



# TERM SHEETS & DUE DILIGENCE

The documents and process that decide whether your deal closes

GUIDE 06

## Founders who understand these stages approach them with confidence.

The term sheet and due diligence process is where many investment deals succeed or fail. This guide explains every significant term sheet clause in plain English, tells you which ones to negotiate hardest, and walks you through exactly what investors will examine during due diligence — and how to prepare.

**GUIDE 06 | Business Lincolnshire Finance Accelerator**

**Who this guide is for:** founders who have had initial investor conversations and believe a term sheet may be coming.

### YOU'LL GET

- Plain-English guidance tailored to Greater Lincolnshire businesses
- Practical steps, checklists and decision points
- A clear route into Accelerator support and adviser conversations

**START:** Use this guide alongside the Finance Accelerator resources and book a fully funded Funding Diagnostic Session when you are ready to discuss your options.

## ABOUT THIS GUIDE

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The term sheet and due diligence process is where many investment deals succeed or fail. Founders who understand these stages approach them with confidence. Those who do not often make costly concessions, cause unnecessary delays, or — at worst — lose deals entirely.

### When to read this guide

Read this guide once you have had initial investor conversations and believe a term sheet may be coming — ideally before you receive it. The best time to understand a term sheet is before you are holding one.

## SECTION 1 — WHAT A TERM SHEET IS (AND IS NOT)

A term sheet is a short document — usually 5–15 pages — that sets out the proposed terms of an investment in summary form. Term sheets are described as 'non-binding' — but this understates their importance. Once signed, it is very difficult to renegotiate individual terms without damaging trust.

| Section               | What it deals with                                                               |
|-----------------------|----------------------------------------------------------------------------------|
| Economics             | Valuation, investment amount, share class, liquidation preference, anti-dilution |
| Governance            | Board composition, reserved matters, information rights                          |
| Founder provisions    | Vesting schedule, good/bad leaver provisions, lock-up                            |
| Transfer restrictions | Pre-emption rights, drag-along, tag-along, right of first refusal                |
| Process terms         | Exclusivity period, long-stop date, conditions to closing                        |
| Exit provisions       | Exit mechanics, IPO rights, co-sale rights                                       |

### Never sign without legal advice

Always take independent legal advice from a solicitor experienced in venture transactions before signing any term sheet. Budget £2,000–£5,000 for a first-round review — this is not an optional expense.

## SECTION 2 — ECONOMICS TERMS: THE NUMBERS THAT MATTER MOST

| Term                          | What it means                                                                                                                | Founder tip                                                                           |
|-------------------------------|------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------|
| <b>Pre-money valuation</b>    | The agreed value before investment — determines how much equity the investor receives                                        | Do not anchor too high or too low; use comparables and be ready to defend your number |
| <b>Liquidation preference</b> | 1× non-participating (standard and fair) vs 1× participating or 2×+ (founder-unfriendly)                                     | Push hard for 1× non-participating                                                    |
| <b>Anti-dilution</b>          | Protection if a future round prices lower — broad-based weighted average is market standard; full ratchet is highly punitive | Accept broad-based; resist narrow-based or full ratchet                               |
| <b>Option pool</b>            | Shares reserved for future employee/advisor grants, typically 10–15%                                                         | Negotiate for it to be created post-money and sized to actual near-term hiring needs  |

## SECTION 3 — GOVERNANCE TERMS: CONTROL OF THE BUSINESS

| Term                      | What it means                                                                                             | Founder tip                                                                                |
|---------------------------|-----------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------|
| <b>Board composition</b>  | Typical early structure: 2 founder directors, 1 investor director, 1 independent chair                    | Ensure founders retain a majority; pursue a genuinely neutral independent chair            |
| <b>Reserved matters</b>   | Decisions requiring investor consent regardless of shareholding — issuing shares, debt, key hires, budget | Push back on any matter requiring approval for day-to-day operations                       |
| <b>Information rights</b> | Monthly/quarterly management accounts, annual audited accounts, budget, key metrics                       | Agree a clear format and stick to it — you should be producing these anyway                |
| <b>Founder vesting</b>    | Typically 4-year vesting with a 1-year cliff                                                              | Negotiate past service credit, a fair good/bad leaver definition, and acceleration on sale |

## SECTION 4 — TRANSFER AND EXIT TERMS

| Term                                        | Plain-English explanation                                                                      |
|---------------------------------------------|------------------------------------------------------------------------------------------------|
| <b>Pre-emption / right of first refusal</b> | Existing shareholders get first opportunity to buy shares before external sale                 |
| <b>Drag-along</b>                           | If a specified majority (e.g. 75%) agree to sell, all shareholders must sell on the same terms |
| <b>Tag-along</b>                            | If majority shareholders sell, minority shareholders can sell on the same terms                |
| <b>Lock-up period</b>                       | Typically 12–24 months post-investment during which founders cannot sell shares                |
| <b>Co-sale rights</b>                       | Investors can sell a proportional number of shares alongside founders                          |

### Founder tip on drag-along

Drag-along rights are standard and generally acceptable. Ensure the threshold is set high enough (75%+) and the price triggers are fair.

## SECTION 5 — PROCESS TERMS

| Term                         | What it means and why it matters                                                                      |
|------------------------------|-------------------------------------------------------------------------------------------------------|
| <b>Exclusivity period</b>    | Typically 4–8 weeks during which you cannot approach other investors — reasonable if short            |
| <b>Long-stop date</b>        | The deadline by which the investment must close, or either party can walk away                        |
| <b>Conditions to closing</b> | Things that must happen before completion — legal due diligence, reference checks, EIS/SEIS assurance |
| <b>Governing law</b>         | For UK businesses this should always be English law                                                   |

### Negotiate the exclusivity length

A 4-week exclusivity period is reasonable; eight weeks is long. Negotiate the shortest period you can, with clear grounds to end it early if the investor fails to meet agreed milestones.

## SECTION 6 — DUE DILIGENCE: WHAT INVESTORS WILL EXAMINE

Due diligence is the investor's process of verifying the claims you have made. It can feel invasive and slow — but it is entirely normal and a sign the investor is serious.

| Area              | What they examine                                                                | Common issues found                                                            |
|-------------------|----------------------------------------------------------------------------------|--------------------------------------------------------------------------------|
| <b>Financial</b>  | Accounts, forecast, bank statements, existing debt, tax position                 | Personal expenses in the business, VAT/PAYE arrears, overstated revenue        |
| <b>Legal</b>      | Constitution, cap table, employment contracts, IP ownership, disputes            | Founder IP not formally assigned to the company; missing IP assignment clauses |
| <b>Commercial</b> | Customer pipeline, contracts, concentration risk, competitive position           | Revenue concentrated in one customer; inflated pipeline                        |
| <b>Technical</b>  | Code quality, architecture, security, manufacturing/supply chain (if applicable) | Single-developer codebase with no documentation; risky licensing dependencies  |
| <b>People</b>     | Founder backgrounds, key person risk, references                                 | CV gaps that do not add up; unresolved co-founder disputes                     |

### The golden rule of due diligence

Disclose everything material before investors find it themselves. What destroys trust is discovering a founder knew about something and chose not to mention it.

## SECTION 7 — THE DUE DILIGENCE CHECKLIST

Use this checklist to prepare before investor conversations begin.

|                                    |                                |                                    |                                |
|------------------------------------|--------------------------------|------------------------------------|--------------------------------|
| Filed accounts (2–3 years)         | <input type="checkbox"/> Ready | Cap table & share register         | <input type="checkbox"/> Ready |
| Management accounts (6–12 mo)      | <input type="checkbox"/> Ready | Articles & Shareholders' Agreement | <input type="checkbox"/> Ready |
| 3-year financial forecast          | <input type="checkbox"/> Ready | IP assignments & registrations     | <input type="checkbox"/> Ready |
| Bank statements (6 months)         | <input type="checkbox"/> Ready | Key customer/supplier contracts    | <input type="checkbox"/> Ready |
| Existing debt schedule             | <input type="checkbox"/> Ready | Employment contracts (key staff)   | <input type="checkbox"/> Ready |
| Tax position / HMRC correspondence | <input type="checkbox"/> Ready | EIS/SEIS advance assurance         | <input type="checkbox"/> Ready |
| Founder CVs                        | <input type="checkbox"/> Ready | Litigation / disputes disclosure   | <input type="checkbox"/> Ready |
| Data protection / GDPR evidence    | <input type="checkbox"/> Ready | Insurance details                  | <input type="checkbox"/> Ready |

## SECTION 8 — MANAGING THE DUE DILIGENCE PROCESS

Set up a dedicated data room — do not email documents back and forth. Organise it clearly by category, control access to only what has been requested, and keep a log of what has been shared and when.

### **Communicate proactively**

Appoint one due diligence lead. Respond to requests within 24–48 hours. If something is taking longer, say so — radio silence is far worse than 'working on it'. Flag issues before investors find them.

Some findings are genuinely deal-breakers; most are manageable. Do not minimise a finding — acknowledge it and come with a plan. Your solicitor can help assess significance.

## SECTION 9 — FROM TERM SHEET TO CLOSE

| Stage                                    | What happens                                                                               |
|------------------------------------------|--------------------------------------------------------------------------------------------|
| <b>Solicitors instructed</b>             | Both parties appoint solicitors; the investor's solicitor typically leads on documentation |
| <b>Investment Agreement drafted</b>      | Shareholders' Agreement, subscription agreement, and associated documents                  |
| <b>Negotiation of legal docs</b>         | Most terms mirror the term sheet, but detail requires further discussion                   |
| <b>Board &amp; shareholder approvals</b> | Must formally approve the investment before completion                                     |
| <b>Completion</b>                        | Documents signed, shares issued, money transferred, filings made                           |
| <b>Post-completion</b>                   | EIS/SEIS compliance documentation, HMRC notified, investor certificates issued             |

### Typical timelines

From signed term sheet to completion typically takes 4–8 weeks for an angel round, and 6–12 weeks for an institutional round. Build this into your runway planning.

## SECTION 10 — GLOSSARY

|                                 |                                                                                    |                                       |                                                                                               |
|---------------------------------|------------------------------------------------------------------------------------|---------------------------------------|-----------------------------------------------------------------------------------------------|
| <b>Anti-dilution</b>            | Protection for investors if the company raises at a lower valuation in future      | <b>Drag-along</b>                     | The right of majority shareholders to require minority shareholders to sell on the same terms |
| <b>Bad leaver</b>               | A departing founder/employee who forfeits unvested equity                          | <b>Exclusivity</b>                    | A period during which the company agrees not to approach other investors                      |
| <b>Break fee</b>                | A payment made by the party that withdraws from a deal without cause               | <b>Full ratchet</b>                   | An anti-dilution form highly punitive to founders in a down round                             |
| <b>Co-sale rights</b>           | The right of investors to sell alongside founders                                  | <b>Good leaver</b>                    | A departing founder/employee who retains vested equity                                        |
| <b>Conditions to closing</b>    | Things that must happen before completion                                          | <b>Information rights</b>             | The investor's right to receive financial and operational data                                |
| <b>Data room</b>                | A secure repository of documents shared during due diligence                       | <b>IP assignment</b>                  | Legal transfer of IP ownership from an individual to the company                              |
| <b>Disclosure letter</b>        | Exceptions or qualifications to warranties given by founders                       | <b>Liquidation preference</b>         | The right to a specified return before ordinary shareholders                                  |
| <b>Long-stop date</b>           | The deadline by which the investment must complete                                 | <b>Option pool</b>                    | Reserved shares for future employee/ advisor grants                                           |
| <b>Participating preference</b> | A founder-unfriendly liquidation preference that also shares in remaining proceeds | <b>Pre-emption rights</b>             | Existing shareholders' right to invest before new parties                                     |
| <b>Reserved matters</b>         | Decisions requiring investor consent regardless of ownership %                     | <b>SHA</b>                            | Shareholders' Agreement — the binding contract governing the company                          |
| <b>Tag-along</b>                | Minority shareholders' right to sell on the same terms as majority                 | <b>Vesting</b>                        | A schedule over which equity is earned — typically 4 years with a 1-year cliff                |
| <b>Warranties</b>               | Contractual representations about the state of the business                        | <b>Weighted average anti-dilution</b> | A founder-friendlier form adjusting conversion price by round size                            |

## START YOUR JOURNEY TODAY

Visit our website to learn more and access support

## Ready to move forward?

The Business Lincolnshire Finance Accelerator gives you the knowledge, tools and expert support to understand your options and prepare to access funding at the right time, in the right way.

### FIND OUT MORE

- Book a fully funded Funding Diagnostic Session
- Access Finance Accelerator tools and templates
- Speak to an experienced Business Lincolnshire adviser

### FIND OUT MORE



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