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- The SAFE is a relatively recent addition to the seed financing toolkit, promoted by the leading startup accelerator, Y Combinator.

- This is an emerging trend in financing business start-ups. It has been proven that lack of access to finance is the most common reason for the failure of most startup businesses.

- At an early stage, startup companies normally do not have access to traditional methods of securing investment like stock investment, bonds, etc.

Introduction

What is SAFE?

SAFE is an arrangement between an investor and a company whereby an investor contributes a certain amount of money to the company to enable it take off. It is important to note that the funds are not tied to equity acquisition at the time of investment or contribution but provides rights to the investor for future equity.

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- Unlike a convertible note, a SAFE is not a loan.
- There is no interest paid and no maturity date, therefore, SAFEs are not subject to the regulations that debt may be subject to.
- In SAFE, shares are not valued at the time the agreement is signed. Instead, investors and the company agree on the method by which future shares will be issued for the investment made but defer actual valuation.

HOW IT WORKS?

SAFEs have all the same conversion features but lack the debt characteristics of convertible notes.

The differences are:

Maturity date. Until a conversion event occurs, SAFEs remain outstanding indefinitely. In effect, the company undertakes to give an investor a future equity stake in the company if certain trigger events occur such as the company's future financing, acquisition, IPO (Initial Public Offering) or another event pre-determined by the SAFE. If the conversion of SAFE is not in any way triggered by any of the events as captured in the terms of the agreement, it may appear that the investor who had decided to invest in the business start-up would have no other option but resort to fate.

Therefore, return on investment depends on the investment amount, the company's exit valuation (how much the company is worth if and when the trigger event happens), and the terms of the SAFE.

Convertible Note carries interest, but a SAFE does not.

Convertible Note identifies the minimum amount of funds to be raised at the equity financing, but a SAFE does not.

HOW IT WORKS?

SAFE is becoming increasingly favoured by founders and early-stage investors for their convenience, simplicity and cost-efficiency.

There is no legal framework for the operation of SAFE in Nigeria, but like every form of legal agreement, it is enforceable.

Comparatively, in Nigeria, in the year 2020, the Securities and Exchange Commission (SEC) established rules allowing investors to participate in securities-based crowdfunding.

Crowdfunding involves the use of an online web-based platform to raise funds from many individuals or organizations to fund a project or business. It is important to note that the SEC Rules are only applicable to investment-based crowdfunding. i.e., where funds are raised in exchange for ordinary shares, plain vanilla bonds or debenture and simple investment contracts or other instruments approved by SEC.

For more on this, see our previous article on crowdfunding(sec-rules-on-crowdfunding).

Advantages of Raising Funds through SAFE

Easy to negotiate: Raising capital through a SAFE is quick and easy to negotiate because there are very few legal formalities involved. Businesses do not have to worry about valuation cap or other debt elements, a simple self-explanatory SAFE document is enough to raise the capital.

No fixed term: Unlike other capital raising instruments, a SAFE does not have any fixed term so there is no need to worry about the deadlines. If the company never reaches the trigger event, no shares are issued.

Not interest-bearing: A SAFE is not interest-bearing so there is no extra work needed to convert the interest into equity.

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- A Simple Agreement for Future Equity (SAFE) is designed to be simple and short.
- It saves startups the trouble of negotiating and agreeing on the amount of equity financing, which is often quite difficult to agree upon between the investor and the company at an early stage of the business.

In our next post, we will be looking at the Terms of the SAFE. Till then, stay safe.

Conclusion

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