor and the startup company will negotiate purchase price and terms for the company’s stock – often by passing a draft term sheet back and forth that stipulates the specific stock price, terms of the security, etc. – very similar to the process a B2B vendor goes through in agreeing with a new customer on pricing of a large purchase.
• “Closing the sale” in capital-raising takes the form of a signed term sheet and/or a signed subscription agreement (which, in B2B sales, usually takes the form of a purchase order or signed purchase agreement from the customer).

Following in this Note are two items that entrepreneurs and startup teams may find useful as they pursue investment capital: an outline for a due diligence notebook, and a sample investor’s due diligence checklist.