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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.

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