7. Managing and financing the new venture

Key Terms

**83(b) election:** IRS provision giving founder shareholders the option to pay taxes on the total fair market value of their restricted stock (stock subject to vesting requirements) at the time of grant.

**Angel investor:** High net worth individual who invests directly in startups at the very earliest stage in exchange for equity.

**Anti-dilution provisions:** Gives present investors the right to maintain their ownership percentage in future financing rounds.

**Articles (or certificate) of incorporation:** Formal document filed with the Secretary of State establishing the existence of the corporation, and outlining its purpose, the incorporators, contact information, shares it is authorized to issue.

**Bootstrap:** Growing a business internally through earning revenue and saving money, without reliance on loans or investors.

**Business judgment rule:** Presumption upholding a board decision if it can be attributed to any rational business purpose, overcome by evidence of disloyalty, bad faith or gross negligence.

**Bylaws:** Describe in detail the procedural and operational mechanics of the business, including the number of rights and responsibilities of directors, officers and shareholders.

**Capitalization (**or **cap) table:** A spreadsheet detailing stockholder name, type of security owned, date(s) of issuance, date(s) of vesting, number of shares/units, date of sale, size of option pool.

**Common stock:** Proportional ownership in a business entitling holders to receive dividends and vote on important matters.

**Controlling shareholders:** A shareholder who becomes a fiduciary through ownership of a majority interest in a corporation, or through exercise of control over the business affairs of a corporation.

**Convertible debt:** A debt that automatically converts in the next preferred round of financing.

**Corporation:** A type of business entity whose legal status is separate from persons involved, formed in order to engage in commerce.

**Crowdfunding exemption:** Part of Regulation D, Rule 505, small businesses may raise capital online without registering those securities with the SEC.

**Debt:** A loan secured by collateral, with priority on repayment.

**Debt securities:** Negotiated for in the earliest rounds, they area negotiable loan such as convertible debt which converts to stock with priority of payment to other holders of company securities.

**Dual-class stock:** Common stock of companies with two classes of shares, A and B shares, wherein one class of stock has more voting power.

**Due diligence:** The process of discovering information about a business for a prospective transaction.

**Duty of care:** A level of care directors and officers are obligated to exercise in managing the affairs of the corporation where they exercise the appropriate degree of diligence, care and skill.

**Duty of loyalty:** A fiduciary duty directors and officers and controlling shareholders have to place all shareholders’ interests before their own.

**Equity:** Ownership of a business, usually in the form of common or preferred stock.

**Exit (**or **liquidity) event:** The act of realizing the value of investment by cashing out or liquidating an ownership interest.

**Fiduciary duty:** Legal relationship of trust requiring the highest levels of duty and care.

**Independent (outside) directors:** Directors who are not employed by or have material relationships with the business or related persons.

**Initial public offering (IPO):** Transition of a private to a public company by offering shares to the public, and enabling those shareholders to sell their shares on the open market for the first time.

**Inside directors:** Those who are employed by or have material relationships with the corporation.

**Option pool:** The number of common stocks reserved for future issues.

**Post-money valuation:** The value assigned to a business after the round of investment occurs.

**Preferred stock:** Proportional ownership of stock entitling holders to priority on dividends and yield, and priority on assets in a change in control.

**Pre-money valuation:** The value assigned to a business before the round of investment occurs.

**Regulation D:** SEC exemption allowing capital to be raised without the need to register those securities with the SEC.

**Securities Act of 1933:** The principal federal law governing investor protections.

**Securities and Exchange Commission:** The federal agency tasked with managing capital markets to promote investor protection by assuring fair and honest practices.

**Security**: A tradeable financial asset purchased for investment purposes and including any: note, stock, future, bond, debenture, voting-trust certificate, certificate of deposit, investment contract, fractional undivided interest in oil, gas, or other mineral rights … and even digital currency.

**Shareholders agreement:** Confidential agreement covering shareholders’ rights, including on governance matters, protective provisions on changes in control, minority shareholder rights, stock conversion and purchase rights, registration rights, voting protections.

**Simple Agreement for Future Equity (SAFE):** An offering in which the issuer agrees to provide future equity share based on the amount invested if a certain triggering event occurs.

**Super-voting or high-vote stock:** A class of common stock with significantly more voting power than another class of common stock.

**Term sheet:** Summary of agreed-upon terms between founders and investors to invest money in the startup.

**Valuation cap:** Entitles investors to convert the note into equity at the lower of this cap or the price in a subsequent financing round.

**Venture capital:** A form of private equity in which general partners pool limited partners’ money and invest in startups for 7–10 years.

**Vesting:** Shares subject to schedule in which the option to receive shares accrues over time to an unconditional right of ownership, usually a four-year time period.

**Warrants:** Contractual financial instruments granting the holders special rights to buy company stock.