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Keeping Secrets While Raising Money

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Entrepreneurs with an idea for a product or startup company are often concerned about revealing information until they are far enough along that others can't copy them. The concern is reasonable; the economy is globally competitive and entrepreneurs are looking to protect any edge they have.

One tool entrepreneurs often use is the nondisclosure agreement, or NDA. Nondisclosure agreements protect against the release of proprietary information and trade secrets. They are commonly used when outside technical expertise is required, when sensitive work must be outsourced, or when discussing the potential sale of the business.

But NDAs are increasingly rare. Many states do not enforce them, there are easy ways for those with malicious intent to circumvent them, and pursuing legal action is more expensive than most startup companies can afford.

In the venture capital business, hundreds of new business ideas come from entrepreneurs each year. In general, most venture capital investors will not review a business proposal if asked to sign a nondisclosure agreement. There are several reasons for this.

Most investors focus on specific industries. Within those sectors, trends and opportunities are broadly recognized; therefore, investors are often presented with several similar proposals at a time. Many aspects of each proposal will turn out to be less original than the entrepreneur thought. If an investor signs NDAs for each proposal and eventually provides funding to one and rejects the others, the rejected entrepreneurs might take legal action based on a mistaken belief that the investor shared confidential information with the company that received funding.

The most important reason venture investors won't sign an NDA, though, reflects an often-misunderstood ranking of what matters to investors. With rare exceptions (such as the recipe for Coca-Cola or the molecular formula for a specific pharmaceutical compound), ideas are plentiful and cheap, but not original. Market opportunities, on the other hand, are rare and valuable. Great entrepreneurs who can successfully target a market opportunity and build a profitable business are the rarest of all. Thus, venture investors spend time looking for great entrepreneurs, somewhat less time looking for new and changing market opportunities, and nearly zero time searching for ideas. The success of a startup company almost never involves proprietary information.

Venture capitalists recognize that confidentiality and discretion are key to their success. An entrepreneur is far better off investing time and energy in seeking referrals to and references for trusted investors than worrying about an NDA.

One of Flywheel's investors had this advice for entrepreneurs: "The only decisions that ultimately matter for entrepreneurs involve deciding who to trust, from employees to customers to investors. If you get those decisions right, everything else will be fine. If you get those decisions wrong, no NDA will protect you from failing anyway."

For more information about Flywheel Ventures, visit www.flywheelventures.com.

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