When Negotiating Term Sheets, How Much Is Too Much?



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It was pounding rain outside my bedroom when my co-founder bursted through the door in a panic. He didn't wait for my reaction to explain his ever pressing fear.

"One of our investor leads is on the phone and he's about to walk away. He said we were too aggressive! How do we save this?

I responded immediately: "What did we do? We asked way too much on the valuation, right?"

"I bid him up on price too much and he is just threatening to walk away. He is not even picking up the phone. He just

periodically texts me now. It’s very scary.”

“Give it some time,” I responded. “Then, let him get in touch with you on his schedule. Make him want to come to you.”

Although my co-founder and I quickly closed this particular deal in a matter of days, it shows how entrepreneurs can take a negotiation too far with investors and easily screw up a potential investment.

The pandemic has historically upended the venture capital market. According to Techcrunch, anecdotal evidence indicates the venture market has either frozen in place or is barely limping along. Data from CB Insights bears this out, with seed venture deals down cumulatively 22 percent year over year from 2019-2020. And that’s just for the second quarter. Since venture data historically lags macro trends, we may be in for even more shocks to the system.

In this environment, entrepreneurs will find it incredibly challenging, Herculean even, to raise capital. Aside from focusing on profitability and the fundamentals of their business, entrepreneurs may be chastised when entering what has rapidly shifted to a buyer’s market. Unfortunately, and if they need to, this means entrepreneurs must accept venture terms that may have been unfathomable just months prior. And it means they must negotiate and fight for what matters to them.

Still, how can an entrepreneur know if their negotiation is going too far? If “too much is just too much”? Luckily, there are some ways to maneuver around this trap. Namely, entrepreneurs must seek guidance from their advisors and other investors constantly in the negotiation process. And secondly, entrepreneurs must research comparative deals, published reports and other sources to truly understand whether their set of asks may push a negotiation too far.

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Lean on Advisors for Guidance

One of the few times I truly enjoyed the negotiation process was when I was stuck in traffic in San Francisco. While on the phone with the prospective investor, I was also furiously texting one of my advisors on specific arrangements in a potential term sheet. Rather than going back and forth for hours, the advisor texted me three key terms to ask for, and the investor and I were at a deal in less than 15 minutes.

Advisors are the lifeblood of any business. Recruiting them is critical to hiring, growth, customer development and eventual success. But it's also critical to raising capital, as many of your advisors may also be your first investors. Oftentimes former entrepreneurs themselves, they have been through the ups and downs of raising capital. They can tell you when your valuation, negotiating skills and focus on specific terms is not warranted or even throwing a deal in jeopardy. They can spot the signals – both in communication cadence and body language – that indicate you are asking "too much" in your deal and a potential investor is pulling away. Collectively, when taking into account the experiences of all your advisors, you may have thousands of hours of capital raising advice.

Use their advice. Listen to them. You won't regret it. Advisors can be critical in pushing you to not focus on the terms that matter and get your negotiation back on track.

One important lesson: you can even go to other investors for advice. Investors are always eager to talk business ideas and proffer advice. Their experience listening to, on average, more than 3,000 pitches a year, will be invaluable in negotiation. And there is a saying with investors, "Ask for advice, get investment."

Research. Research. Research.

If, after many rounds of negotiation, you still feel you are not getting the best terms for your company and you need capital, you should engage in extensive third-party research to understand the true scope of the market.

Venture terms are incredibly dynamic and subject to constantly changing market forces. They are also private and not widely reported, so you need to do some intensive homework and investigation to understand if you are getting a good deal or asking “too much.”

First, you can ask other founders for comparative data to see what they are getting in terms of valuation, stock options and other terms that are relevant for the initial team. This will give you a good read on the status of the market. Often, other founders over-report and share their struggles on platforms like Twitter and even Quora, but you should back this up with first-hand accounts.

Second, you can turn to third-party verified reporting databases like CB Insights, AngelList and Crunchbase to get a historical breakdown of round size, pricing and valuation metrics to benchmark your requests against what is being reported at large.

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The Right Deal is Waiting for You.

Even in these extraordinary times, if you have a fundamentally strong business idea, you will find investors that jump at the chance to partner with you. When they do, you need to know how much is “too much” when negotiating the investment term sheet. You can make this process easier by relying on your trusted advisors for guidance and counsel, as well as focusing on

third-party research to obtain comparable data.

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