

## Before the raise: Tips to get your Canadian startup investor-ready

*By Morgan McDonald and Michael Reid*

Pitch and the funds will come, right? Hopefully! But there's a lot that comes between delivering the pitch and receiving the cheque.

After your initial friends and family round, and perhaps even after an angel investment or two, your next step will likely come in the form of investment from established strategic investors, venture capital firms, private equity, angel syndicates or similar professional investor groups. With a little bit of advanced preparation, you can get your startup ready for investor scrutiny, helping you save time and maintain value as you negotiate with investors.

Preparing for this outside investment round is important, as this next round of investors will dig in deeper to diligence and expect founders to have cleaned up their companies in previous rounds. Through our work as both company and investor counsel, we've seen many companies dive into an outside round before they are ready. Unfortunately, failing to take the time to properly prepare can lead to a longer, bumpier transaction period and ultimately an investment on terms that are far less company-friendly than the founders expected after the original term sheet was signed.

Read on for a few tips to get your Canadian startup ready for outside investment from a legal perspective.

### Keep it clean; keep it simple

One goal in keeping an investors' interest and favour is to keep them focused on the business and the problem you are solving or the solution you are providing. A messy share structure, incomplete corporate records, and strange shareholder provisions disrupt this focus and instead bring investors' attention to what may be required to clean up the company (with their funds).

Most startup investors expect to be coming into a company with one class of common shares and perhaps a class of preferred shares, if there has already been a priced round. There can be very good reasons for a second class of non voting shares (often used for employee stock option plans), though this tends to be more common in Canada, and less common in the US. The simpler and more familiar your share structure, including the number of shares actually issued and the size of any reserved option pool, the more accustomed the investor and their counsel will be. This will allow them to focus on your business and projections, rather than on the fact that you have Class H redeemable, retractable, voting, preferred shares issued that may, in some circumstance, sit in preference to their to-be created series.

There are reasons to have a "funky" share structure, but more often than not the reason ends up being because you engaged an advisor unfamiliar with startups and the typical fund raising path, who then had you set up 18 classes of shares like a small family run business. This can all be cleaned up, but it is easier and cheaper to do it before you have other shareholders who require input and sign-off. Moreover, waiting to clean up a complicated or unnecessary share structure until a deal is on the table can slow down funding, as many investors will request this type of clean up be completed before they fund.

## Consider intellectual property (IP) ownership

If IP is a major asset in your company, you will need to take steps to protect it and ensure that the company owns all of it. This will come up as one of the first and stickiest questions in an investors' due diligence, which is fair if IP is a large portion of the value ascribed to the business. When taking stock of IP ownership and protection, there are a number of protections to consider. The more obvious forms of IP protection may be filing trademark applications, developing and filing patent claims and confirming trade secrets are protected under NDAs.

Less obvious and more often overlooked, even though it's just as important, is ensuring that all IP created by anyone who has touched a material or early part of the business has been properly assigned to, and moral rights waived in favour of the company. While current employees and contractors may be top of mind here, you will also need to consider agreements and/or IP assignments from the initial founders or former key employees who may have since left the company. It is never too early to track these folks down now rather than hold up a future closing in order to find a former founder, who has since moved on, to convince them to sign a confirmatory assignment of IP.

## Prepare early for due diligence

Get your (legal) ducks in a row before you go out to share a data room. It is common to see clients assume that once they have incorporated their business online, they have completed the process. This is a fair assumption, as the online filing system (and many of the available third-party services) are not particularly clear in this respect. In reality, there are often a few more steps required to complete your company's corporate records. These include: resolutions appointing directors, setting a financial year end, waiving a requirement for annual financials, actually issuing shares, and creating central securities registers and registers of directors and officers. These are the bare minimum corporate records an investor will expect to see in a legal section of a data room. Failing to have these threshold items leaves founders on their heels responding to the simplest of requests rather than focusing investors on their product or service.

If you are further along and have a product or service launched, start compiling your standard form documents, as well as all fully executed customer, supplier, and other commercial agreements, statements of work, and licenses. Having a data room from the start specifically organized for investor due diligence will place the company ahead of the game when investors ask for access, rather than have you scrambling to find where in Google Docs that key customer contract may be.

The right startup lawyer should be able to support you in considering the types of items that should be included. They might even provide a sample diligence list of items an investor may initially request. It is also important to consider the company's confidentiality obligations in this process, including to employees, customers, and other parties. For this reason, it is essential to require an NDA or similar confidentiality provisions (these may be included in some data room platforms) before sharing confidential or protected information with a third party.

## Plan for timing

Raising money takes time and effort. While some investors may be able to move things along as quickly as a matter of weeks, pencil in at least a few months for a full round to be safe. You want to avoid having to ask a soon-to-be investor for additional bridge financing because you assumed a raise would take two weeks and did not plan adequate runway. This could potentially leave you in a less advantageous bargaining position when you need the funds to keep the lights on. Putting your best foot



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forward also means engaging appropriate legal and financial advisor(s) to assist in your go-to-market plan early to ensure you have the best chance at an efficient and successful financing.

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Raising funds from outside investors can be a long and challenging process. Good preparation can help remove impediments which can otherwise slow down, side track or completely overwhelm a potential deal. The above tips are intended to help you prepare for what else you may need to do before polishing that next pitch deck, so that the journey from pitch to payday is smooth sailing.

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