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Looking for Venture Capital Investment?
How to Use Due Diligence to Your Advantage

By Seth I. Rubin, Esq.

For those entrepreneurs who have ever tried to obtain venture capital (VC) funding, just the sound of the words due diligence can bring back memories of a stressful, time-consuming and demanding process. But due diligence does not have to be so. With the proper preparation and presentation, you can use due diligence to your advantage and increase your chance of obtaining VC investment.

At the outset, entrepreneurs should understand that due diligence is a process by which VCs evaluate a potential investment and hope to confirm what they think they already know about a business. To use this process to your advantage, you must understand the due diligence process from the VC perspective: What documents and information do VCs want to see? What form should the materials take? Should you hide negative information about your business?

Let's start with numbers -- that is, detailed and accurate financial statements and information regarding your business. These numbers should be given on a current and historical basis and should be updated on an interim basis. VCs will also want to see all key contracts with third parties and with your own personnel. VCs will want documentary proof, were available, that the assets your business purports to own – whether it be intellectual property, customer contracts or anything else – are actually owned by you.

The presentation of information to VCs should be seamlessly handled. All key documents should be available for delivery immediately upon request, as delays may be misconstrued as disorganization throughout your business or simple sloppiness. Either way, this is not the kind of impression you want to make with people you're trying to convince to put money in your company. A good practice when seeking VC money is to organize all records and agreements in chronological order and by document type. This kind of meticulous preparation, if done on a continuous basis, can be relatively pain-free and will make a positive impression.

Entrepreneurs often ask how much they should embellish the prospects of their business or whether they should hide potential negatives. While you don't need to dwell on negatives, you should ***never*** lie about your business or agreements you purport to have with third parties. For starters, you are looking to form a partnership with your VC investor, not simply separate it from its money. Second, investment documents you enter into with your VC investor will contain representations and warranties that protect the VC and could result in the payment by you of damages to the VC. Third, hiding serious potential negatives about your business will do nothing more than prove to VCs that you are not deserving of their money.

Due diligence should be used to make a positive statement about you and your business. Organize yourself and your documents to accentuate the strengths of the business but also to explain potential problems. Finally, due diligence should be used to continue to build a foundation of trust and partnership with your prospective VC investor.

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