Digital Collective Africa

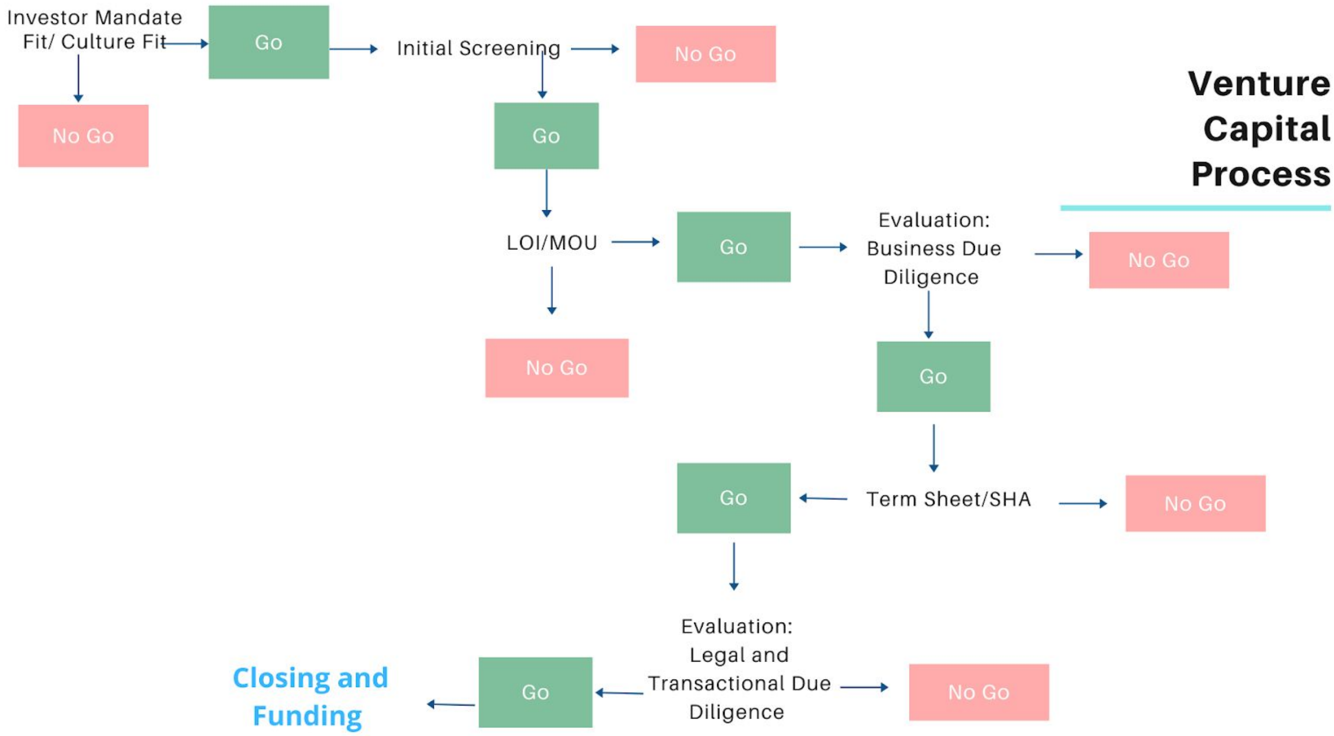
The fundraising process can be quite daunting, especially for founders raising seed or series A rounds. We have decided to focus on seed and series A vs. a series B because series B is more complicated with an already established methodology. Digital Collective Africa created this manual and checklist to increase the ease of cooperation between founders and investors. This document will provide an overview of the process, insights on why venture capitalists ask for what they ask for, and advice on how to prepare for the procedure.

The due diligence checklist is a standardized Pan-African checklist that provides a more accessible, thorough flow of information between founders and venture capitalists. Our goal is to ensure founders have increased visibility of what is expected of them when it comes to due diligence, improve accuracy and reduce the overall cost of the process.

Venture Capital Fundraising Process

The purpose of due diligence is to allow investors to get to know you and your firm and ensure your startup is the right fit for their portfolio. Additionally, the information you provide directly impacts the offer, or term sheet.

This process is a way to come clean. Founders must be honest with the venture capitalists with which they are working. While going through the due diligence process, if the founders realize they have missing documents, they should inform venture capitalists, and not try to get the document or create a temporary solution quickly. Venture capitalists either have the resources or will add it to the shareholder agreement as a milestone. A startup’s data room does not need to be 100% complete.


Venture Capital Process
Investor Mandate Fit/ Culture Fit
Go
No Go
Initial Screening
Go
No Go
LOI/MOU
Go
No Go
Evaluation: Business Due Diligence
Go
No Go
Term Sheet/SHA
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No Go
Evaluation: Legal and Transactional Due Diligence
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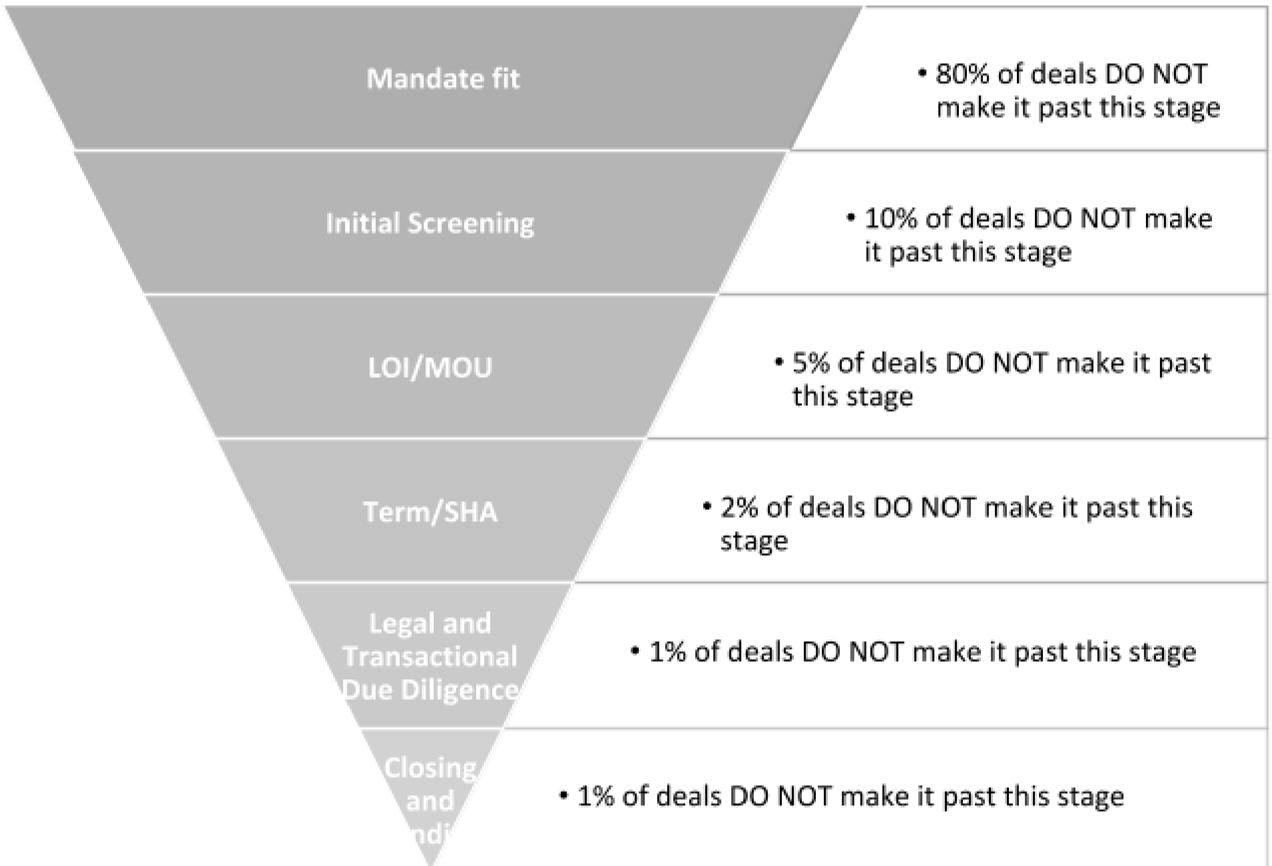
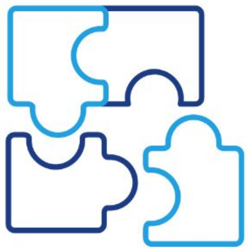
No Go
Closing and Funding

Venture Capital Deal Funnel

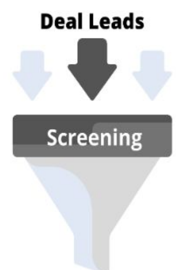


Stages in the Deal Process



Mandate Fit: The first thing that venture capitalists look at is fit. In this context, fit usually means geography, industry, and fundraising round. Founders should attempt to research investors they reach out to before coffee chats and cold emails. Many startups fall out of the pipeline during this stage because they pursue investors who may not invest in their type of company.

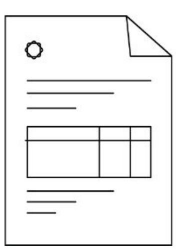
Initial Screening: Venture capital firms receive many deals through their network, referrals, pitch competitions, etc. They usually go through an initial screening process to find deals that fit their portfolio. This phase is all about investor-founder fit. The investor will go through the pitch deck and ask preliminary questions on the business plan and financials.



Questions for founders to ask investors:

- What is your typical process? What's the usual timeline?
- Aside from capital, how else do you support founders?
- What is your decision process?
- Which investment instrument does your firm typically use?
- How do you deal with conflict of interests?

- Founders should also reach out to portfolio companies to learn more about their experience with that particular venture capital firm.



LOI/MOU: Letter of Intent/ Memorandum of Understanding. This document is a non-binding NDA. This is where the investors spell out the terms and conditions of the investment in a similar manner to the term sheet.

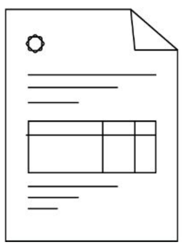
Questions for founders to ask investors:

- Are there terms or costs that deviate outside industry norms?
- What happens if we fail?
- What's a risk you are more comfortable with than the average VC?
- Founders are encouraged to negotiate and push back on terms laid out in LOI.

Business Due Diligence: After passing the initial screening, investors will do a deep dive into areas ranging from finance and taxes to "Know Your Customer" (KYC) on founders and the board. This is a critical phase in the founder/investor relationship. Investors view this part as the costly, risk assessment stage and look for potential risks and holes in the founder's paperwork and processes. Negative findings can either end a deal or impact the startup's valuation and, consequently, the term sheet.

Questions for founders to ask investors:

- What resources do you have to help me plug these holes?
- Which findings are ultimate deal breakers?
- How can the gaps be incorporated into milestones in the shareholders' agreement?



Term Sheet and Shareholders Agreement (SHA): Check out the [Southern Africa Term Sheet Guidance Note] for more information on the term sheet. Once the investors and founders sign the SHA, the investors will ask for exclusivity for 30-40 days. In other words, they want to be the only venture capital firm the founders interact with during the due diligence time frame.

Questions for founders to ask investors:

- How will this partnership help prepare me for future fundraising rounds?
- How can we ensure that we still maintain control of the board?

Legal and Transactional Due Diligence: Depending on the firm, legal due diligence is either done inhouse or outsourced to a law firm. This stage is where founders run into trouble and need to make sure they have all their paperwork and processes in tack. The best investors are those that are strong at conducting legal due diligence. If the startup gets passed this phase, investors will offer a subscription and shareholder agreement, also known as the term sheet. These documents may include conditions. For example, the investor may have discovered some less than ideal findings during the due diligence process. They may consist of a clause in the term sheet stating that certain items need to be remediated within the year before the firm receives the investment.

Closing and Funding

Term Sheet

Once the venture capital firm is ready to invest in the startup, they will offer the founder a term sheet which lays out the proposed agreement on future investment. For more information on the term sheet, please check out the Southern Africa Term Sheet Guidance Note we produced in conjunction with Endeavor South Africa.

Data Security and Storage

Investors and founders alike want to ensure that required due diligence data is kept safe. Currently, investors use tools such as Google Drive and Dropbox to store and organize due diligence data. Yue Diligence, an interactive web-based data room management tool, also exists to support founders and investors. Ansarada, an AI-powered virtual data room, is also used in this process for later-stage deals. Although all these methods work well, we have a few suggestions on how to improve the process.

- We propose structuring the data room so that it is in line with the checklist. This process will help founders keep track of their data and help founders, find what they need quickly.
- We suggest that startups sign an NDA with the venture capital firm before going into the Business Due Diligence phase. The purpose is to protect the founder and his confidential data from potential mishaps on the investor side.
- We propose that founders share their pitch deck via a link connecting them to a database controlled by the founder. This method will help the founder keep track of who is accessing the pitch deck and allow founders to control sharing.

Acknowledgments

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