

Knowledge Series

How to structure deals

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Introduction

Structuring deals is a pivotal aspect of angel investing, ensuring alignment and protection for both investors and entrepreneurs.

A well-structured deal provides clarity on investment terms, sets the foundation for a successful partnership, and mitigates risks.

In this article, we'll explore the essential components of structuring deals for angel investors, encompassing various investment instruments and strategies.

Understanding Investment Instruments

Equity Investment: Angel investors commonly acquire ownership stakes in startups through equity investment, purchasing preferred shares in exchange for capital.

Convertible Instruments: Convertible instruments, such as Convertible Cumulative Preference Shares (CCPS), Convertible Debentures, or Simple Agreements for Future Equity (SAFEs), offer flexibility. These instruments start as debt but convert into equity at a future funding round.

Valuation: Determining the startup's valuation is crucial for negotiating investment terms.

Key Considerations in Deal Structure

Rights and Preferences: Negotiating for certain rights and preferences, such as anti-dilution provisions, liquidation preferences, and voting rights, safeguards investors' interests.

Milestone-based Financing: Structuring investments based on milestones ensures capital deployment aligns with the startup's progress and achievement of key milestones.

Vesting Schedules: Implementing vesting schedules for founders' equity encourages long-term commitment and aligns interests between founders and investors.

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Legal and Regulatory Compliance

Due Diligence: Thorough due diligence is essential to assess the startup's financial health, market potential, and legal compliance.

Compliance Documentation: Drafting legally binding agreements, including Term Sheets, Shareholder Agreements, and Subscription Agreements, ensures clarity and protection for all parties involved.

Regulatory Compliance: Adhering to regulatory requirements and compliance standards, such as SEBI guidelines in India, mitigates legal risks for investors.

Negotiation and Communication

Transparent Communication: Open and honest communication fosters trust and collaboration between investors and entrepreneurs. Clear articulation of expectations, risks, and opportunities is essential.

Fair Negotiation: Negotiating fair terms that balance the interests of both parties is critical for building a strong foundation for the partnership.

Professional Guidance: Seeking advice from legal and financial experts specializing in startup investments provides valuable insights and ensures compliance with regulatory requirements.

Conclusion

Structuring deals involves a comprehensive understanding of investment instruments, deal structure considerations, legal compliance, and negotiation strategies. By adopting best practices and seeking professional guidance, angel investors can structure deals that mitigate risks, maximize returns, and support the growth of promising startups.