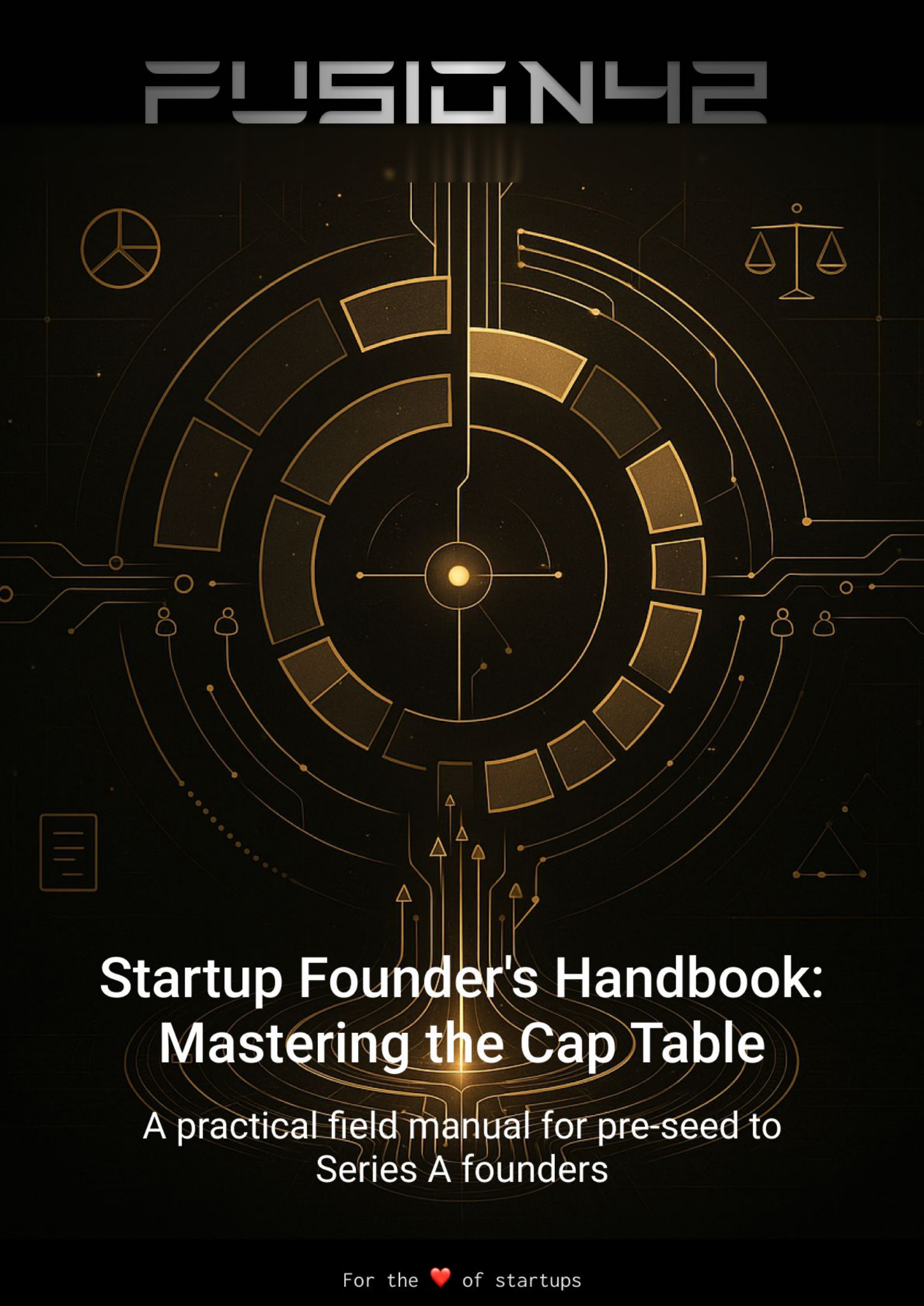


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Startup Founder's Handbook: Mastering the Cap Table

A practical field manual for pre-seed to
Series A founders

For the ❤️ of startups

About This Handbook

This handbook is designed as a practical field manual for startup founders navigating the complexities of cap table management from pre-seed through Series A. It incorporates market-standard terms and founder-friendly approaches based on current venture capital practices.

Disclaimer: This handbook is for educational purposes only and does not constitute legal or financial advice. Always consult with qualified legal and financial professionals before making equity-related decisions.

Feedback: This is a living document. Send suggestions and improvements to help make this resource even more valuable for the founder community.

"The best version of the truth is the beautiful lie we tell ourselves that equity dilution is always bad. The real truth? Smart dilution compounds value."

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Startup Founder's Handbook: Mastering the Cap Table

A practical field manual for pre-seed to Series A founders

Why Your Cap Table is Your Startup's DNA

Alright, let's get straight to it, shall we? You're a founder, brimming with brilliant ideas, boundless energy, and a vision that could change the world. You're probably juggling a million things – product development, market research, team building, and, of course, fundraising. Amidst all this, there's one document that often gets overlooked, misunderstood, or simply put off until it becomes a headache: the capitalisation table, or 'cap table' for short.

Now, you might be thinking, 'Another spreadsheet? Really?' But trust us, your cap table is far more than just a dry list of numbers. It's the genetic code of your company, a living, breathing document that tells the story of who owns what, how much, and under what conditions. It's the foundational blueprint of your startup's ownership structure, and understanding it inside out is absolutely crucial for your long-term success.

What is a Cap Table?

At its core, a cap table is a detailed record of your company's equity ownership. Think of it as a snapshot, or perhaps a constantly evolving family tree, showing every single person or entity that holds a piece of your company. This includes you, your co-founders, early employees, advisors, and, of course, your investors. It meticulously tracks the types of shares they hold (common, preferred), the number of shares, their percentage of ownership, and how that ownership changes over time, especially as you raise more capital.

It's not just about who owns what today; it's about understanding the potential future state of your ownership, particularly when new investment rounds come into play. A well-maintained cap table allows you to see the fully diluted ownership – that's what everyone would own if all potential shares (like those from employee stock options or convertible notes) were converted into actual shares.

Why is it Crucial for Founders?

Here's the rub: many founders, especially at the pre-seed and seed stages, treat their cap table as an afterthought. Big mistake. Your cap table isn't just an administrative chore; it's a strategic asset. Here's why it's absolutely vital:

Clarity of Ownership: It provides an unambiguous record of who owns what. This prevents disputes among founders, employees, and investors down the line, which can be incredibly costly and damaging.

Fundraising Readiness: Investors, particularly those at Series A and beyond, will scrutinise your cap table with a fine-tooth comb. A messy, inaccurate, or poorly understood cap table is a massive red flag that can derail a funding round faster than you can say 'due diligence'.

Strategic Decision-Making: Your cap table directly impacts your ability to raise future rounds, attract talent, and even plan for an eventual exit. Understanding dilution, option pools, and investor rights allows you to make informed decisions that protect your equity and the company's future.

Employee Motivation: A clear and fair equity plan, properly reflected in your cap table, is essential for attracting and retaining top talent. Employees want to understand their stake in the company's success.

Exit Planning: When it comes time for an acquisition or IPO, your cap table will dictate how the proceeds are distributed. Any ambiguities or errors can lead to significant delays and legal battles.

Who is This Handbook For?

This handbook is specifically crafted for founders navigating the exciting, yet often bewildering, journey from pre-seed to Series A funding. Whether you're just sketching out your initial equity split with co-founders, contemplating your first angel investment, or gearing up for a significant Series A round, this guide is for you.

We'll cover the basics, delve into the nuances, and highlight the pitfalls to avoid, all with a practical, founder-first approach. This isn't academic theory – it's battle-tested advice from the trenches of startup fundraising.

How to Use This Handbook

Consider this your trusted companion, a no-nonsense guide to demystifying the cap table. We've structured it to be useful, to the point, and, dare we say, interesting. Each chapter includes:

- **TL;DR sections** for when you need the key points quickly
- **Practical frameworks** you can apply immediately
- **Worked examples** with real numbers
- **Action items** for each week
- **Red-flag warnings** to help you avoid common mistakes

Don't just read it; use it as a reference, come back to it as your company evolves, and let it be a tool that helps you make smarter, more strategic decisions about your startup's most valuable asset: its ownership.

The appendices contain the tools you'll actually use – checklists, calculators, and reference guides that you can copy and adapt for your own company.

A Word on Tone

We're not here to impress you with jargon or overwhelm you with legal complexity. We're here to give you the knowledge and confidence to master your cap table and make decisions that will serve your company well for years to come.

So, let's dive in, shall we? Your cap table awaits, and it's time to master it.

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Start Here: Your Next 10 Decisions About Equity

TL;DR

- Ten critical equity decisions determine your startup's success from day one to Series A
- Get founder splits, vesting, and ESOP sizing right early—they're nearly impossible to fix later
- Model dilution before every funding round; surprises kill founder ownership

Alright, let's cut to the chase. You're a founder. You're busy. You need to know what matters *now*. This chapter is your executive summary for the entire handbook. It's a list of the ten most critical decisions you'll make about your startup's equity, from day one to your Series A. Get these right, and you're on solid ground. Get them wrong, and you're storing up a world of pain for later.

Think of this as your strategic checklist. We'll dive deep into each of these topics in the chapters to follow, but for now, let's get them on your radar.

The 10 Critical Equity Decisions

- **How will you split equity with your co-founders?** This is the first, and arguably most important, equity decision you'll make. It's not just about the numbers; it's about fairness, contribution, and protecting the company if a founder leaves.
- **What vesting schedule will you put in place?** Vesting is non-negotiable. It ensures that founders and employees earn their equity over time. A standard four-year vest with a one-year cliff is the norm for a reason.
- **How will you size your employee stock option pool (ESOP)?** Your ESOP is your most powerful tool for attracting and retaining talent. You need to decide how much equity to set aside and how you'll grant it.
- **Will you use SAFEs or convertible notes for your first funding?** These instruments are the standard for early-stage funding, but they have different implications for dilution and control. You need to understand the difference between pre-money and post-money SAFEs.

- **What valuation cap and discount will you offer early investors?** These two numbers will have a significant impact on how much of your company you give away in your first funding rounds. You need to get comfortable with the maths.
- **How will you model dilution from future funding rounds?** Dilution is inevitable, but it doesn't have to be a surprise. You need to build a simple model to understand how your ownership will change as you raise more capital.
- **What kind of liquidation preference will you give your Series A investors?** This is a critical term in any venture deal. A 1x non-participating preference is the founder-friendly standard. Anything else needs careful consideration.
- **Who will control your board of directors?** Board control is a big deal. You need to think carefully about who you invite onto your board and how you'll manage investor influence.
- **What protective provisions will you agree to?** These are the "veto rights" that you give your investors. You need to make sure they are reasonable and don't give investors too much control over the day-to-day running of your company.
- **Who will be responsible for keeping your cap table clean and up-to-date?** Your cap table is a living document. You need to have a clear process for keeping it accurate and a single owner who is responsible for it.

Founder Actions This Week

1. **Have the co-founder equity conversation.** If you haven't already, now is the time. Use the frameworks in this handbook to guide you.
2. **Draft your vesting agreements.** Don't put this off. Get them in place before you hire anyone or take any investment.
3. **Build a simple cap table.** You can use a spreadsheet to start. Just get the basics down on paper.

Quick Decision Framework

Decision	When to Act	When to Wait
Co-founder Split	Day 1	Never
Vesting	Day 1	Never
ESOP Sizing	Pre-first hire	After problem fit and early traction
SAFEs vs Notes	First funding	If you can bootstrap
Valuation Cap	First funding	If you can get a priced round
Dilution Modelling	Pre-funding	Never
Liquidation Prefs	Series A	Pre-seed/seed
Board Control	Series A	Pre-seed/seed
Protective Provisions	Series A	Pre-seed/seed
Cap Table Hygiene	Day 1	Never

Chapter 1: Build It Right from Day One

TL;DR

- Founder equity splits and vesting are nearly impossible to fix later—get them right from day one
- Use ESOP grant bands to standardise equity offers and manage your option pool effectively
- First investor cheques set precedents for all future rounds—understand the terms

Map Your Ownership: The Founder Equity Split

This is it. The first big test of your co-founder relationship. The equity split conversation can be awkward, emotional, and fraught with tension. But it's a conversation you absolutely must have, and you must have it early. Putting it off is a recipe for disaster.

There's no single 'right' way to split equity, but there are plenty of wrong ways. A 50/50 split might seem fair, but is it? What if one founder is bringing more experience, capital, or a critical skill set to the table? What if one founder is working full-time while the other is still part-time?

Here are a few frameworks to guide your conversation:

- **The 'Even Stevens' Split:** This is the default for many founding teams. It's simple, and it sends a message of equal partnership. But it can breed resentment if contributions aren't truly equal.
- **The 'Contribution' Split:** This is a more nuanced approach. You assign points to different contributions, such as:
 - Idea and vision
 - Domain expertise
 - Capital investment
 - Full-time commitment
 - Pre-existing IP
- **The 'Dynamic' Split:** This is a more complex approach where the equity split can change over time based on hitting certain milestones. It's flexible, but it can also be a source of ongoing negotiation and friction.

Founder Vesting That Protects Everyone

Vesting is your safety net. It protects the company, your co-founders, and your investors if a founder decides to leave. Without vesting, a founder could walk away with a significant chunk of the company's equity without having put in the time and effort to earn it.

The standard vesting schedule is four years with a one-year cliff. This means that a founder must stay with the company for at least one year to receive any equity. After the one-year cliff, the founder's equity will vest on a monthly or quarterly basis over the remaining three years.

Key Vesting Terms:

- **Vesting Period:** The total time over which the equity is earned (usually four years).
- **Cliff:** The initial period that must be completed before any equity vests (usually one year).
- **Acceleration:** A provision that allows for the vesting of unvested equity upon the occurrence of a specific event, such as an acquisition. Single-trigger acceleration (vesting on acquisition) is common. Double-trigger acceleration (vesting on acquisition *and* termination without cause) is even more founder-friendly.

ESOP Grant Bands by Role and Seniority

Your employee stock option pool (ESOP) is your secret weapon in the war for talent. It allows you to compete with larger, better-funded companies by offering employees a piece of the upside. But how much equity should you give to your first hires? And how should that change as the company grows?

This is where ESOP grant bands come in. Grant bands are a way of standardising equity compensation by role and seniority. They provide a framework for making fair and consistent equity offers, and they help you to manage your option pool effectively.

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Refer to **Appendix C** for a detailed breakdown of ESOP grant bands by role, seniority, and stage. But here are a few key principles:

- **Early hires get more equity.** Your first 10 employees are taking a huge risk. They should be rewarded accordingly.
- **Seniority matters.** A VP of Engineering will get a larger grant than a junior engineer.
- **Equity is not a substitute for salary.** You should still pay your employees a competitive salary. Equity is the icing on the cake.

First Investor Cheques Without Regret

Taking your first investment is a huge milestone. But it's also a decision that will have long-term consequences for your company. The terms of your first funding round will set a precedent for all future rounds, so it's important to get them right.

Most pre-seed and seed rounds are done using SAFEs (Simple Agreements for Future Equity) or convertible notes. These are simpler and cheaper than priced rounds, but they still have their complexities.

Key Terms to Understand:

- **Valuation Cap:** The maximum valuation at which the SAFE or note will convert into equity.
- **Discount:** A discount on the price of the next funding round.
- **Pre-money vs Post-money SAFEs:** This is a critical distinction that affects how much dilution you take on. See **Appendix D** for a detailed explanation.

Founder Actions This Week

1. **Schedule the equity conversation.** Don't do it over text or email. Sit down together, face-to-face.
2. **Use a framework.** Don't just pull numbers out of thin air. Use a structured approach to guide your conversation.
3. **Get it in writing.** Once you've agreed on a split, document it in a founder agreement.

Chapter 2: Bridge to Your Next Round

TL;DR

- Post-money SAFEs stack dilution on founders; pre-money SAFEs are more founder-friendly
- MFN clauses can quietly worsen dilution if later SAFEs get better terms
- Model all convertible scenarios before signing—surprises kill ownership

SAFES, Notes, and Convertible Instruments

Welcome to the world of convertible instruments. For most early-stage founders, this is how you'll raise your first significant capital. Instead of setting a firm valuation and selling shares (a 'priced round'), you'll use instruments that convert into equity at a later date, typically your Series A. The two most common vehicles are SAFEs (Simple Agreements for Future Equity) and Convertible Notes.

Why use them? They are generally faster, cheaper, and simpler than a priced round. They defer the difficult conversation about valuation until you have more data and traction. But don't be fooled by the simplicity. The devil is in the details, and the choices you make here will have a significant impact on your cap table down the line.

SAFE Pre-Money vs Post-Money (With Dilution Math)

This is, without a doubt, the most important concept to understand when using SAFEs. The distinction between a 'pre-money' SAFE and a 'post-money' SAFE determines who bears the dilution from other convertible instruments. In short:

- **Post-Money SAFE:** The investor's ownership percentage is fixed. Any subsequent SAFEs or convertible notes will dilute the founders, not the post-money SAFE holders.
- **Pre-Money SAFE:** The investor's ownership percentage is not fixed. It can be diluted by other SAFEs and convertible notes issued after it.

Let's be clear: **post-money SAFEs are investor-friendly, and pre-money SAFEs are founder-friendly.** The market has shifted towards post-money SAFEs in recent years, largely driven by Y Combinator's updated SAFE documents. This means you need to be extra careful when raising multiple rounds on post-money SAFEs, as the dilution can stack up on you, the founder, very quickly.

We've created a detailed, worked example in **Appendix D** that walks you through the math. You need to read it, understand it, and model it for your own fundraising scenarios.

Caps, Discounts, and MFN Clauses That Bite Back

Beyond the pre-money vs post-money distinction, there are three other key terms in any SAFE or convertible note:

- **Valuation Cap:** This sets the maximum valuation at which the instrument will convert into equity. A lower cap is better for the investor, as it means they get more equity for their money.
- **Discount:** This gives the investor a discount on the price of the next funding round. A 20% discount is standard. If you have a valuation cap, the investor will get the better of the two conversion prices (either the cap or the discount).
- **Most Favoured Nation (MFN) Clause:** This is a provision that gives the investor the right to adopt the terms of any subsequent, more favourable convertible instrument.

MFN upgrades early SAFEs to the best later terms (lower cap/higher discount/better pro-rata). Treat it like a hidden stacker—model all MFN paths before issuing a new paper.

When Convertibles Help vs Hurt

Convertible instruments are a fantastic tool for early-stage fundraising. But they are not without their risks. Here's a quick rundown of when they help and when they can hurt:

When they help:

- **You need to raise money quickly.** A SAFE or convertible note can be closed in a matter of days.
- **You don't have the traction to set a valuation.** Deferring the valuation conversation can be a smart move.
- **You want to keep legal costs down.** A standard SAFE is much cheaper than a full priced round.

When they can hurt:

- **You raise too much money on too many convertibles.** The 'death by a thousand cuts' scenario is real. The stacked dilution from multiple post-money SAFEs can be brutal.
- **You have complex MFN clauses.** This can lead to a messy and unpredictable cap table.
- **You don't understand the conversion math.** You need to model how your convertibles will impact your ownership at the next round.

Founder Actions This Week

1. **Read Appendix D. Twice.** Make sure you understand the dilution math.
2. **If you're raising on post-money SAFEs, model the impact of multiple closes.** Don't be surprised by the final dilution.
3. **Try to limit the number of individual SAFEs you issue.** A single, larger SAFE is easier to manage than a dozen smaller ones.

Chapter 3: Make Dilution Work for You

TL;DR

- Smart dilution compounds value—would you rather own 100% of £1m or 20% of £100m?
- Weighted-average anti-dilution is much gentler than full ratchet (avoid full ratchet at all costs)
- Model three scenarios: clean seed→A, heavy SAFEs, and down-round with anti-dilution

Models and Anti-Dilution Mechanics

Dilution. It's a word that strikes fear into the heart of every founder. It's the process of your ownership percentage shrinking as you issue new shares to investors and employees. And while it's often seen as a negative, that's the wrong way to think about it. Dilution is not the enemy. It's the fuel for your growth. The goal is not to avoid dilution at all costs; the goal is to manage it strategically, ensuring that every percentage point you give up is in exchange for something of greater value – capital, talent, or expertise.

Think of it like this: would you rather own 100% of a £1 million company or 20% of a £100 million company? The answer is obvious. The pie is getting bigger, and while your slice is proportionally smaller, its absolute value is exponentially greater. That's dilution that compounds value.

Three Dilution Scenarios Every Founder Should Model

To make dilution work for you, you need to understand it. And to understand it, you need to model it. You don't need a complex financial model to do this. A simple spreadsheet will do. Here are three scenarios that every founder should model before they start fundraising:

- **The 'Clean Seed to A' Scenario:** This is the best-case scenario. You raise a seed round on a single SAFE or convertible note, and then you go on to raise a healthy Series A. This model will help you to understand the basic mechanics of dilution in a priced round.

- **The 'Heavy SAFEs at Low Cap to A' Scenario:** This is a more common, and more complex, scenario. You raise multiple rounds on post-money SAFEs with low valuation caps. This model will show you how dilution can stack up on you, the founder, and how a low cap can have a big impact on your ownership.
 -
- **The 'Down-Round with Weighted-Average Anti-Dilution' Scenario:** This is the scenario that everyone dreads, but you need to be prepared for it. A down-round is when you raise money at a lower valuation than your previous round. This can trigger anti-dilution provisions, which protect your investors but can be very painful for founders.

We'll provide detailed, worked examples of these three scenarios in **Appendix E**.

Weighted-Average vs Full Ratchet (Worked Examples)

Anti-dilution provisions are designed to protect investors in a down-round. They work by adjusting the conversion price of the investor's preferred shares, effectively giving them more shares to compensate for the lower valuation. There are two main types of anti-dilution provisions:

- **Full Ratchet:** This is the most aggressive and founder-unfriendly type of anti-dilution. It reprices the investor's shares to the new, lower price of the down-round, regardless of how many shares are issued in the down-round. It's a brutal mechanism that can wipe out a huge amount of founder equity. **You should avoid full ratchet anti-dilution at all costs.**
- **Weighted-Average:** This is a more moderate and founder-friendly type of anti-dilution. It takes into account the number of shares issued in the down-round, resulting in a less severe adjustment to the conversion price. There are two types of weighted-average anti-dilution: broad-based and narrow-based. Broad-based is more common and more founder-friendly.

We've included a worked example of weighted-average anti-dilution in **Appendix E**. You need to understand how it works, as it's a standard feature of most Series A term sheets.

How to Negotiate Dilution That Compounds Value

Dilution is a negotiation. It's a trade-off between ownership and capital. Here are a few tips for negotiating dilution that compounds value:

- **Focus on the post-money valuation.** This is the number that really matters. A higher post-money valuation means less dilution.
- **Justify your valuation with traction.** The more progress you can show, the more leverage you'll have in the negotiation.
- **Create a competitive process.** The best way to get a good valuation is to have multiple investors competing for your deal.
- **Don't be afraid to walk away.** If an investor is offering you a bad deal, you need to be prepared to say no.

Founder Actions This Week

1. **Build a simple dilution model in a spreadsheet.** Use our examples in Appendix E as a guide.
2. **Model the impact of different valuation caps and round sizes.** See how these variables affect your ownership.
3. **Update your model after every funding round.** Your model should be a living document.

Chapter 4: Series A Without Regret

TL;DR

- 1× non-participating preferred is the founder-friendly standard for liquidation preferences
- Fight for post-money option pool placement—it can save you 3-4 percentage points of dilution
- Three-person board with independent director prevents investor control

Liquidation Preferences That Don't Kill Upside

This is, without a doubt, the most important economic term in a Series A term sheet. A liquidation preference determines who gets paid first, and how much they get paid, in a liquidation event (an acquisition or a sale of the company). It's the investor's downside protection. They put their capital at risk, and they want to make sure they get their money back before anyone else.

There are two main types of liquidation preferences:

- **Non-Participating Preferred:** This is the founder-friendly standard. In a liquidation event, the investor has a choice: either take their preference (usually 1x their investment) or convert to common stock and share in the proceeds with the founders and employees. They can't do both. This aligns the interests of the investors and the founders. In a successful exit, the investors will convert to common and everyone will make money together.
- **Participating Preferred:** This is the investor-friendly option. In a liquidation event, the investor gets their preference *and* they get to participate in the remaining proceeds on a pro-rata basis. This is often referred to as "double-dipping." It can have a huge impact on the amount of money that founders and employees receive in a mid-range exit. **You should avoid participating preferred stock if at all possible.**

We've included a detailed breakdown of liquidation preferences, with worked examples, in **Appendix F**.

Board Composition and Control Dynamics

Your board of directors is responsible for the overall governance of your company. They have the power to hire and fire the CEO, approve the budget, and make major strategic decisions. In a Series A round, you will almost certainly be giving up a board seat to your lead investor. This is a normal and expected part of the process. But you need to be very careful about how you structure your board to ensure that you, the founder, remain in control.

The ideal board structure for a Series A company is a three-person board:

- One founder representative (usually the CEO)
- One investor representative (from your lead investor)
- One independent director (mutually agreed upon by the founders and investors)

This structure ensures that no single party has control of the board. The independent director acts as a tie-breaker, which forces everyone to work together and build consensus.

Option Pool Placement (Who Bears the Dilution?)

As part of your Series A round, your new investors will require you to create or increase your employee stock option pool (ESOP). This is to ensure that there is enough equity to attract and retain talent until your next funding round. But who bears the dilution from this new option pool? The answer to this question is determined by whether the option pool is created "pre-money" or "post-money."

Pool Placement Worked Example:

Pre-money £12m, raise £4m, founders 10.0m shares, target pool 15% post-money.

Pre-money pool:

- Pool = 2.5m shares; Investor = 4.17m shares
- **Final:** Founders 60.0%, Investor 25.0%, Pool 15.0%

Post-money pool:

- Investor = 3.33m shares, then add pool = 2.35m shares
- **Final:** Founders 63.8%, Investor 21.3%, Pool 15.0%

Takeaway: Post-money pool saves founders ~3.8pp here; always model.

This is a subtle but important point. Investors will always push for the option pool to be created pre-money, as it means they don't have to bear the dilution. You should push back and argue for the option pool to be created post-money. It's a negotiation, and the outcome will depend on your leverage.

Secondary Sales at Series A/B

As your company matures, you may want to take some money off the table through secondary sales. This is when you sell some of your existing shares to investors, rather than the company issuing new shares. Secondary sales can be acceptable when done properly, but there are important guardrails:

When they're acceptable:

- Typically up to 10-15% of founder holdings with board/lead consent
- Tied to company milestones or performance targets
- Not executive-only liquidity (team should participate)

ROFR/co-sale interplay:

- Right of first refusal (ROFR) gives the company first option to buy
- Co-sale rights allow other shareholders to participate pro-rata
- These can slow down secondary transactions but provide important protections

Optics matter: Secondary sales signal confidence if done modestly, but can signal lack of commitment if overdone.

Founder Re-vesting Guardrails

It's becoming increasingly common for investors to ask founders to re-vest a portion of their equity at Series A. This can be a tough pill to swallow, but it can also signal your long-term commitment to the company.

What's reasonable:

- Re-vesting 25-50% of founder equity over 3-4 years
- Credit for time already served (e.g., 1 year cliff already satisfied)
- Double-trigger acceleration (vesting on acquisition AND termination without cause)
- No re-vesting for advisors or early employees

Protective Provisions Red Flags

Protective provisions are a set of "veto rights" that you give to your investors. They are designed to protect the investors from the company making major decisions without their consent. While some protective provisions are standard and reasonable, others can be a sign of an overly controlling investor.

Refer to **Appendix B** for a detailed list of protective provisions and their corresponding red-flag ratings.

Founder Actions This Week

1. **Model option pool placement scenarios.** Use the worked example above to see the dilution impact.
2. **Push for a three-person board with an independent director.** Don't agree to investor control.
3. **Insist on 1× non-participating preferred stock.** This is the market standard.

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Chapter 5: Operate the Machine

TL;DR

- Single owner, 48-hour update rule, monthly hygiene—cap table discipline prevents disasters
- Transparent equity communication builds trust with investors and employees
- Use cap table management platforms as you scale beyond spreadsheets

Monthly Cap Table Hygiene Checklist

Good cap table hygiene is all about process. It's about having a regular cadence for reviewing and updating your cap table to ensure that it's always accurate. Here's a simple monthly checklist that you can use to stay on top of things:

- **Reconcile with legal documents:** Cross-reference your cap table with all the underlying legal documents (founder agreements, option grants, convertible notes, etc.) to ensure that everything matches up.
- **Update for new hires and departures:** Have you hired any new employees? Have any employees left the company? Make sure that all option grants and cancellations are properly reflected in your cap table.
- **Track vesting progress:** Update the vesting schedule for all founders and employees. This is especially important if you have monthly or quarterly vesting.
- **Review for errors:** Even the most carefully managed cap table can have errors. Take the time to review it for any inconsistencies or mistakes.
- **Backup your cap table:** This should go without saying, but make sure you have a secure backup of your cap table in a separate location.

We've included a more detailed version of this checklist in **Appendix A: Cap Table Readiness Checklist**.

Who Owns Updates and When

To avoid confusion and errors, you need to have a single owner who is responsible for maintaining your cap table. In the early days, this will probably be you, the founder. As the company grows, you may delegate this responsibility to your CFO or a dedicated finance person. But there should always be one person who is ultimately responsible for the accuracy of the cap table.

In addition to having a single owner, you also need to have a clear process for when the cap table should be updated. The rule of thumb is that the cap table should be updated within 48 hours of any equity-related event.

Investor and Employee Equity Communications

Your cap table is not just a financial document; it's a communication tool. It's a way of showing your investors and employees how much they own and what their stake in the company is worth. Clear and regular communication about equity is essential for building trust and alignment.

For Investors:

- Provide a copy of the cap table after every funding round
- Include a summary in quarterly investor updates
- Be prepared to answer questions about the cap table

For Employees:

- Provide clear explanation of equity grants
- Give access to employee portal for viewing equity
- Hold regular all-hands meetings about company performance and equity value

Founder Actions This Week

1. **Schedule a monthly cap table review.** Put it in your calendar and treat it like any other important meeting.
2. **Designate a single owner for your cap table.** Make it clear who is responsible.
3. **Establish a 48-hour update rule.** Don't let things slide.

Chapter 6: Avoid Avoidable Pain

TL;DR

- Dead equity kills cap tables—use vesting and repurchase rights to keep equity with contributors
- Term sheet red flags can be spotted early with the traffic light system (Appendix B)
- Clean documentation prevents legal disputes and funding delays

Dead Equity Playbook: Re-vesting and Repurchase Rights

"Dead equity" is equity that is held by people who are no longer contributing to the company. This can be a founder who leaves early, an employee who is fired, or an advisor who disappears after a few months. Dead equity is a problem because it takes up valuable space on your cap table and it can create a misalignment of interests.

The best way to deal with dead equity is to prevent it from happening in the first place. This is where vesting comes in. As we discussed in Chapter 1, all founders and employees should be on a vesting schedule. If they leave before their equity is fully vested, the unvested portion is returned to the company.

But what about the vested portion? This is where a repurchase right comes in. A repurchase right gives the company the option to buy back a departing employee's vested shares at fair market value. This is a powerful tool for cleaning up your cap table and ensuring that equity stays in the hands of the people who are actively contributing to the company.

Term Sheet Red Flags (Traffic Light System)

Your Series A term sheet is a legally binding document that will govern your relationship with your investors for years to come. It's full of complex legal jargon, and it can be easy to get lost in the details. But there are a few key terms that you absolutely must understand.

We've created a **Term Sheet Red-Flag Guide (Appendix B)** that breaks down the most important terms in a Series A term sheet and gives them a red, amber, or green rating. This will help you to quickly identify the terms that are market standard and the terms that you should push back on.

Clean Documentation Checklist

A messy cap table is often a symptom of messy documentation. If you don't have a clean and complete record of all your equity-related transactions, it's only a matter of time before your cap table becomes a tangled mess. Here's a simple checklist to help you keep your documentation in order:

- **Signed founder agreements:** Make sure you have signed copies of all your founder agreements.
- **Signed option grant agreements:** Every employee who has been granted options should have a signed agreement.
- **Board resolutions for all equity issuances:** Every time you issue new equity, it needs to be approved by your board of directors.
- **A complete record of all convertible instruments:** You should have a log of all your SAFEs and convertible notes, including the key terms (cap, discount, MFN, etc.).
- **A single, up-to-date cap table:** As we discussed in Chapter 5, you should have a single source of truth for your cap table.

Founder Actions This Week

1. **Put everyone on a vesting schedule.** No exceptions.
2. **Read the Term Sheet Red-Flag Guide (Appendix B) before you sign a term sheet.** You need to know what you're signing.
3. **Create a dedicated folder for all your equity-related documents.** Keep everything in one place.

Appendix A: Cap Table Readiness Checklist

Pre-Round Checklist

Company Structure

- Articles of incorporation filed and current
- Share classes properly defined (common, preferred)
- Board resolutions for all equity issuances
- Option plan approved and documented

People & Equity

- Founder vesting agreements signed and filed
- All advisor equity letters executed
- Employee option grants issued and signed
- Consultant equity properly documented

Instruments & Convertibles

- All SAFEs/notes logged with terms (cap, discount, MFN, pro-rata)
- Conversion mechanics clearly documented
- Most Favoured Nation (MFN) clauses tracked
- Outstanding warrants or other convertibles listed

Records & Documentation

- Share register ties to certificates
- All equity documents stored securely
- Access controls in place for sensitive documents
- Legal counsel contact details current

Post-Round Checklist

- New shares issued and certificates generated
- Board resolutions passed for new issuance
- Updated articles filed with Companies House (UK) / Secretary of State (US)
- Investor rights agreements executed
- Updated option pool sized and approved
- All convertible instruments converted or updated
- Cap table updated within 48 hours
- Investor onboarding completed

Monthly Hygiene Checklist

- Single source of truth maintained (one master cap table)
- All equity changes logged within 48 hours
- Quarterly cap table audit completed
- Employee equity communications up to date
- Investor reporting package includes current cap table
- Legal and accounting teams have latest version
- Backup copies stored securely

Red Flags to Address Immediately:

- Multiple versions of cap table in circulation
- Unexercised options approaching expiry
- Missing signatures on equity documents
- Convertible instruments with unclear terms
- Founder vesting schedules not properly documented

Appendix B: Term Sheet Red-Flag Guide (Traffic Light System)

GREEN - Standard Market Terms (Accept)

Liquidation Preferences

- 1× non-participating preferred
- Straight liquidation preference (no participation)

Anti-Dilution

- Broad-based weighted average
- Narrow-based weighted average (acceptable but less founder-friendly)

Option Pool

- Sized for 12-18 months of hiring
- Pool sized post-money (investors don't bear dilution)

Board Composition

- Investor gets 1 seat on 3-person board
- Independent director for tie-breaking

Protective Provisions

- Major corporate actions only (M&A, liquidation, new equity rounds)
- Budget approval for annual plans
- Hiring/firing of CEO

Pro-Rata Rights

- Standard pro-rata participation rights
- Reasonable information rights

AMBER - Negotiate Carefully (Proceed with Caution)

Liquidation Preferences

- 1× participating preferred with 2× cap
- Multiple liquidation preference (1.5×)

Anti-Dilution

- Narrow-based weighted average (less protection for founders)
- Pay-to-play provisions (forces participation in future rounds)

Option Pool

- Oversized pool (>20% pre-money)
- Pool sized pre-money (founders bear all dilution)

Board Composition

- Investor-controlled board from Series A
- Investor gets 2+ seats early

Protective Provisions

- Operational decisions requiring approval
- Hiring approval for senior roles
- Compensation committee control

Other Terms

- Drag-along rights with low thresholds
- Tag-along rights that slow M&A
- Redemption rights (investor can force buyback)

RED - Avoid or Walk Away (Serious Red Flags)

Liquidation Preferences

- 1× participating preferred uncapped
- Multiple liquidation preference (2×+)
- Cumulative dividends

Anti-Dilution

- Full ratchet anti-dilution
- Weighted average with narrow base and low threshold

Board & Control

- Investor majority control from seed/Series A
- Supermajority voting on routine matters
- CEO removal without cause

Protective Provisions

- Micromanagement of day-to-day operations
- Approval required for individual hires
- Veto over product decisions
- Control over IP licensing

Economic Terms

- Management fees or monitoring fees
- Excessive option pool (>25%)
- Founder vesting acceleration removal
- No-shop periods >60 days

Appendix C: ESOP Grant Bands Reference

- Pre-Series A Grant Ranges (% of Fully Diluted)

Engineering & Product

Role Level	Engineering	Product	Vesting
C-Level			
CTO/CPO	1.0% - 3.0%	1.0% - 3.0%	4yr, 1yr cliff
VP Engineering	0.5% - 1.5%	-	4yr, 1yr cliff
VP Product	-	0.5% - 1.5%	4yr, 1yr cliff
Senior Level			
Engineering Manager	0.2% - 0.5%	-	4yr, 1yr cliff
Senior Engineer	0.1% - 0.3%	-	4yr, 1yr cliff
Product Manager	-	0.1% - 0.4%	4yr, 1yr cliff
Mid Level			
Software Engineer	0.05% - 0.15%	-	4yr, 1yr cliff
Product Designer	-	0.05% - 0.2%	4yr, 1yr cliff
Junior Level			
Junior Engineer	0.01% - 0.05%	-	4yr, 1yr cliff
Junior Designer	-	0.01% - 0.05%	4yr, 1yr cliff

Sales & Marketing

Role Level	Sales	Marketing	Vesting
C-Level			
VP Sales	0.5% - 1.5%	-	4yr, 1yr cliff
VP Marketing	-	0.3% - 1.0%	4yr, 1yr cliff
Senior Level			
Sales Director	0.2% - 0.6%	-	4yr, 1yr cliff
Marketing Manager	-	0.1% - 0.3%	4yr, 1yr cliff
Mid Level			
Account Executive	0.05% - 0.2%	-	4yr, 1yr cliff
Marketing Specialist	-	0.03% - 0.1%	4yr, 1yr cliff
Junior Level			
SDR/BDR	0.01% - 0.05%	-	4yr, 1yr cliff

Operations & Advisors

Role Level	Operations	Advisors	Vesting
C-Level			
CFO/COO	0.5% - 1.5%	-	4yr, 1yr cliff
Mid Level			
Operations Manager	0.05% - 0.15%	-	4yr, 1yr cliff
Advisors			
Strategic Advisor	-	0.1% - 0.25%	24-48mo, quarterly
Board Advisor	-	0.2% - 0.5%	24-48mo, quarterly

Key Guidelines:

Timing Adjustments:

- **Employee #1-10:** Add 50-100% to base ranges
- **Employee #11-25:** Add 25-50% to base ranges
- **Employee #26-50:** Use base ranges
- **Employee #51+:** Reduce by 25-50%

Performance Adjustments:

- **Exceptional hire:** +50% of range
- **Strong hire:** Top of range
- **Standard hire:** Middle of range
- **Risk hire:** Bottom of range

Geographic Adjustments:

- **Silicon Valley/London:** +25-50%
- **Major tech hubs:** Base ranges
- **Secondary markets:** -25-40%
- **Remote:** Depends on location

Post-Series A Adjustments:

- Reduce all ranges by 40-60%
- Focus on cash compensation increases
- Reserve equity for key strategic hires

Appendix D: SAFE Pre-Money vs Post-Money Guide

The Key Difference

Post-Money SAFE: Investor percentage is fixed regardless of other SAFEs

Pre-Money SAFE: Investor percentage can be diluted by subsequent SAFEs

Worked Example: £500k Investment

Company Setup:

- Founders own 8,000,000 shares
- Raising £500k via SAFE
- Planning Series A at £5m pre-money

Scenario 1: Post-Money SAFE at £4m

SAFE Terms:

- Investment: £500k
- Post-money valuation cap: £4m
- Investor gets: $\text{£500k} \div \text{£4m} = \mathbf{12.5\% \text{ fixed}}$

At Series A Conversion:

- Series A: £2m at £5m pre-money (£7m post-money)
- SAFE converts at lower of cap (£4m) or Series A pre-money (£5m)
- SAFE uses £4m cap (better for investor)

Final Ownership:

- SAFE investor: **12.5%** (fixed)
- Series A investor: $\text{£2m} \div \text{£7m} = 28.6\%$
- Founders: $100\% - 12.5\% - 28.6\% = \mathbf{58.9\%}$

Scenario 2: Pre-Money SAFE at £3.5m

SAFE Terms:

- Investment: £500k
- Pre-money valuation cap: £3.5m
- Post-money: £3.5m + £500k = £4m
- Initial investor percentage: $£500k \div £4m = 12.5\%$

But then... Second SAFE issued:

- Another £300k SAFE at £3.5m pre-money
- This dilutes the first SAFE investor!

At Series A Conversion:

- Total SAFE money: £800k
- Converts at £3.5m pre-money cap
- SAFE investors get: $£800k \div (£3.5m + £800k) = 18.6\%$
- First SAFE investor: $(£500k \div £800k) \times 18.6\% = \mathbf{11.6\%}$
- Second SAFE investor: $(£300k \div £800k) \times 18.6\% = \mathbf{7.0\%}$

Final Ownership:

- Total SAFE investors: **18.6%**
- Series A investor: $£2m \div £7m = 28.6\%$
- Founders: $100\% - 18.6\% - 28.6\% = \mathbf{52.8\%}$

Summary Table

SAFE Type	First Investor Gets	Founder Dilution	Risk Level
Post-Money	12.5% (fixed)	58.9% final	Lower for investor
Pre-Money	11.6% (diluted)	52.8% final	Higher for investor

Key Takeaways:

For Founders:

- Pre-money SAFEs are more founder-friendly
- Post-money SAFEs can stack dilution quickly
- Always model multiple SAFE scenarios

For Investors:

- Post-money SAFEs provide certainty
- Pre-money SAFEs carry dilution risk from future SAFEs
- MFN clauses can help but add complexity

MFN upgrades early SAFEs to the best later terms (lower cap/higher discount/better pro-rata). Treat it like a hidden stacker—model all MFN paths before issuing a new paper.

-

Appendix E: Three Scenario Models (Detailed Calculations)

Scenario 1: Clean Seed to A (Best Case)

This is the textbook scenario. Single SAFE, clean conversion, healthy Series A.

Initial Setup:

- Founder shares: 8,000,000
- Founder ownership: 100%

Seed Round (SAFE):

- Investment: £500,000
- Valuation cap: £4,000,000
- Implied ownership at cap: 12.5%

Series A Round:

- Investment: £2,000,000
- Pre-money valuation: £5,000,000
- Post-money valuation: £7,000,000

SAFE Conversion:

- Converts at: £4,000,000 (lower of cap vs pre-money)
- SAFE shares issued: 1,000,000
- Series A shares issued: 2,571,429

Final Ownership:

- **Founders: 69.1%** (8,000,000 shares)
- **SAFE investor: 8.6%** (1,000,000 shares)
- **Series A: 22.2%** (2,571,429 shares)
- **Total shares: 11,571,429**

Key Takeaway: Clean structure, reasonable dilution. Founders retain strong control.

Scenario 2: Heavy SAFEs at Low Cap to A (Dilution Stacking)

This shows how multiple post-money SAFEs can stack dilution on founders.

Initial Setup:

- Founder shares: 8,000,000
- Founder ownership: 100%

Multiple SAFE Rounds (Post-Money):

- SAFE 1: £200,000 at £2,000,000 cap = **10.0% fixed**
- SAFE 2: £300,000 at £2,500,000 cap = **12.0% fixed**
- SAFE 3: £400,000 at £3,000,000 cap = **13.3% fixed**
- Total SAFE investment: £900,000

Series A Round:

- Investment: £2,000,000
- Pre-money valuation: £8,000,000 (higher due to traction)
- Post-money valuation: £10,000,000

Final Ownership (Post-Money SAFEs):

- **Founders: 44.7%** (lost majority control!)
- **SAFE 1: 10.0%**
- **SAFE 2: 12.0%**
- **SAFE 3: 13.3%**
- **Series A: 20.0%**
- **Total SAFE dilution: 35.3%**

Key Takeaway: Post-money SAFEs stack dilution on founders. Multiple low-cap SAFEs can cost you control.

Scenario 3: Down-Round with Weighted-Average Anti-Dilution

This shows how anti-dilution protects investors in a down-round.

Pre-Series B Setup:

- Founder shares: 6,000,000
- Series A shares: 2,000,000
- Series A price: £2.50 per share
- Total shares: 8,000,000

Series B (Down-Round):

- Investment: £3,000,000
- Price per share: £1.50 (down from £2.50)
- New shares issued: 2,000,000

Weighted-Average Anti-Dilution Calculation: Using formula: $\text{New Price} = \text{Old Price} \times [(A + B) \div (A + C)]$

- A (existing shares): 8,000,000
- B (shares at old price): 1,200,000
- C (shares at new price): 2,000,000
- **New conversion price: £2.30**
- **Additional Series A shares: 173,913**

Final Ownership After Anti-Dilution:

- **Founders: 59.0%** (6,000,000 shares)
- **Series A: 21.4%** (2,173,913 shares)
- **Series B: 19.7%** (2,000,000 shares)

Without Anti-Dilution Protection:

- Series A would own: 20.0%
- **Anti-dilution benefit: 1.4%**

Key Takeaway: Weighted-average anti-dilution is much gentler than full ratchet, but still protects investors at founders' expense.

Appendix F: Exit Waterfall Calculator

Liquidation Preference Impact Analysis

Cap Table Setup:

- Founders: 60%
- Series A: 40% (£2,000,000 invested)
- Liquidation preference: 1× non-participating

Exit Value	Series A Choice	Series A Payout	Founder Payout
£25m	Convert to common	£10,000,000	£15,000,000
£75m	Convert to common	£30,000,000	£45,000,000
£250m	Convert to common	£100,000,000	£150,000,000

Participating vs Non-Participating Comparison

Same cap table, but with 1× participating preferred:

Corrected Math:

- Investor payout = $0.40 \times \text{Exit} + 0.60 \times \text{£2m preference}$
- Founder payout = $0.60 \times \text{Exit} - 0.60 \times \text{£2m preference}$
- **Founders' shortfall vs non-participating = $0.60 \times \text{£2m} = \text{£1.2m}$**
(independent of exit size)

Exit Value	Non-Participating	Participating	Founder Difference
£25m	£15,000,000	£13,800,000	-£1,200,000
£75m	£45,000,000	£43,800,000	-£1,200,000
£250m	£150,000,000	£148,800,000	-£1,200,000

Key Takeaway: Participating preferred costs founders £1.2m in every scenario (60% of the liquidation preference amount). This is why 1× non-participating is the founder-friendly standard.

Appendix G: Jurisdiction Quick Notes

United States

Key Points:

- ISOs (Incentive Stock Options) vs NSOs (Non-Qualified Stock Options)
- 409A valuations required for option pricing
- 83(b) elections for early exercise
- Delaware incorporation standard for VC-backed companies

Talk to Counsel When:

- Setting up option plans
- Pricing options below fair market value
- Dealing with early exercise provisions
- Planning liquidity events

United Kingdom

Key Points:

- EMI (Enterprise Management Incentives) options offer tax advantages
- Company must qualify for EMI scheme (employees <250, assets <£30m)
- CSOP (Company Share Option Plan) as alternative
- EIS/SEIS for investor tax relief

Talk to Counsel When:

- Qualifying for EMI status
- Structuring international option plans
- Managing tax implications for employees
- Cross-border equity arrangements

EU/UAE

Key Points:

- Varies significantly by jurisdiction
- Tax treatment of options differs widely
- Some countries restrict foreign ownership
- Regulatory approval may be required

Talk to Counsel When:

- Setting up in any EU/UAE jurisdiction
- Cross-border equity structures
- Employee option plans for international teams
- Compliance with local securities laws

Appendix H: Glossary of Terms

- **Anti-Dilution Provisions:** Contractual protections that adjust an investor's conversion price in a down-round to maintain their economic position.
- **Board of Directors:** The governing body of a corporation, responsible for major strategic decisions and oversight of management.
- **Cap Table (Capitalisation Table):** A document showing the ownership structure of a company, including all shareholders and their respective ownership percentages.
- **Cliff:** A period of time that must pass before any equity vests. Typically one year for employees and founders.
- **Common Stock:** The basic form of corporate ownership, typically held by founders and employees. Usually has voting rights but is subordinate to preferred stock in liquidation.
- **Convertible Note:** A debt instrument that converts into equity at a future financing round, typically with a discount and/or valuation cap.
- **Dilution:** The reduction in ownership percentage that occurs when new shares are issued.
- **Drag-Along Rights:** Rights that allow majority shareholders to force minority shareholders to join in the sale of a company.
- **Employee Stock Option Pool (ESOP):** Shares set aside for employee equity compensation, typically 10-20% of the company.
- **Fully Diluted:** Ownership percentages calculated assuming all convertible securities (options, warrants, convertible notes) have been converted to common stock.
- **Liquidation Preference:** The right of preferred shareholders to receive their investment back before common shareholders in a liquidation event.

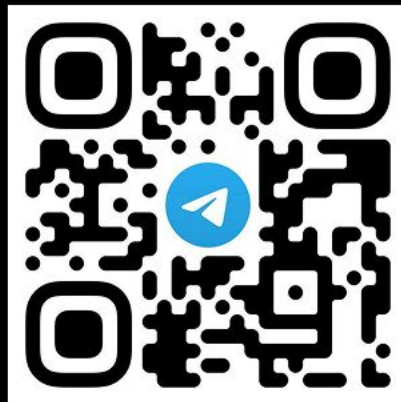
- **Most Favoured Nation (MFN):** A clause that automatically gives an investor the benefit of any better terms granted to future investors.
- **Non-Participating Preferred:** Preferred stock that must choose between its liquidation preference or converting to common stock (cannot do both).
- **Option Pool:** See Employee Stock Option Pool (ESOP).
- **Participating Preferred:** Preferred stock that receives its liquidation preference AND participates in remaining proceeds with common shareholders.
- **Post-Money Valuation:** The value of a company immediately after a financing round (pre-money + investment).
- **Pre-Money Valuation:** The value of a company immediately before a financing round.
- **Preferred Stock:** A class of ownership with special rights and preferences, typically held by investors.
- **Pro-Rata Rights:** The right of existing investors to participate in future financing rounds to maintain their ownership percentage.
- **Protective Provisions:** Veto rights given to investors over certain major corporate actions.
- **SAFE (Simple Agreement for Future Equity):** A convertible security that converts into equity at a future priced round, similar to a convertible note but without debt characteristics.
- **Tag-Along Rights:** Rights that allow minority shareholders to join in the sale of shares by majority shareholders.
- **Valuation Cap:** The maximum valuation at which a convertible security will convert into equity.

- **Vesting:** The process by which equity is earned over time, typically 25% after one year (cliff) and monthly thereafter.
- **Voting Rights:** The right to vote on corporate matters, typically held by common shareholders and some classes of preferred stock.
- **Waterfall:** The order in which proceeds are distributed in a liquidation event, typically preferred shareholders first, then common.
- **Weighted-Average Anti-Dilution:** A formula that adjusts conversion prices in a down-round based on the amount of new money raised and shares issued.

THANK YOU

FUSION42

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FOUNDERS, FRAMERS AND FUNDERS
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