USBC 360°
Legal Session 2

Capital Raising for Early-Stage Companies

About Basswood

Navigating Legal Complexities With Care

Basswood Counsel is a boutique law firm specializing in complex business transactions, including mergers and acquisitions, corporate law, and international tax structuring. Our experienced team offers personalized attention, combining large-firm sophistication with the accessibility of a smaller practice.

Our Services

We provide top-tier legal services tailored to your needs, covering tax planning, corporate finance, cross-border transactions, and securities. Combining global reach with he personalized attention of a boutique practice, we deliver expert legal strategies to help you achieve your goals.

Business & Finance

- General Corporate
- Fund Formation & Investment Management
- Emerging Companies Startups
- Infrastructure Project Development & Project Finance

Tax

- Corporate Fiduciary Representation
- Corporate Tax
- Executive Compensation
- International Tax
- State & Local Tax (SALT)
- Tax Controversy & Litigation
- Tax-Exempt Organizations
- Estate Planning

Family Office

- Family Office Services
- Wealth & Estate Planning

Meet The Team

Our team, composed of attorneys with both domestic and international training, stands ready to navigate the complexities of your legal needs with sophistication and a bespoke approach.

Jephte Lanthia

Equity Partner and Co-Founder

Jephte Lanthia advises on corporate and securities, fintech, and investment management, assisting fund managers and founders with securities offerings, broker-dealer regulation, and regulatory compliance matters. Before co-founding Basswood Counsel, he served as Special Counsel at the Advocate for Small Business Capital Formation at the U.S. Securities & Exchange Commission (SEC).

Connect with Jephte
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Hazvinei Mugwagwa

Of Counsel

Hazvinei approaches deal-making and transactions like soccer, valuing teamwork and achieving success when every participant brings their best effort to deliver optimal outcomes on and off the field.

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Presentation Purpose

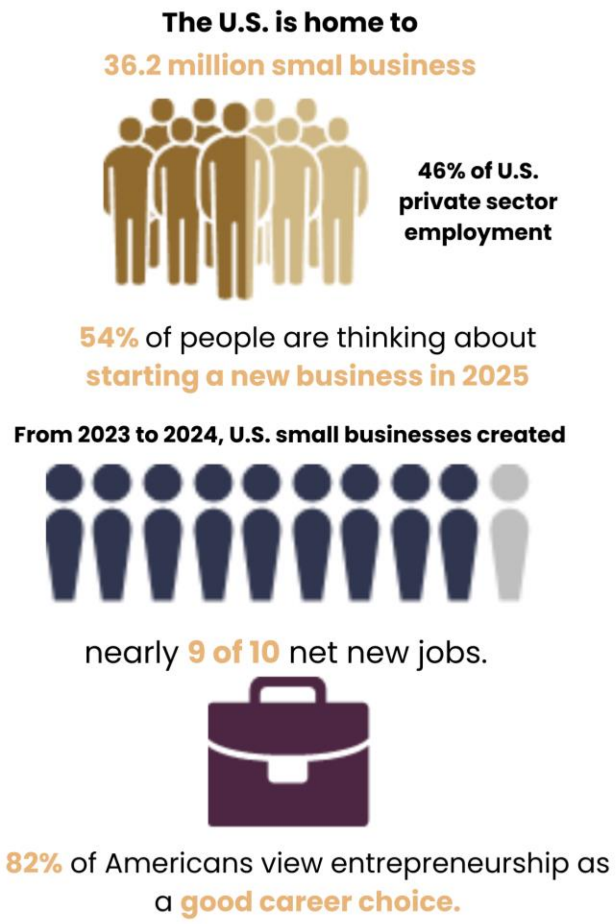
This deck is not only about compliance. It is meant to help founders — especially first-time founders — understand the investor landscape and how seasoned investors think, so they can negotiate more effectively knowing the lay of the land. Covering securities laws and key terms is meant to make founders more fluent when discussing raises, disclosures, and risk with investors.

Presentation Roadmap

- **Setting the stage** — why access to capital matters for small businesses, and the start-up-to-exit lifecycle (grants, loans, and securities as the three paths to funding).
- **The investor landscape** — types of investors, venture capital funds by stage, and how the venture fundraising process works end-to-end.
- **The regulatory framework** — securities transaction types, offering pathways (Regulation D, Regulation CF, Regulation A), the IPO/registered offering process, the private offering process, and broker-dealer considerations.
- **Deal mechanics** — SAFEs, convertible notes, equity securities (preferred vs. common), and the economics-vs-control framework that drives every negotiation.
- **The numbers behind the deal** — key economic terms, company valuation, and the capitalization table.
- **Practical takeaways** — fatal mistakes founders make when negotiating with VCs, and best practices for financing and raising capital.

Why is access to capital for small businesses so important?

Small business remain central to our society, economy, and the American dream.



Staff Report from the Office of the Advocate for Small Business Capital Formation, Fiscal Year 2025, U.S. Sec. & Exch. Comm'n (Jan. 8, 2026), https://www.sec.gov/files/2025-oasb-staff-report.pdf.

However, the cost to start a business often prevents entrepreneurs from achieving this dream.

Staff Report from the Office of the Advocate for Small Business Capital Formation, Fiscal Year 2025, U.S. Sec. & Exch. Comm'n (Jan. 8, 2026), https://www.sec.gov/files/2025-oasb-staff-report.pdf.

Start-Up to Exit

Timeline: Start-up → Growth/Scaling → Exit (M&A or IPO)

- Founders should always be thinking about the exit, whether via M&A or IPO.
- Planning early lets founders prepare and stay exit-ready.
- A company with governance or compliance gaps may struggle to exit cleanly — a buyer (in M&A) or the SEC (in an IPO) will ask many questions, delaying the process.
- Corporations are perpetual entities — they live on until dissolved. Human beings, including founders, are not perpetual. Founders will eventually have to leave, which is part of why exit planning matters.

Growth and Scaling Require Money

81% of small business owners who applied for a business loan or line of credit found it difficult to **access affordable capital.**

40% of small businesses seeking financing and credit products **sought less than $50,000** in capital

Over the last decade, the number of small banks **decreased by 49%.**

Entrepreneurs reported access to capital as the **#1 obstacle limiting growth** in their business.

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Before a company can exit, it has to grow and scale — and that requires money. There are three general ways of raising money or financing:

- Grants
- Loans
- Securities

Grants

Grants are often called "free money," but they are not truly free. They come with requirements, provisions, and compliance obligations.

- Not dilutive to the company — no equity is given up.
- Founders must weigh the time and effort required to apply for and receive a grant against the practicality of using it to fund the business.

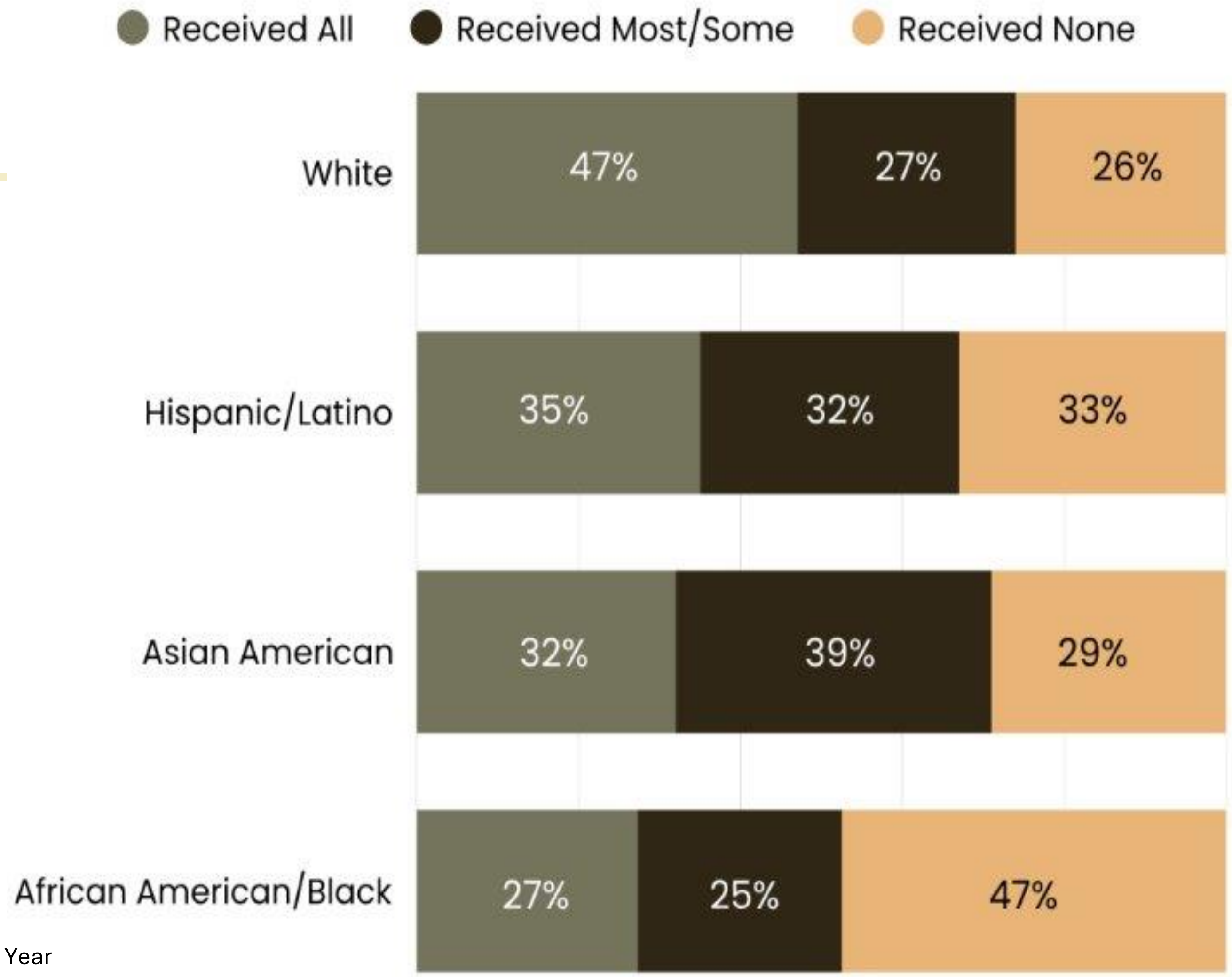
Loans

Loans, like grants, are not dilutive — no part of the company is given away. But a loan must be repaid.

- Terms depend on the interest rate and the amount a bank is willing to lend.
- Sidebar: CDFIs (Community Development Financial Institutions) — worth knowing which CDFIs operate in your state and registering with them.
- CDFIs and MDIs, particularly CDFIs, generally offer loans at lower rates than traditional banks.

Loans

•Many founders sought capital through a small business loan or line of credit, but the amount received varied.



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Securities

Most founders finance their business through a securities offering by inviting investors to invest in their business.

https://www.sec.gov/resources-small-businesses/capital-raising-building-blocks/private-companies-sec

The Securities and Exchange Commission (SEC)

The SEC was created in 1934 in response to the 1929 crash. It has three core missions:

- Protect investors
- Facilitate capital formation
- Maintain efficient markets

Every business that raises money through an instrument other than a loan or grant has likely touched the securities world in some way. Whenever a company is raising money or discussing investors, the first question should be whether securities are involved — and to contact a securities attorney.

What is a Security?

Federal securities laws broadly define the term "security," capturing many different forms of investment interests. Some types of securities that startups often issue include:

- Stock
- Membership Interest
- Stock Option
- Restricted Stock
- Convertible Instruments
- Debt

Types of Securities: Debt vs. Equity

Securities generally fall into two buckets, with variations within each:

- Debt – money borrowed that must be paid back.

- Equity - giving up part of the company; if the investor loses their investment, there is often no requirement to pay it back.

Each type of security reflects a different level of risk to the investor.

Defining Key Security Types

Debt Instruments

- Bonds — a formal, longer-term debt instrument where the company borrows a set principal amount and repays it at maturity, with periodic interest (coupon) payments.
- Notes — a general term for a debt instrument (a written promise to repay a loan with interest), often shorter-term and more flexible than bonds.
- Convertible notes — a debt instrument that starts as a loan (accrues interest, has a maturity date) but is designed to convert into equity — typically preferred shares — at a future priced round.

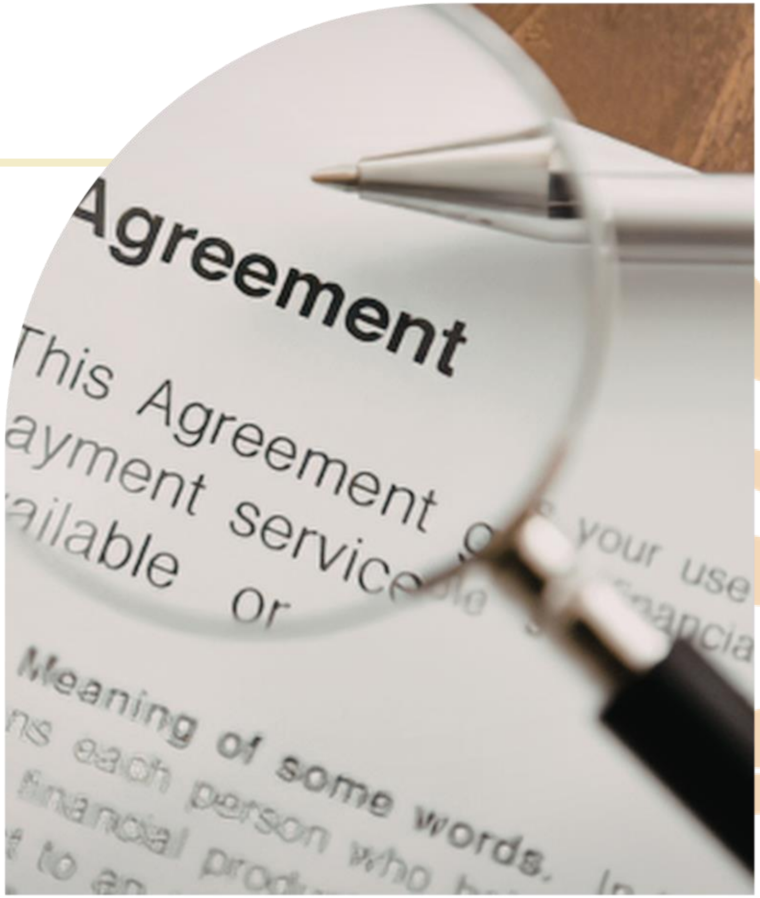
Equity Instruments

- Preferred shares — equity with preferential rights over common stock, including a liquidation preference and often anti-dilution protection, board seats, or voting rights.
- Common shares — the basic equity ownership stake, typically held by founders and employees; no liquidation preference, paid last in a dissolution, but full upside participation.

Defining Key Security Types

Hybrid Instrument

- SAFEs (Simple Agreement for Future Equity) — not debt, no interest or maturity date; gives the investor the right to receive equity at a future priced round, usually with a valuation cap and/or discount.



Payout Order on Dissolution or Bankruptcy

In a dissolution or bankruptcy proceeding, proceeds are generally paid out in this order (highest priority first):

1. Loans, debts, and notes – paid first, in full, before others
2. Preferred equity – paid after debt is satisfied
3. Common stock – paid last, only if funds remain

Every business that raises money through an instrument other than a loan or grant has likely touched the securities world in some way. Whenever a company is raising money or discussing investors, the first question should be whether securities are involved — and to contact a securities attorney.

Types of Investors

- **Family and friends** — invest based on personal trust rather than formal due diligence; often the first outside "friends and family round." Still subject to securities law compliance even though investors are personally close to the founder. Typically smaller, simpler terms (a basic note or SAFE).

- **Angel investors** — invest personal capital directly in early-stage companies for equity or convertible instruments, generally at the seed stage (after friends and family, before institutional VC). Angel investors are generally high-net-worth individuals who invest their own money directly in emerging businesses. Most angel investors are accredited investors, and many are current or former entrepreneurs themselves.

- **VC funds** — professionally managed pooled investment funds that raise capital from limited partners and deploy it into early-stage, high-growth companies for equity. A venture capital (VC) fund is a type of private fund that typically invests in rapidly growing companies, often with a specific industry focus.VC funds are typically structured to last at least ten years, with the first few years focused on investing in portfolio companies, followed by monitoring their investments, and then "exiting" and hopefully returning a profit to their own investors (or limited partners).

Comparison

	Friends & Family	Angel Investors	Venture capital funds
Investor profile	Personal network of the founders; investing on relationship rather than industry expertise	High-net-worth individuals, often current or former entrepreneurs; most are accredited investors	Private funds pursuing a venture capital strategy; typically structured to last at least 10 years
Company Stage	Pre-seed or seed round	Seed through Series A	Series A through IPO; often reinvest in later rounds.
Investment structure	Direct investment (not through a fund); loans, convertible debt, or equity	Direct investment, often syndicated with other angels; convertible debt or equity	Usually equity (e.g., preferred stock); funds may syndicate together
Level of involvement	Generally passive; not actively involved in oversight	Often active — board or advisory board seat, strategic industry guidance	Active — board seat, mentoring, help with hiring, customers, and follow-on capital
Scale of investment	Typically $10,000 to $50,000 per deal	Typically $200,000 to $400,000 per deal (syndicated); angels invested over $17.9 billion in early-stage companies in 2024	Not disclosed per deal; total VC investment grew from approximately $164 billion (2023) to approximately $215 billion (2024)

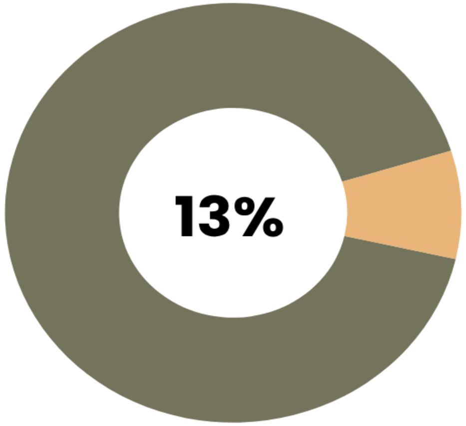
This summary is for general informational purposes and does not constitute legal advice. See the full SEC resource at sec.gov/resources-small-businesses/capital-raising-building-blocks/early-stage-investors.

Accredited Investor

Under SEC Rule 501(a) of Regulation D, individuals may qualify as accredited investors based on wealth, income, or financial sophistication criteria. The most commonly used tests: individual income exceeding $200,000 in each of the past two years ($300,000 combined with a spouse or partner), or net worth exceeding $1 million excluding a primary residence. A third pathway allows qualification through certain professional credentials. This status generally determines who can participate in private, unregistered securities offerings.

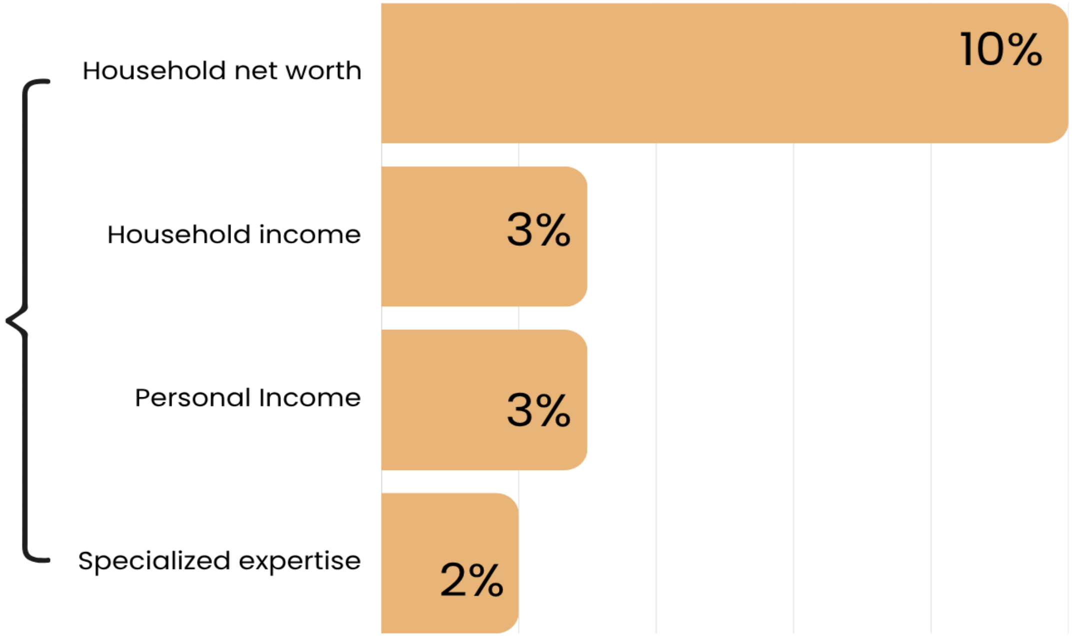
https://www.sec.gov/resources-small-businesses/capital-raising-building-blocks/accredited-investors

What does the pool of accredited investors look like?



of the U.S. population
qualifies as an
accredited investor

Those individuals qualify based on:



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What does the pool of accredited investors look like (cont.)?

Accredited investors are

nearly **3X** more likely

to be interested in

investing in new or private companies

as compared to the total U.S. population.[46]

SCAN FOR MORE INFO

ACCREDITED INVESTORS

Angel investors are a vital component in creating the next generation of startups.

Staff Report from the Office of the Advocate for Small Business Capital Formation, Fiscal Year 2025, U.S. Sec. & Exch. Comm'n (Jan. 8, 2026), https://www.sec.gov/files/2025-oasb-staff-report.pdf.

VC Funding to Black-Founded Startups

Share of total U.S. venture capital funding going to Black-founded or Black co-founded startups, by year:

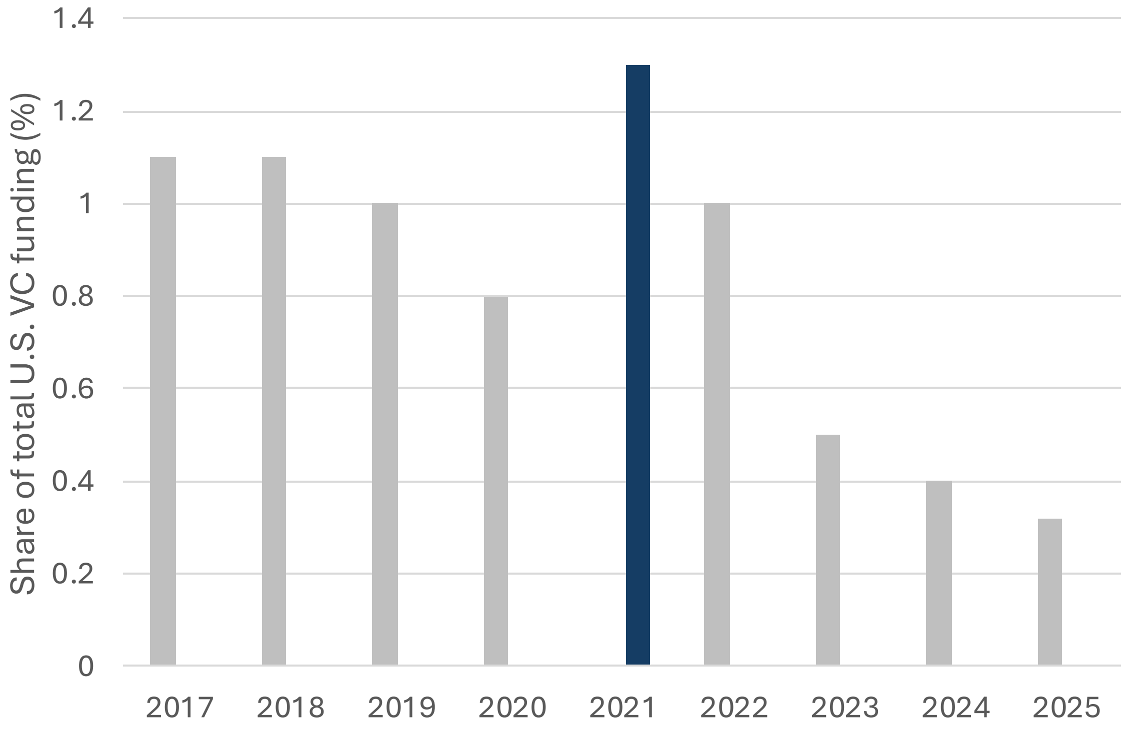
Year	Share of total U.S. VC Funding
2017	1.1%
2018	1.1%
2019	1.0%
2020	0.8%
2021	**1.3% (peak)**
2022	1.0%
2023	<0.5%
2024	-0.4%
2025	0.32% (-$942M)

2026 context: **Black founders raised $643M** in the opening months of 2026 — nearly 70% of 2025's full-year total — though this remains a **small fraction of the $252 billion raised by all U.S.-based startups,** and the gains were driven largely by a handful of standout deals rather than broad-based growth.

Series A funnel gap: a 2024 HBCUvc report found **only 17% of Black-founded deals reached Series A**, compared to 37.7% overall.

Source: Crunchbase data. https://techcrunch.com/2023/01/11/funding-for-black-founders-remains-dismal-where-do-we-go-from-here/

Share of Total U.S. VC Funding to Black-Founded Startups (2017-2025)



Founders received the following percentages of equity venture funding in 2023:

2%

Went to Middle Eastern founders (up from 1% in 2021)

0.6%

Went to African American/Black founders (down from 1.2% in 2021)

1%

Went to Hispanic/Latino founders (down from 5% in 2021)

39%

Went to Asian American founders (up from 37% in 2021)

57%

Went to White founders (up from 56% in 2021)

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Women founders face challenges that can hinder expansion and growth.

Access to Funding	That is critical to their startup's success.
	42% of women entrepreneurs who applied did not secure a **bank loan**.
Less established networks	**50%** of women entrepreneurs struggle to find **help to start their business.**
	27% of women entrepreneurs **lacked mentorship**
	66% of women entrepreneurs believe **access to capital**

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Types of VC Funds by Stage

Fund Type	Typical AUM	Characteristics
Micro Funds	\$5M - \$50M	Small checks (\$100K–\$750K) into **pre-seed/seed** deals; often solo GPs or small teams.
Seed stage funds	\$50M - \$200M	Invest after friends/family/angels; company has an idea or early product, little to no revenue.
Early stage funds (Series A/B)	\$100M - \$500M	Company shows product-market fit and some revenue; funds focus on scaling the business model.
Mid stage funds (Series C/D)	\$500M - \$1B+	Company has proven traction and revenue growth; capital used to expand market share, hire, or enter new markets.
Late stage funds	\$1B - \$5B+	Company is mature, often pre-IPO or pre-acquisition; larger check sizes, lower relative risk, growth equity focus.

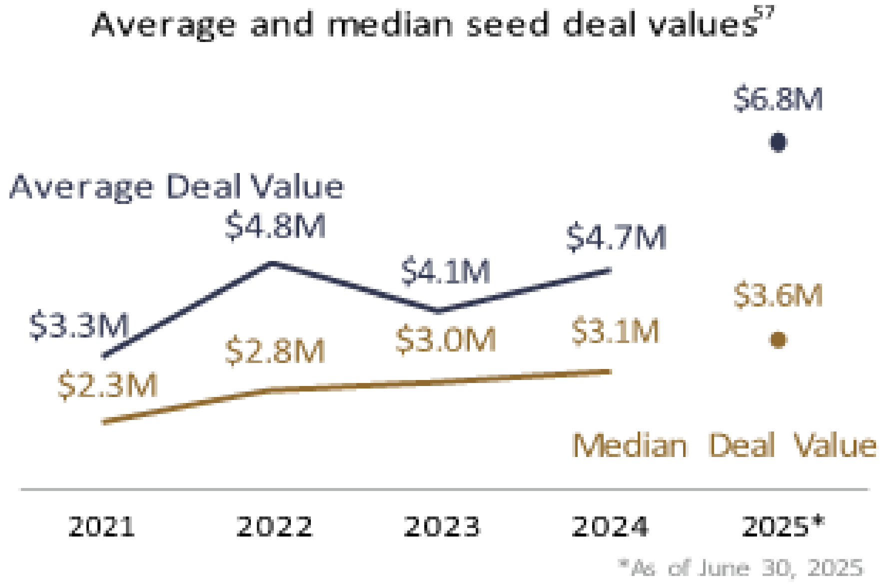
Types of Funding Rounds

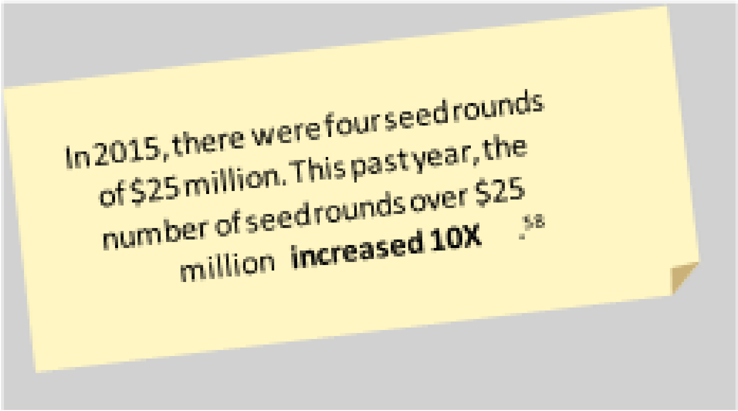
- **Bootstrapping** — funding growth using personal savings, founder resources, or the business's own revenue, without outside investors or debt. No dilution, no investor obligations, but growth is limited to what can be self-funded.
- **Pre-seed** — the earliest formal round, used to develop an idea into a prototype or MVP; often funded by founders, family/friends, or pre-seed-focused angels/micro-VCs.
- **Seed** — the first significant institutional round; funds validate the business model, build the initial product, and find product-market fit.
- **Series A** — company has demonstrated product-market fit and some revenue traction; capital optimizes the business model and begins scaling.
- **Series B** — company has a proven, working business model and is focused on scaling — expanding market reach, growing the team, increasing market share.
- **Series C and beyond** — later rounds for companies already scaling significantly; capital used for major expansion, acquisitions, new product lines, or entering new markets, often as a bridge toward an IPO or acquisition.

A pre-seed or seed round is typically a company's first funding round.[54] This round may include funding from friends and family, angel investors, or early-stage funds. Capital at this stage is **often used for product development and market research**

	Pre-Seed	Seed
Typical amount raised	$50,000 - $250,000	$1M - $5M
Investor profiles	Friends and family, crowdfunding, angel investors, pre-seed and seed VC funds, incubators, and accelerators.	Angel investors, pre-seed and seed VC funds, incubators, accelerators, and seed funds.
Typical stage/use of funds	Idea validation, team formation, initial prototype, market research, development of a minimum viable product.	Product development, testing, and refining, market fit testing, marketing development, documented traction and milestones.

Mirroring overall market trends, **seed deals increased in size**.





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As seed rounds increased, so did the time between seed and Series A.

2.1 years

The median time between raising a seed round and Series A increased to 2.1 years in 2024—**84% longer** than in 2021 (up from 1.2 years in 2021).

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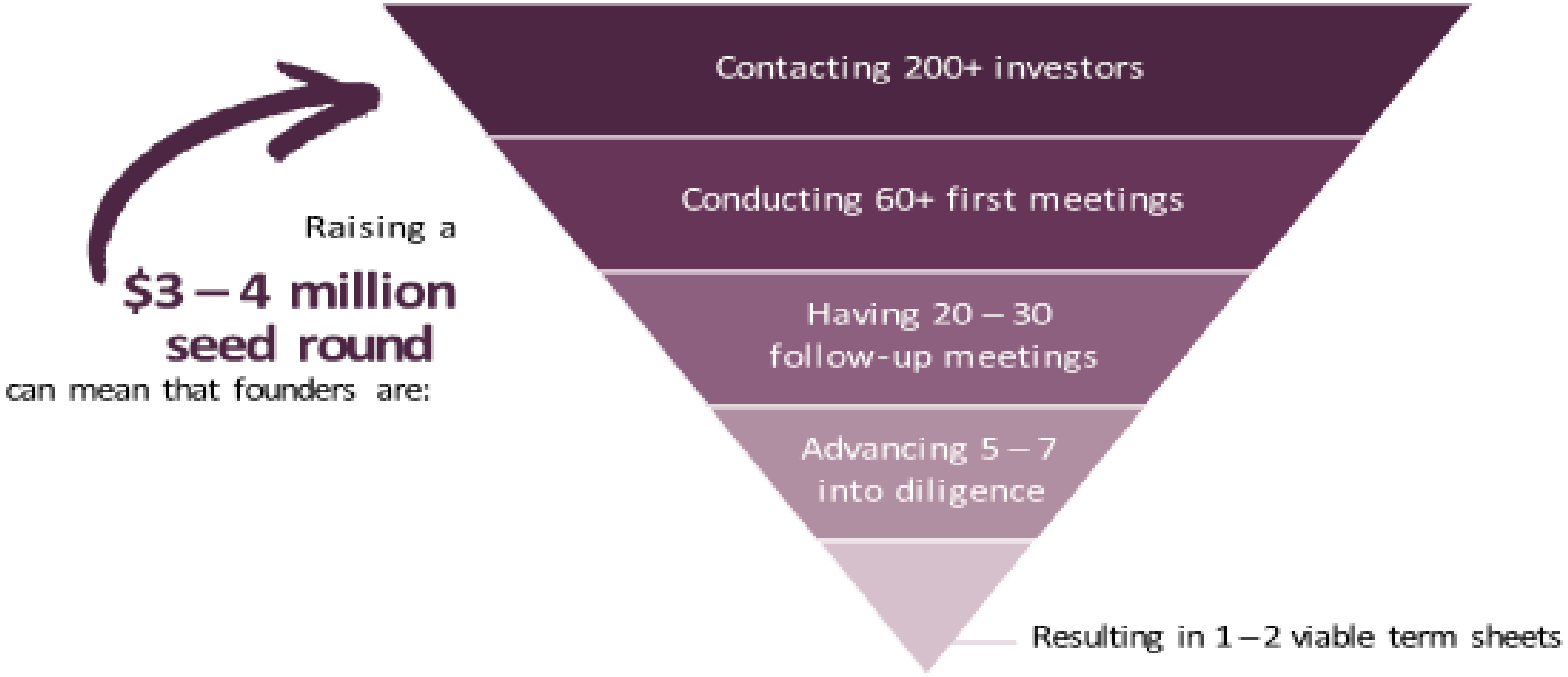
What does it take to raise a seed round?



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Types of Transactions for Raising Capital

Issuing any security — notes, common stock, or otherwise — triggers securities laws. Section 5 of the Securities Act of 1933 provides that **all offers or sales** of securities must be registered unless an exemption is available.

Securities transactions fall on a public-private spectrum:

- Public offerings involve **more investors**, including retail investors, and carry **more compliance** rules and disclosure requirements.
- Private offerings involve a **smaller pool of investors**; not publicly advertised, more streamlined and quicker, but limited to certain investors such as accredited investors, **generally with less compliance**.

Source: https://www.sec.gov/files/2022-oasb-offering-types-building-block.pdf

What pathways are available to raise capital from investors?

A business may not offer or sell securities unless the offering has been registered with the SEC or falls within an exemption from registration.

EXEMPT OFFERINGS

Offerings conducted pursuant to an exemption from registration are often referred to as exempt offerings. There are multiple exemptions available for small businesses looking to raise capital from investors.

Rule 506(b) Private Placements

Rule 506(b) Private Placements allow companies to raise unlimited capital from investors with whom the company has a relationship and who meet certain wealth thresholds or have certain professional credentials. A company cannot use general solicitation in a 506(b) private placement.

Rule 506(c) General Solicitation Offerings

Rule 506(c) General Solicitation Offerings allow companies to raise unlimited capital by broadly soliciting investors who meet certain wealth thresholds or have certain professional credentials.

Rule 504 Limited Offerings

Rule 504 Limited Offerings allow companies to raise up to $10 million in a 12-month period, in many cases from investors with whom the company has a relationship.

Intrastate Offerings

Intrastate Offerings allow companies to raise capital within a single state according to state law. Many states limit the offering to between $1 million and $5 million in a 12-month period.

Regulation A Offerings

Regulation A Offerings (sometimes called a "mini-IPO") allow eligible companies to raise up to $20 million in a 12-month period in a Tier 1 offering and up to $75 million in a 12-month period in a Tier 2 offering through a process similar to, but less extensive than, a registered offering.

Regulation Crowdfunding Offerings

Regulation Crowdfunding Offerings allow eligible companies to raise up to $5 million in investment capital in a 12-month period from investors online via a registered funding portal.

REGISTERED PUBLIC OFFERINGS

A registered public offering is commonly used to describe an offer and sale of securities that has been registered under the Securities Act. Companies must file a registration statement with the SEC and may not sell the securities until the SEC declares the registration statement effective.

Registered Offerings

Registered Offerings allow companies to raise unlimited capital through initial public offerings or secondary offerings using a registration statement filed with the SEC.

Initial Public Offerings

Initial Public Offerings provide an initial pathway for companies to raise unlimited capital from the general public through a registered offering. After its IPO, the company will be a public company with ongoing public reporting requirements.

Source: https://www.sec.gov/files/2022-oasb-offering-types-building-block.pdf

Offering Pathways

Offering Type	Capital Limit	Key Feature
Regulation D Rule 506(b) Private Placement	Unlimited	Sold to investors with whom the company has a relationship and who meet wealth/credential thresholds; **no general solicitation allowed**.
Regulation D Rule 506(c) General Solicitation Offering	Unlimited	Can be broadly solicited, but all investors must meet wealth thresholds or hold certain professional credentials; must take reasonable steps to verify investors' status.
Regulation D Rule 504 Limited Offering	Up to $10 million per 12-month period	Issuers must comply with state securities laws and regulations in the states in which securities are offered or sold. Each state's securities laws have their own registration requirements and exemptions to registration requirements.
Regulation Crowdfunding (Reg CF)	Up to $5 million per 12-month period	Eligible companies raise capital online from investors through a registered funding portal
Intrastate Offering	State-law limit (many states: $1 million–$5 million per 12-month period)	Capital raised within a single state, governed by that state's law
Regulation A Offering ("mini-IPO")	Tier 1: up to $20 million; Tier 2: up to $75 million per 12-month period	Eligible companies use a process similar to, but less extensive than, a full registered offering
Initial Public Offering (IPO)	Unlimited	Registered offering to the general public; company becomes a public reporting company after the IPO

Regulation D: Rule 506(b) vs. Rule 506(c)

Two of the primary exemptions from Section 5 registration under Regulation D:

Requirement	Rule 506(b)	Rule 506(c)
General solicitation	Not allowed — must rely on pre-existing relationships	Allowed — public advertising, social media, etc.
Investor pool	Unlimited accredited + up to 35 sophisticated non-accredited	Accredited investors only
Verification	No verification required — reasonable belief standard	**Must take reasonable steps to verify accredited status**
Capital raise limit	Unlimited	Unlimited
Disclosure	**Enhanced disclosures required if any non-accredited investors included**	No mandated disclosure format (though a PPM is still typical)
Form D Filing	Required within 15 days of first sale	Required within 15 days of first sale

Regulation CF (Crowdfunding)

What it is: a securities exemption that lets eligible private companies raise capital from the general public — including everyday, non-accredited investors.

When adopted: created under Title III of the 2012 JOBS Act, effective May 2016 through SEC rulemaking.

Offering limit: **up to $5 million in any 12-month** period.

Regulation CF (Crowdfunding)

Key Requirements:

- All transactions must take place **online through an SEC-registered intermediary** — a broker-dealer or a funding portal.
- An issuer may only use one intermediary per offering.
- The funding portal must be **registered with both the SEC and FINRA**.
- Individual **non-accredited investor investment limits** apply, tiered by income/net worth.
- Required disclosures to the SEC, investors, and the intermediary.
- Subject to “bad actor” disqualification provisions.
- Securities **generally cannot be resold for one year** after issuance.
- Public reporting companies may not use Reg CF.

What has been happening with Regulation Crowdfunding offerings?

Staff Report from the Office of the Advocate for Small Business Capital Formation, Fiscal Year 2025, U.S. Sec. & Exch. Comm'n (Jan. 8, 2026), https://www.sec.gov/files/2025-oasb-staff-report.pdf.

Regulation A: Tier 1 vs. Tier 2

Requirement	Tier 1	Tier 2
Offering limit (12-month)	**Up to $20 million**	**Up to $75 million**
Investor eligibility	Accredited and non-accredited investors	Accredited and non-accredited (investment limits apply to non-accredited unless listed on a national exchange)
State Blue Sky review	Required — **state-by-state registration**	**Exempt — preempted**
Audited financials	Not required	Required
Ongoing SEC reporting	Not generally required	Required (Forms 1-K, 1-SA, 1-U)
Affiliate resale cap	No more than $6 million	No more than $22.5 million

Note: a bill introduced in December 2025 (the Regulation A+ Improvement Act) would double the Tier 2 limit from $75 million to $150 million. Not yet law as of this draft.

A variety of founders participated in Regulation A and Regulation Crowdfunding offerings in 2024.

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The IPO Process/ Registered offering

Unlike Reg D, Reg CF, or Reg A, an IPO is not an exemption from registration — it is a fully registered offering under the Securities Act. The company becomes publicly traded on a national securities exchange.

Key Steps and Requirements:

- Form S-1 registration statement — the core disclosure document filed with the SEC, including audited financials, business description, risk factors, use of proceeds, and executive compensation.
- SEC review process — staff reviews the S-1 and issues comments; the company amends and refiles until the registration is declared effective.
- Underwriters — investment banks manage the offering, help set the price, and market/sell the shares (the "roadshow").
- National exchange listing — the company must meet the listing standards of the exchange (minimum share price, market cap, shareholder count, governance requirements).
- Ongoing public company obligations — continuous reporting under the Exchange Act (Forms 10-K, 10-Q, 8-K), Sarbanes-Oxley compliance, and other public company governance requirements.

Source:
https://www.sec.gov/resources-small-businesses/capital-raising-building-blocks/ready-raise-capital

How do I know when I am ready to raise capital from investors?

A number of factors go into being ready to raise capital from investors. Most sophisticated investors will expect the company to have taken certain steps and prepared certain documents before they enter the room to pitch for funding. Before you embark on capital raising, we encourage you to consider some key fundamentals of your business, which you can remember using the acronym CAPITAL.

C

Cap tables and financials

Update your financials for disclosure— Investors will expect you to have a cap table that clearly reflects the ownership interests in the company. In addition, companies should have their financial statements ready to convey the financial position of the company.

A

Amount Needed

Calculate your runway needs— One of the first questions a company will hear is "how much money are you looking to raise?" The answer to that question should reflect a thoughtfully calculated "runway" based upon projected expenses.

P

Plan for proceeds

Describe how you'll use the money— Investors expect to hear not only how much money you need, but a plan for how that funding will be spent in furtherance of the company's goals. This plan should include meeting the expenses projected in your "runway."

I

Investor Strategy

Focus on experts who bring value— Many investors are focused on particular sectors or stages of a company's life cycle, and early-stage investors in particular often become involved as advisors to the company. Target investors who know your industry, bring value beyond financing, and have a clear long-term vision for the company that is consistent with your own goals.

T

Time and resources

Prepare to invest yourself in the process— Entrepreneurs will tell you that raising capital takes time and resources, often from the senior leadership team. Prepare to spend time and resources throughout the capital raising process outside of the day-to-day operations of running the business.

A

Advisors

Line up your attorneys and accountants— Hiring the right professional advisors with experience in capital raising is critical to navigating a smooth financing in compliance with laws.

L

Long-term vision

Pitch with the investors' exit in mind— Be able to explain your long-term vision for how the company will return capital back to the investors.

Have suggestions on additional educational resources? Email smallbusiness@sec.gov.

The Private Offering Process

Typical Process:

1. Determine the exemption/structure — Reg D 506(b), 506(c), SAFE, convertible note, or priced equity round.
2. Prepare offering documents.
3. Solicit investors — through the founder's network, or via general solicitation under 506(c), verifying accreditation as required.
4. Negotiate terms — often via a term sheet before final documents are signed.
5. Close the round — investors sign subscription documents and wire funds; company issues securities.
6. File Form D — within 15 days of the first sale. (https://www.sec.gov/resources-small-businesses/capital-raising-building-blocks/what-form-d)
7. Post-closing housekeeping — update the cap table, issue certificates, board consents/resolutions.

The Private Offering Process (cont.)

Common Documents:

- Term sheet — non-binding summary of proposed deal terms
- Private Placement Memorandum (PPM) — disclosure document describing the company, offering, risk factors, and use of proceeds.
- Subscription agreement — the investor's binding agreement to purchase securities.
- Investor questionnaire — confirms accredited investor status.
- Note/SAFE/stock purchase agreement — the actual instrument being issued.
- Board resolutions/consents — corporate approval authorizing the issuance.
- Form D — the SEC notice filing.

Broker-Dealers/ Unregistered BD

A broker-dealer is a person or firm engaged in the business of effecting securities transactions for the account of others (broker) or for its own account (dealer). Anyone acting as a broker generally must register with the SEC and FINRA unless an exemption applies.

A broker-dealer is generally required when someone is paid transaction-based compensation — a commission or fee tied to the size or success of a securities sale — in connection with soliciting or facilitating that sale.

Broker-Dealers/ Unregistered BD (cont)

Risks of Using an Unregistered Finder

- The Exchange Act allows for rescission of transactions involving an unregistered broker-dealer — giving investors a “put” right.
- The SEC may impose civil money penalties, disgorgement of fees/commissions, and prejudgment interest; individuals or firms may face industry suspensions, censure, or lifetime bars.
- A company that pays an unregistered finder can itself be held responsible for aiding and abetting or causing the violation.

Caveat: there is no such thing as a general "finder’s exemption." The SEC’s 2020 proposal for a two-tier finder exemption was never finalized — the traditional broker-registration analysis under Exchange Act Section 15(a) still applies.

https://www.sec.gov/resources-small-businesses/capital-raising-building-blocks/broker-dealers

Venture Capital Fundraising Process

From LOI/term sheet to closing:

1. LOI / term sheet — non-binding key deal terms agreed.
2. Due diligence — VC reviews financials, legal, IP, and team.
3. Definitive documents — stock purchase agreement, investor rights agreement, charter.
4. Disclosure schedules — company discloses exceptions, IP, and contracts.
5. Board and stockholder approval — resolutions authorizing the financing.
6. Signing — parties execute definitive documents.
7. Closing and funding — funds wired, shares issued, cap table updated.
8. Post-closing housekeeping — update the cap table, issue certificates, board consents/resolutions.

SAFE Explained

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SAFE Explained—What is a SAFE?

- A SAFE (Simple Agreement for Future Equity) is a contract where an investor gives **money now in exchange for the right to receive equity later** — usually at the company's next priced round;
- Introduced by Y Combinator in 2013 as a faster, simpler alternative to convertible notes;
- **No interest, no maturity date, no set valuation** at the time of investment — that's the core trade-off vs. debt instruments;
- Until conversion, the SAFE holder **has no voting rights** and isn't yet a shareholder; they are recorded on the cap table as separate, non-equity line items until they convert;
- Depending on the agreement, if the company is acquired before a priced round occurs (an event that would trigger the liquidation preferences of other shareholders), the SAFE holder typically has the option to get their investment back or convert into equity at the valuation cap.

SAFE Explained—Key terms in a SAFE

- **Valuation cap** — the ceiling price at which the SAFE converts, regardless of how high the priced round's actual valuation goes; rewards early investors for taking risk before the company had a track record;
- **Discount** — a percentage off the price-per-share that new investors pay in the priced round; roughly a third of SAFEs carry both a cap and a discount, and the investor gets whichever term is more favorable;
- **Pre-money vs. post-money SAFE** — determines when the cap is applied relative to the new round's funding;
- **MFN (Most Favored Nation)** clause — if a later SAFE is issued on better terms (lower cap, higher discount), the MFN clause automatically extends those better terms to the earlier investor; it stops applying once that SAFE converts to stock;

SAFE Explained—Founders’ vs. Investors’ View

	Investors want	Founders want
Valuation cap	Lower — locks in more ownership for the same money	Higher (or none) — protects their own ownership
Discount	Higher percentage — bigger guaranteed reward for going early	Lower percentage — smaller giveaway if the round prices close to the cap
Pre-money vs. post-money	Post-money — clearer, and typically dilutes founders more	Pre-money, if they can get it — less dilution on their side
MFN clause	Yes — protection against being undercut by later, better-terms SAFEs	Avoid stacking too many MFN SAFEs — each one can silently reprice the others

SAFE Explained-- Factors to consider before issuing a SAFE

- **How much equity are you giving up?** — It's hard to know exact dilution upfront since a SAFE doesn't set a share count at signing; estimate the eventual dilution once conversion happens, not just the dollar amount raised.
- **How much do you want to raise in your next priced round?** — Raising too much via SAFEs can over-dilute your future priced-round investors when those SAFEs convert; leave enough room on the cap table to make the next round attractive to new investors.
- **What milestones will this money get you to?** — Tie the raise to specific, concrete goals (a growth metric, a product launch, a fundraising target, landing a key investor) rather than raising an arbitrary amount; clear milestones support a more realistic ask and reduce the temptation to over-raise.
- **How will you track your SAFEs?** — Each SAFE can carry a different cap, discount, or combination of terms; failing to track them precisely is a common early-stage mistake that leads to bigger-than-intended dilution at conversion — this is exactly the "math gets ugly" problem when SAFEs stack.

See also, Understanding the SAFE (Simple Agreement for Future Equity), The Carta Team, August 4, 2026. Available at https://carta.com/learn/startups/fundraising/convertible-securities/safes/

SAFE Explained--Advantages and disadvantages of SAFEs

Advantages

Faster and cheaper than a priced round;

Attractive to early investors — cap/discount offer real upside;

Buys time to hit milestones before a formal valuation;

No interest, no debt on the balance sheet;

Disadvantages

Can lead to excessive dilution if the cap is set too low;

Harder to attract a lead investor without a formal round to rally around;

Investors don't get preferred-stock-level protections;

QSBS holding period doesn't start until conversion — can delay tax benefits;

SAFE vs Priced Round

	SAFE - "a promise"	Price Round - "the real thing"
What it is	You give money now, I promise equity later, once we agree what the company is worth. **Simple Agreement for Future Equity.**	We agree what the company is worth right now, and you get actual shares.
Valuation	Not set today **— deferred** to the next priced round, usually with **a cap and/or discount.**	Set now — pre-money and post-money negotiated and fixed as part of the round.
Rights	**No board seat**, no protective provisions, no mess.	Real rights come with real shares: board seats, pro rata, protective provisions, voting rights
Speed & cost	**Fast and cheap** — a few pages, **minimal negotiation**, no SPA or IRA needed.	Slower and more expensive — full definitive documents (SPA, IRA, amended charter, disclosure schedules).
Ownership	Not finalized until conversion — depends on the terms of whatever priced round triggers it	Fixed at closing — defined price per share, shares issued immediately.
Typical stage	Pre-seed and seed, when a defensible valuation is hard to agree on.	Series A and beyond, once there's enough traction to support real valuation negotiation.
The catch	Stack five SAFEs at five different terms, and the conversion math gets ugly fast.	Higher bar because there's now something everyone agrees is worth protecting.

A valuation cap in a SAFE is the maximum company valuation at which the SAFE investor's money will convert into equity

Convertible Notes

What it is: a loan. It starts as debt — the company owes the investor money, with interest, by a maturity date — but it's designed to convert into equity, usually at a future priced round, rather than actually being repaid in cash.

How It's Different from a SAFE

- Interest rate. Notes accrue interest (often 2–8% annually), which gets added to the principal at conversion — so the investor ends up with more shares than their original check alone would buy. SAFEs don't accrue interest at all.
- Maturity date. A note has one; a SAFE doesn't. If no priced round or acquisition happens by maturity, the note is technically due and payable in cash — which forces a conversation (extension, repayment, or conversion on other terms) that a SAFE never forces.
- It's actually debt. Until it converts, a note sits on the balance sheet as a liability. That has real consequences — it affects how the company looks to future lenders or investors, and in a wind-down scenario, note holders sit ahead of equity holders in the payout order (see the earlier dissolution waterfall).

Convertible Notes (cont)

Same Core Mechanics as a SAFE

- Usually includes a valuation cap and/or a discount, working the same way — the investor converts at whichever is more favorable to them.
- Triggered by a priced “Qualified Financing,” typically defined by a minimum raise threshold — not by another unpriced raise.
- Multiple notes at different terms stack the same way multiple SAFEs do, and create the same conversion-math complexity at the priced round.

Convertible Notes (cont.)

Why Some Prefer Notes Over SAFEs

- The maturity date creates a forcing function. A SAFE can sit unconverted indefinitely if a priced round never comes — a note eventually has to be dealt with, which can be useful leverage for the investor and useful discipline for the company.

- Because it's debt, the legal and economic treatment is more established and predictable — courts and practitioners have dealt with notes for far longer than with SAFEs, which is part of what makes them a more comfortable instrument for some investors and some counsel.
- The interest component means the investor's return isn't purely tied to the discount/cap mechanics — it's a small additional layer of compensation for the time value of their money while waiting for the priced round.

Convertible Instrument Mechanics

Valuation Cap

The maximum valuation at which the investor's money will convert into equity, regardless of the actual priced round's valuation. Protects early investors from dilution if the company's valuation grows significantly.

Discount

A percentage discount off the price per share of the next priced round, applied at conversion. Common range: 10–25% (20% typical).

Interest Rate

Convertible notes (not SAFEs) typically accrue interest, often 2–8% annually, added to principal at conversion.

Maturity Date

The date by which a note must convert to equity or be repaid, though parties often renegotiate an extension in practice.

Convertible Instrument Mechanics (cont.)

Conversion Mechanics

- A future priced equity round occurs (the “qualified financing” trigger).
- Principal (plus accrued interest, for notes) converts into the same class of preferred stock sold in that round.
- Conversion price is set at the lower of the cap-implied price or the discounted price, whichever is more favorable to the investor.
- Investor receives shares alongside the new round's investors.

MFN (Most Favored Nation) Clause

Sometimes included, giving the investor the right to swap into more favorable terms if the company issues a later SAFE/note with better terms to someone else before the round converts.

Equity Securities in VC Deals:

Preferred vs. Common

Common Stock — What Founders and Employees Hold

- The baseline ownership interest. No special rights beyond a basic claim on the company and a vote.
- Paid last in a liquidation, after all debt and all preferred (see the earlier payout waterfall).
- Full, uncapped upside — if the company does extremely well, common holders participate in that growth without any negotiated ceiling.
- Usually priced lower than preferred at the same round for tax and valuation purposes (common is valued via a 409A appraisal, separate from the price VCs pay for preferred).

Equity Securities in VC Deals: (cont.)

Preferred vs. Common

Preferred Stock — What VCs Actually Buy

- Not just "equity with extra steps" — preferred is a distinct security with rights layered on top of the basic ownership interest, and in a VC deal, those rights are the deal.
- Liquidation preference — gets paid before common, typically 1x, non-participating as the market standard.
- Conversion rights — preferred can convert into common (usually 1:1) when it's advantageous to the holder, most commonly to participate pro rata in a very successful exit instead of taking the liquidation preference.
- Protective provisions — veto rights over major company actions, voting as a separate class from common.
- Pro rata rights — the right to invest in future rounds to maintain ownership percentage.
- Anti-dilution protection — adjusts the conversion price if a later round prices lower (a down round).
- Often board representation and information rights attach here as well, not to common.

Equity Securities in VC Deals: (cont.)

Preferred vs. Common

Why VCs Almost Never Buy Common Stock

- Common gives them none of the downside protection, governance rights, or anti-dilution mechanics that justify the size and risk of an institutional check.
- Preferred lets a VC size their risk to their return expectations — the liquidation preference in particular exists because VC portfolios are built on a small number of big wins covering many losses, and preferred protects the capital on the losses.

Why this matters for founders: every VC round adds a new class of preferred stock, and each class can carry its own version of these rights. By the time a company has raised a Series A, B, and C, the cap table isn't just "founders and investors" — it's common stock sitting underneath multiple stacked layers of preferred, each with its own preference, protective provisions, and conversion terms, all interacting with each other in a way that only becomes fully visible at an exit.

Venture Deal Negotiation: Economics and Control

Negotiation in venture deals turns on primarily two factors: **economics and control.** Knowing which aspect matters most to a given investor allows the founder to negotiate more effectively. This framework applies whether the instrument is debt or equity — a convertible note (debt converting to equity), preferred shares, or common shares.

Economics

- Valuation (pre-money / post-money)
- Liquidation preference
- Dividend rights
- Anti-dilution protection
- Pro-rata rights
- Option pool
- Vesting

Control

- Board composition
- Protective provisions
- Voting rights
- Drag-along rights
- Information rights
- Right of first refusal (ROFR) / co-sale rights

Certain Key Economic Terms Explained

Pre-Money and Post-Money Valuation

Pre-money valuation is the company's agreed-upon value before the new investment is added. Post-money valuation equals pre-money plus the amount of new money raised, and determines the new investor's ownership percentage.

- ➢ Founder perspective: wants pre-money as high as possible — gives up less of the company for the same check size.
- ➢ Investor perspective: wants pre-money as low as possible relative to the amount invested.

An investor invests $2 million.

- Pre-money **= $8 million** → Post-money = $**10 million** → investor gets $2M ÷ $10M = **20%** ownership.
- Pre-money = **$18 million** → Post-money = **$20 million** → investor gets $2M ÷ $20M = 10% ownership.

Why **founders** want it high: **A higher pre-money valuation** means the same dollar investment buys **a smaller slice of the company**.
Why **investors** want it low**: A lower pre-money means their check buys more ownership** for the same money — more upside if the company succeeds, since they own a bigger piece.

Certain Key Economic Terms Explained (cont.)

Anti-Dilution Protection

A mechanism protecting existing preferred investors if the company later raises money at a lower valuation (a "down round"). It adjusts their effective conversion price so they receive more common shares upon conversion.

- Full ratchet — the most investor-favorable version: conversion price resets all the way down to the new round's price, regardless of how much stock was sold at that price. Can cause severe founder dilution.
- Weighted average (broad-based or narrow-based) — the more common, more founder-friendly approach: the adjustment factors in both the lower price and how many shares were sold at that price.

Company Valuation

Startup valuation is hard to determine precisely — early-stage companies often have little or no revenue, no earnings history, and an uncertain future. Valuation ends up being as much art as science.

Common Valuation Approaches

- **Comparable company**/transaction analysis ("comps") — benchmarking against similar recent raises.
- Berkus Method — assigns dollar values to qualitative factors (**idea, prototype, team, relationships**, rollout); common for pre-revenue companies.
- Scorecard Method — starts with the average **valuation of similar startups, adjusted for team, market size, competition, and traction.**
- Risk Factor Summation Method — starts with a base valuation, adjusted up or down by a checklist of risk categories.
- Discounted Cash Flow (DCF) — projects future cash flows discounted to present value; more reliable for later-stage companies.
- Venture Capital Method — works backward from a projected exit value, applying the investor's required return multiple.

In practice, early-round valuation is often driven less by formal modeling and **more by negotiation dynamics** — comparable deals, investor demand/competition for the deal, and founder leverage.

Company Valuation (cont.)

Factors That Influence Valuation

- Stage of the company
- Competition
- Experience of the entrepreneurs/founders and leadership team
- Size and trendiness of the market
- Current economic climate

The Capitalization Table

A cap table is the master record of a company's ownership — who owns what, in what form, and in what proportion. It typically includes shareholders, security type, number of shares/units, ownership percentage (as-issued and fully diluted), and price paid per share. It changes every time the company issues new shares: a new financing round, new option grants, vesting, or a convertible note/SAFE converting.

Why It Matters in Negotiation

- The cap table is the **numerical expression of economics, control, and dilution.**
- Investors model the cap table under different scenarios before agreeing to terms.
- Founders should **always maintain an up-to-date**, fully diluted cap table — surprises here are a common source of deal friction.

Cap Table Example: Worked Calculation

Starting point: 2 founders hold 10,000,000 shares total (all common stock), fully diluted.
Deal terms: $8,000,000 pre-money valuation; $**2,000,000** new investment; 10% pre-money option pool (created before the round closes).

Shareholder	Shares	Ownership %
Founders	10,000,000	70%
Option pool (unissued, reserved)	1,428,571	10%
Seed investor	2,857,143	**20%**
Total (fully diluted)	14,285,714	100%

- Price per share: $0.70
- Pre-money valuation: $8,000,000 (10,000,000 founder shares + 1,428,571 pool shares × $0.70)
- Post-money valuation: $10,000,000

Key takeaway: Founders' actual share count (10,000,000) stays the same before and after the round — only the percentage drops, because the total share count expands around them. This is the “option pool shuffle” — the pool is carved from the founders' side, not the new investor's, so the headline “we're giving up 20%” understates real founder dilution once the pool is added.

Fatal Mistakes Founders Make When Negotiating with VCs and Investors

1. Not knowing which terms are market-standard versus aggressive. Founders who don't know that broad-based weighted average anti-dilution is standard (and full ratchet isn't) end up accepting outlier terms without realizing it, simply because they have no reference point.

2. Fixating on valuation while ignoring the terms that actually determine the outcome. A high valuation with a 2x participating liquidation preference and full ratchet anti-dilution can leave founders worse off than a lower valuation with clean, standard terms — but the headline number is what gets remembered and negotiated hardest.

3. Going into negotiations without a lawyer, or bringing one in too late. Trying to save legal fees by negotiating the substantive terms alone, then handing a lawyer a semi-finalized deal to "paper up" — at which point there's little room left to fix problematic terms without reopening the whole negotiation.

Fatal Mistakes Founders Make When Negotiating with VCs and Investors (cont.)

4. Letting emotion or ego drive the negotiation. Getting defensive about tough questions, taking protective provisions personally, or refusing reasonable investor protections out of principle — all of which can sour a relationship the founder will likely be stuck with for years.

5. Not modeling the cap table before accepting terms. Agreeing to a deal without running the actual dilution numbers — including the option pool shuffle — and only discovering the real ownership impact after signing, when it's too late to renegotiate.

6. Losing track of key provisions from prior financing rounds when negotiating a new one. As a company raises across multiple rounds — seed SAFEs, a Series A, a Series B — each round's liquidation preference, conversion terms, anti-dilution rights, and pro-rata rights stack on top of the ones before it. Founders who don't keep a clear running record of what was already agreed to in earlier rounds can walk into a new negotiation not realizing: how the new round's liquidation preference will stack against (or subordinate) earlier preferred; whether earlier SAFEs/notes are still unconverted and need to be accounted for in the new round's cap table math; whether an MFN clause from an earlier round gives an old investor the right to swap into the new round's better terms; or whether pro-rata rights granted earlier obligate the company to offer existing investors an allocation in the new round before finalizing terms with a new lead. Missing any of these can blow up a deal late in diligence, or create investor disputes after closing.

Fatal Mistakes Founders Make When Negotiating with VCs and Investors (cont.)

7. Underestimating how restrictive protective provisions can compound across rounds. Each new round typically adds its own class of preferred with its own protective provisions. Founders who don't push back on scope early can end up needing separate approval from multiple classes of preferred just to take routine actions — a problem that's much harder to unwind after the fact than to prevent at drafting.

8. Not getting counsel to review the disclosure schedule as carefully as the main agreement. The disclosure schedule is where a company lists every exception to its representations and warranties — missing or incomplete disclosures here can create real post-closing liability, even if the main agreement itself was heavily negotiated and looks clean.

12 Best Practices for Financing and Raising Capital

1. Build investor relationships before you need the money. Warm introductions and informational conversations months ahead of a raise almost always beat a cold pitch under time pressure — investors back founders they've had time to build trust with.
2. Diversify your investor pipeline early, and don't assume the “standard” path is the only path. CDFIs, MDIs, angel networks, and crowdfunding all exist because access to traditional VC capital isn't evenly distributed — founders who explore multiple channels early tend to have more leverage and more options later.
3. Know your numbers cold before you're in the room. Burn rate, runway, unit economics, and use of proceeds should be answers you give without hesitation — hesitating on your own numbers is one of the fastest ways to lose investor confidence.
4. Negotiate economics and control separately — know which one the investor actually cares about. Not every term is equally important to every investor. Figuring out whether a given investor is optimizing for downside protection or governance influence tells you where you can flex and where you can't.
5. Understand where the option pool comes from before agreeing to a valuation. A “20% raise” can quietly become a 30% dilution once a pre-money option pool is added. Always ask where the pool is being carved from.
6. Model your liquidation preference stack against realistic exit scenarios, not just the headline valuation. A “successful” exit on paper can still leave founders with very little if participating preferred and high multiples are stacked across multiple rounds.

12 Best Practices for Financing and Raising Capital

7. Don't over-optimize for the highest valuation at the expense of investor fit. The wrong investor at a great valuation can cost more in board friction, misaligned expectations, and follow-on support than a slightly lower valuation with the right partner.
8. Keep your cap table clean and updated in real time. Don't let SAFEs, notes, and option grants pile up untracked. A messy cap table is one of the most common — and most avoidable — sources of diligence delay and investor distrust.
9. Start thinking about exit-readiness on day one, not when you get an offer. Clean governance, organized IP assignments, and up-to-date corporate records aren't just nice-to-haves — they directly speed up diligence and protect leverage when M&A or IPO conversations start.
10. Don't treat every financing source the same — match the capital to the need. Grants are "free" but slow; loans are fast but must be repaid regardless of performance; equity is flexible but permanent and dilutive. The right mix depends on timeline, risk tolerance, and how much control you're willing to trade. \
11. Talk to a securities attorney before you take a single dollar. Even a "friends and family" round touches securities law. Getting the structure right at the start (SAFE vs. note vs. priced round, which exemption applies) is far cheaper than fixing it later.
12. Never pay anyone a commission or success fee for introducing investors unless they're a registered broker-dealer. There's no "finder's exemption" — using an unregistered finder exposes both the finder and your company to real liability, including investor rescission rights.

USBC Capital Raising for Early-Stage Companies | Session 2 Slide Deck

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Basswood Counsel

Hope you enjoyed the presentation. Please contact us with any questions

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