

NAVIGATING THE TERM SHEET: SETTING THE FOUNDATION FOR STARTUP INVESTMENTS

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A term sheet marks the formal beginning of a fundraising transaction. It is a pre-contractual document that outlines the key commercial and legal contours of a proposed investment. While it is not a binding agreement in itself, it serves as a structured summary of the parties' understanding and intent, setting the stage for the detailed documentation that follows. By defining the broad framework of the deal, a term sheet bridges the gap between initial discussions and definitive agreements, giving the transaction its first formal shape.

At its essence, a term sheet captures the critical commercial terms, valuation, investment amount, and shareholding structure, alongside the key rights and obligations of the investors and the company. It also records the basic conditions for investment, such as completion of due diligence, fulfillment of conditions precedent, and closing mechanics. In doing so, it helps “freeze” the financial and structural positioning of the parties, reducing uncertainty and aligning expectations before the parties proceed to negotiate binding documents.

Beyond providing commercial clarity, the term sheet acts as a guiding reference for drafting the share subscription agreement and the shareholders' agreement. Its structure and level of detail often vary depending on the nature of the transaction, the stage of fundraising, and the type of instrument, whether equity, preference, convertible, or hybrid. In essence, a well-crafted term sheet is both a roadmap and a negotiation tool, balancing investor protections with the company's flexibility to move forward with confidence.

Breaking Down a Startup Fundraising Term Sheet

The terms incorporated in a term sheet depend on the nature and complexity of the transaction. However, a well-drafted term sheet typically captures all essential commercial, legal, and governance elements that shape the eventual investment. Generally, a comprehensive term sheet includes the following components:

1. Parties

The term sheet begins by identifying the key participants in the transaction—the company seeking investment, its existing shareholders, and the proposed investors. Clearly defining the parties helps avoid ambiguity, particularly where multiple shareholders, group entities, or nominee arrangements are involved. It also establishes the framework for determining rights, obligations, and representations at later stages.

2. Nature and Details of the Investment Instrument

This section specifies the type of instrument through which the investment will be made, whether equity shares, preference shares, or convertible instruments such as CCPS or CCDs. The instrument chosen determines the rights attached to the investment, including

conversion mechanics, voting powers, and participation in profits. The term sheet often includes a brief description of these attributes to set the commercial foundation for the definitive documents.

3. Investment Economics

Perhaps the most closely negotiated aspect, this section details the valuation of the company, the investment amount, and the resulting shareholding of the investor post-closing. It may also outline pre-money and post-money valuation, the price per share, and the percentage stake proposed to be acquired. By crystallizing these figures, the term sheet “freezes” the financial structure and helps both parties assess dilution and control implications.

4. Conditions to Investment

Before the investment can be completed, certain preconditions must be satisfied. These typically include completion of legal and financial due diligence, fulfilment of conditions precedent (CPs), and completion of closing actions such as filing forms and issuing share certificates. The term sheet outlines these steps to ensure a clear roadmap from signing to closing.

5. Rights Associated with the Instrument

The rights conferred on investors depend on the nature of the instrument. Common rights include liquidation preference (priority in distribution of proceeds upon liquidation), dividend entitlement, voting powers, and conversion rights in case of convertible instruments. These provisions directly affect the investor’s economic and governance position in the company.

6. Governance Rights

Investors often seek certain governance and oversight mechanisms to protect their interests. The term sheet may provide for board representation, observer rights, or specific affirmative voting matters (AVMs) requiring investor consent. It may also include information rights, allowing investors access to financial statements, management updates, and operational reports, thereby promoting transparency.

7. Transfer Restrictions

To maintain stability in the company’s shareholding structure, term sheets typically include transfer restrictions. These may involve lock-in periods for founders, vesting schedules for their shares, rights of first refusal (ROFR) preventing transfers to third parties without offering shares to existing holders, and tag-along or drag-along rights to facilitate joint exits. Such provisions balance liquidity with control over ownership changes.

8. Shareholding Maintenance

This section addresses mechanisms that protect investors from dilution or preserve their proportionate ownership. Common clauses include pre-emptive rights, which allow existing investors to participate in future fundraises, and anti-dilution protections that adjust conversion ratios or shareholding percentages in the event of down-rounds or discounted issuances.

9. Exit Rights

A key consideration for investors is clarity on their exit opportunities and timelines. The term sheet outlines potential exit routes such as an initial public offering (IPO), promoter or company buyback, sale to a third party, or a strategic acquisition. In addition to defining the mode of exit, it often specifies an exit period, typically ranging from three to seven years, within which the investor expects liquidity. The exit period provides both parties with a shared understanding of the investment horizon and may include provisions for a mandatory exit if no liquidity event occurs within the agreed timeframe. These rights define the investor's pathway to realization and are crucial in aligning expectations between founders and investors.

10. Indemnity and Remedies

To safeguard against losses arising from breach, misrepresentation, or unforeseen contingencies, investors may seek indemnity protections. The term sheet may also refer to events of default and corresponding remedies, ensuring that any breach or failure to perform obligations has predefined consequences.

11. Binding Clauses

While most commercial terms in a term sheet are non-binding, certain provisions, such as confidentiality, exclusivity (or no-shop), governing law, and dispute resolution, are binding. These clauses ensure that deal discussions remain protected, that parties negotiate in good faith, and that any disputes during the negotiation stage are handled under agreed mechanisms.

12. Capitalization Table

Finally, the term sheet usually includes a snapshot of the company's capitalization structure, both before and after the proposed investment. The cap table illustrates the shareholding pattern, highlighting how ownership and control will evolve post-transaction. This not only aids clarity but also provides a visual reference for assessing dilution and valuation accuracy.

Together, these elements form the backbone of a term sheet, providing a shared understanding of the transaction's structure, economics, and governance—well before definitive documents are signed.

Are Term Sheets Legally Binding?

A term sheet often serves as a preliminary framework for an investment transaction rather than the final, binding contract. It sets out the broad terms, creates commercial alignment, and provides a roadmap for the parties to negotiate definitive agreements. However, whether a term sheet is legally binding or merely “exploratory” depends on the language of the document, the intention of the parties, and how the parties act pursuant to it.

Case Summary: Oravel Stays Pvt. Ltd. (OYO) v. Zostel Hospitality Pvt. Ltd.¹

- (a) Facts: The dispute between OYO and Zostel Hospitality stemmed from a proposed acquisition transaction initiated in 2015. Under the term sheet, OYO agreed to acquire Zostel’s hotel-aggregation business, including its intellectual property, software, and employees, in exchange for a 7% equity stake in OYO and a cash consideration of USD 1 million. The term sheet explicitly stated that it was non-binding, except for specific provisions such as confidentiality, exclusivity, and governing law. The parties intended to enter into definitive agreements to formalize the transaction, but these were never executed.
- (b) The Dispute: Zostel claimed that it had substantially fulfilled its obligations by transferring its business, intellectual property, and employees to OYO, thereby enabling OYO to benefit from the integration. Zostel contended that only the formal issuance of shares remained and sought specific performance of the term sheet. OYO, however, maintained that the term sheet was expressly non-binding and that no enforceable contract existed, as the execution of definitive agreements was a condition precedent to the transaction’s completion.
- (c) Arbitral Tribunal: The Arbitral Tribunal ruled in favour of Zostel, holding that the term sheet had effectively become binding by virtue of the parties’ conduct. It observed that the extensive performance by both sides, including business transfer and integration, indicated a meeting of minds and a concluded contract. The tribunal directed OYO to issue shares equivalent to the agreed 7% stake to Zostel.
- (d) The Delhi High Court: OYO challenged the arbitral award before the Delhi High Court. The Court set aside the award, holding that the term sheet was expressly non-binding and could not, through conduct alone, become a binding contract. It observed that the term sheet was contingent upon execution of definitive agreements, which were never signed, and that the parties had not reached consensus on all essential terms. The Court further noted that the arbitral tribunal’s conclusion disregarded the explicit non-binding nature of the document and therefore violated public policy. The judgment reaffirmed that the enforceability of a term sheet depends on the parties’ clear intent to be bound, not merely on their conduct during negotiations.

Key Takeaways from the OYO-Zostel Case

- (a) A term sheet is generally non-binding unless the document expressly states otherwise or the parties demonstrate an unambiguous intent to be bound.

¹ 2025 SCC OnLine Del 3377

- (b) Courts will give primacy to the language of the term sheet—if it explicitly declares itself non-binding, it will not create enforceable rights and obligations.
- (c) Partial performance or conduct, without execution of definitive agreements, does not convert a non-binding term sheet into a concluded contract.
- (d) It is prudent for parties to clearly distinguish binding and non-binding clauses, ensuring that the document accurately reflects their commercial intent and avoids future disputes.

Practical Consideration while Structuring a Term Sheet

While a term sheet is largely a pre-contractual document, the manner in which it is drafted can significantly influence the efficiency and tone of subsequent negotiations. A thoughtfully structured term sheet ensures clarity of expectations, reduces the risk of disputes, and accelerates the transition from intent to execution. The following considerations are key while framing a term sheet for a startup fundraising transaction.

1. Balance of Specificity and Flexibility

A well-drafted term sheet should strike the right balance between clarity and flexibility. Terms must be defined with sufficient precision to avoid ambiguity, yet not so exhaustively that they limit the parties' ability to negotiate finer details later in the definitive agreements. Overly rigid drafting at this stage may discourage investors or constrain founders, while excessive vagueness can lead to interpretational gaps.

2. Inclusion of Core Terms

The term sheet should include all essential commercial, legal, and governance terms that define the framework of the transaction. These typically relate to valuation, investment size, rights associated with the instrument, governance structure, and exit mechanisms. Covering the core aspects early helps align expectations and prevents last-minute divergences during the negotiation of the definitive documents.

3. Clarity on Binding Clauses

Since most provisions in a term sheet are non-binding, it is critical to clearly identify and mark those that are binding, such as confidentiality, exclusivity, governing law, and dispute resolution. The drafting tone for these clauses should be definitive and unambiguous to avoid interpretational uncertainty. Explicitly distinguishing binding obligations ensures that both parties are aware of the legal weight carried by certain commitments even before definitive documents are signed.

4. Consistency with Applicable Law

The term sheet should be structured in compliance with relevant legal and regulatory frameworks, including the Companies Act, 2013, the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, and other sector-specific guidelines. Ensuring that the proposed terms are legally permissible at the preliminary stage prevents the need for substantive restructuring later.

5. Investor and Founder Alignment

A balanced term sheet reflects the mutual objectives of both investors and founders. While investors typically seek protective rights, such as affirmative voting, liquidation preferences, and anti-dilution, founders aim to retain operational flexibility and control. Achieving equilibrium between these perspectives builds trust and sets the tone for a long-term partnership.

6. Confidentiality and Exclusivity

Finally, confidentiality and exclusivity provisions play a pivotal role in preserving deal integrity. Confidentiality ensures that sensitive commercial information exchanged during the process remains protected. Exclusivity, often referred to as a “no-shop” clause, prevents the company from engaging with other potential investors during a specified period, allowing parties to negotiate in good faith without external interference.

A carefully constructed term sheet, therefore, does more than record preliminary intent, it reflects the professionalism, preparedness, and foresight of both parties as they move toward a definitive transaction.

Closing Thoughts

A well-negotiated term sheet is more than a preliminary step; it is the foundation upon which the entire fundraising transaction is built. It brings structure and discipline to discussions, helps parties identify potential friction points early, and ensures that negotiations proceed with transparency and mutual understanding. In many ways, the tone and clarity of a term sheet reflect the professionalism of the parties and their intent to build a lasting business relationship.

For founders and investors alike, the emphasis should be on striking a balance between legal precision and commercial flexibility, and between protection and partnership. When thoughtfully drafted, a term sheet does not merely record terms; it sets the stage for a collaborative, well-governed, and legally sound investment journey.

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