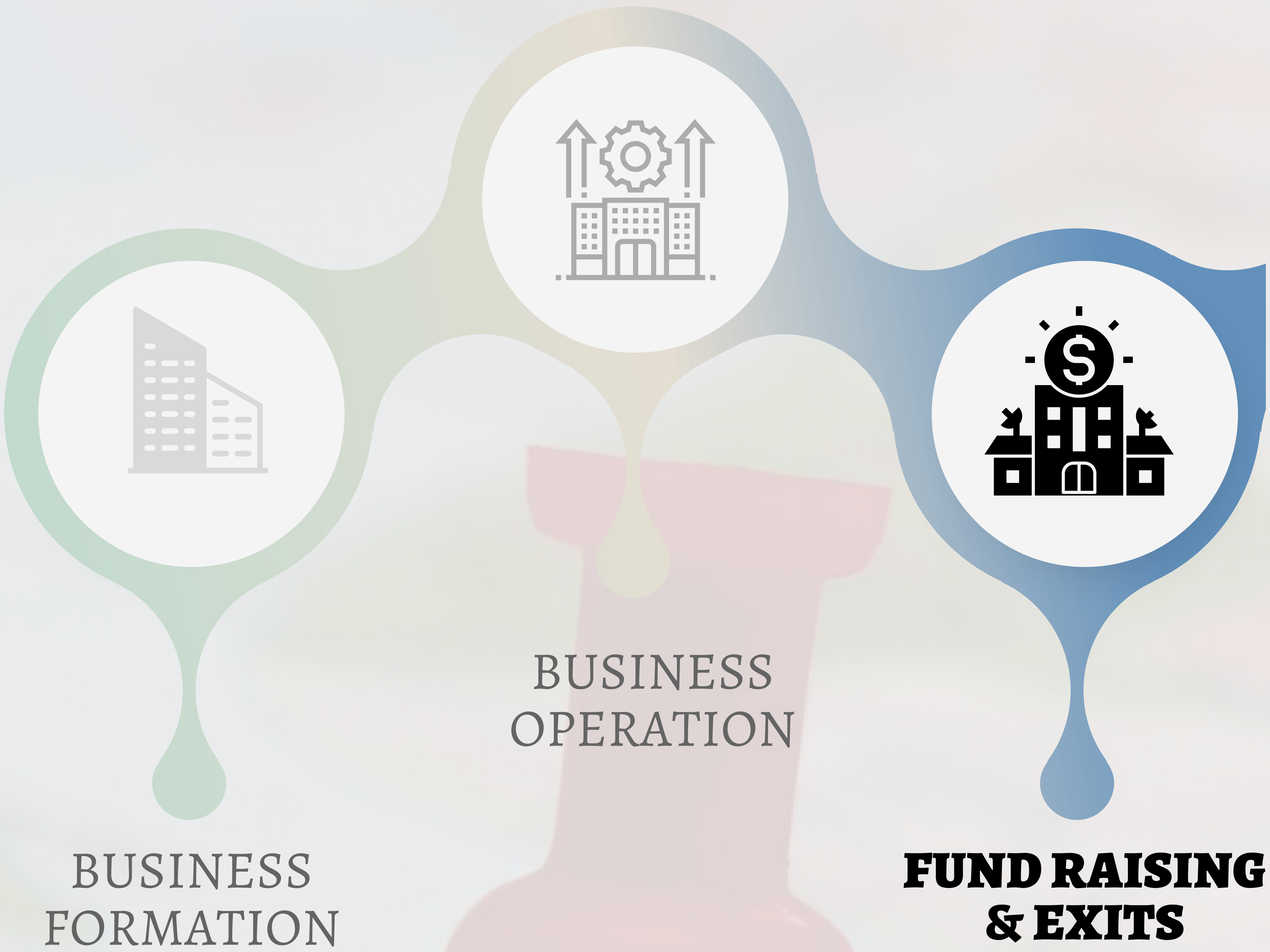
ROADMAP FOR TECH STARTUPS LAUNCHING IN NIGERIA

(PART 3)



Detail

PART 3- FUND RAISING & EXITS

House-Keeping

1. **Corporate Affairs:** It is important that before a start-up seeks to raise funds, it ensures that it is in compliance with required corporate filings and that its records at the Corporate Affairs Commission (CAC) are up to date. An important corporate filing required by all companies is the yearly filing of annual returns.

2. **Financial Obligations:** For start-ups that have raised funds in the past, it is imperative that they evaluate their obligations under the relevant transaction documents and how the obligations may have an impact on plans to raise future financing. Important questions here include: whether existing existing assets were pledged as security, restrictions to change in ownership, limitation on the lending threshold, etc.

3. **Regulatory and Tax Obligations:** The tech start-up will need to ensure that its sectoral licensing and regulatory requirements, including tax compliance, which it requires to legally operate in Nigeria are in place. This directly affects the ability to provide returns to the financiers, either in interest or dividends.

4. **Contractual Documentation:** It is important to document all contractual relationships with revenue generating customers/end users. Contracts should be clearly drafted, should address payment risks, and mitigate losses. Having properly drafted and negotiated contracts is key to strengthening investor confidence.

Detail

Sources of Financing For Start- Ups

There are two broad sources of financing available to start-ups - debt and equity. In some cases, you can have a combination of both.

DEBT FINANCING

1. This will include loans of different types provided by banks loans of various tenures from banks/ institutions/ individuals.
2. Usually with strict repayment obligations but does not involve the sale of shares or giving up of significant control.
3. It is important not to borrow excessively as lenders look favourably on a company with a good debt-to-equity ratio.
4. Transaction documents need to be reviewed to check for clauses such as restrictive covenants that place limitations on the tech start-up. Also, clauses on the assignment of receivables should be carefully considered to prevent future cash flow problems.

EQUITY FINANCING

1. This involves the investment in either cash or kind in return for shares in a start-up exchange of the shares of the start-up for investment.
2. There are no direct repayment obligations, but investors require a return on investment which is usually delayed.
3. A start-up should have a table disclosing the shareholding of each member and earmark the precise portion of the share capital to be made available to investors.
4. Founders are to consider whether they require active or silent investors based on the needs of the start-up. The type of investor can vary from angel investors to venture capitalists.

Detail

Stages of Equity Funding for Start-ups

1 Pre-Seed Funding

- Bootstrapping phase
- Typically use your own resources to get operations and the start up off the ground
- Here you are exploring the feasibility of building an idea into a product/service
- Market testing
- Develop a marketing and sales plan for the product launch

2 Seed Funding

- Here, a start-up receives help in determining its final products and demographics
- Launch product
- Build traction until revenue starts coming in
- Recruiting
- Developing the product for the market
- Potential Investors are angel investors, friends and family, micro-VCs and Crowdfunding

3 Venture Capital Phase

- Series A - Series A funding is to further develop products. At this stage, the start-up already has a track record in terms of revenue, clients and key performance indicators that are premised on future growth. Investment at this stage is less risky to investors than at the seed stage.

- Series B, C, D – These are funding stages used to move the start-up business to the next level beyond developmental stages, e.g., expansion into other markets geographically or product wise. There may be no need for Series D unless there is a need to push valuation ahead of an IPO or similar exit strategy.

Relevant Finance Agreements

Detail

Some key agreements used for equity and debt financing arrangements are discussed below.

Debt Financing Agreements

01 Term Sheet
The term sheet is typically not binding on the parties and is subject to the terms of the final transaction documents to be entered into by the parties. It sets out the broad terms under which the debt or equity financing will be provided to the start-up.

02 Loan Agreement
The Loan Agreement sets out the terms and conditions under which the loan is advanced to the start-up.

03 Security Documents
The Security Documents give lenders (banks) interest in assets or properties that are pledged as collateral. The terms and conditions in the Security Documents regulate how the lender recovers a loan when there is a default.

04 Loan Notes
The Loan Notes are legally binding promissory notes that list out the obligations of a lender and a borrower. A borrower can use Loan Notes as an alternative to cash and can be issued to multiple holders as part of seed fundraising.

05 Revenue Sharing Agreements (Debt based)
A Revenue Sharing Agreement assigns profits or an income generating stream of a Start-up to a lender. Repayment is tied to a percentage of the start-up's revenue and not monthly interest rates.

Equity Financing Agreements

01 Term Sheet
The term sheet is typically not binding on the parties and is subject to the terms of the final transaction documents to be entered into by the parties. It sets out the broad terms under which the debt or equity financing will be provided to the start-up.

02 Share Purchase Agreement
The Share Purchase Agreement is an agreement containing the terms for the sale of shares of a company.

03 Shareholders' Agreement
The Shareholders' Agreement is an agreement between shareholders on their respective rights and obligations with respect to the operation of the company.

04 Simple Agreement for Future Earnings (SAFE)
SAFE is an agreement between the start-up and an investor for the future conversion of an investment into equity. The convertible equity under a SAFE remains unvalued but the mechanism for its future valuation is agreed between parties. Investments under SAFEs are not loans and do have interest or maturity dates.

05 Convertible Notes
A Convertible Note is an agreement between the start-up and an investor for the conversion of an investment into equity when the condition method agreed to occur.

06 Revenue Sharing Agreements (Equity based)
A Revenue Sharing Agreement assigns profits or an income generating stream of a Start-up to an investor in exchange for financing. Repayment is flexible as it is tied to a percentage of the start-up's revenue and not monthly interest rates.

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