

Priced Equity Term Sheet Explainer

Background

Venture capital terminology can be complex. The following guide is provided as a supplement to the [Maine Venture Fund Convertible Preferred term sheet](#) to help explain what different terms mean and why they are important for both investors and companies. MVF terms are based on standard, [model documents](#) provided by the National Venture Capital Association (NVCA). For even more detailed explanations, consider reading [Venture Deals](#) by Brad Feld and Jason Mendelson.

Common Vocabulary

There are a handful of common concepts related to venture capital investment that are helpful to know even *before* reading a term sheet. These are defined below:

- **Equity:** Ownership in a company, usually allocated in *shares*, like slices of a pie.
- **Lead Investor:** The investor who negotiates the term sheet with the Company. Other investors in the funding round (often there are many investors in a single round) will be expected to invest on the same terms; a lead investor reduces or eliminates the Company's need to negotiate separately with each.
- **Definitive Documents:** Legally binding agreements that are signed to finalize a deal. The term sheet is a non-binding precursor to the Definitive Documents.
- **Governance:** The practices and structure of the Board of Directors of a Company. Boards are critical to the success of venture-backed companies.

Introduction to Priced Equity

One of the most important negotiation points in a Priced Equity round, usually sold to investors in the form of *Convertible Preferred Shares*, is *valuation*, which sets a price for the company and allocates ownership across investors and company employees.

Convertible Preferred Shares are a type of investment that allow investors to secure certain rights along with their ownership (thus, "Preferred") vs the rights of the shares owned by company employees, called "Common" shares. These rights generally allow investors to receive information from management about the health of the company and to share in important decisions the company may make. If the company does not perform well, these rights also allow investors to recoup their investment. If the company is successful and sells to a buyer or goes public through an Initial Public Offering (IPO), investors will waive their preferred rights and "Convert" to common shares alongside the employees, and all shares receive an equal payout.

Review of Important Terms

Term	Explanation of Term	Perspectives
Type of Security and Amount	The stage ("Series") and type ("Convertible Preferred") for the round, as well as the investment size.	Max and min limits provide the company with enough capital to meet milestones, but not too much so as to overly dilute ownership.
Price Per Share	Determined by declaring a Valuation for the company, and then dividing by the # of existing shares prior to investment ("pre-money").	A higher valuation increases price per share, which retains more ownership for employees for a given investment. But a valuation that is too high can disproportionately dilute employees during the next round if the company does not grow quickly enough. A valuation that is too low disincentivizes employees by removing too much ownership too early in the company lifecycle.
Closing	All investors will sign and wire funds on the same day once the minimum amount has been committed.	Either the company legal counsel or that of the lead investor will facilitate the closing. Additional investors may participate after the Initial Closing until either the Final Closing Date or the max amount has been met.
Dividend	Dividends accrue over time as a percentage of the investment amount.	Dividends act like interest but generally are not paid until conversion or a final exit, where they are factored into total ownership.
Option Pool	Sets aside a portion of the company to be issued to employees in the future.	Options are a key compensation tool for cash-strapped startups, and allow key employees beyond founders to have skin in the game.
Capitalization	A "cap table" shows ownership before and after the raise.	The cap tables outlines how the raise will affect company ownership.
Founders	Founders "reset" their ownership and "vest" or earn into that ownership over time.	Founders are the most important recipe to company success; vesting is a critical retention tool. "Double Trigger" protects founders from losing ownership if they are unreasonably let go.
Inclusion	A process for Board oversight of inclusion practices.	Companies benefit from being thoughtful about inclusivity best practices and should have buy-in from their Boards. Inclusive teams are generally more creative, innovative and successful.
Governance	The structure of the Board.	A balanced board provides well reasoned decision-making; non-employee chair role and committees allow CEOs to focus more energy on the business.
Consent of Directors	Rules of engagement for the board which outline the decisions that require board approval.	Investors seek outsized decision-making authority relative to ownership % to compensate for the lack of control they have in running the business day to day. Shared decision-making on a strategic level leads to better outcomes. Trust, transparency and integrity are key for Boards.
Liquidation Preference	If the company fails, Preferred Share are entitled to payout before Common Shares.	Preference allows investors to recoup their investment, which serves as downside protection if the original investment thesis is proved wrong. In the case of a successful exit, liquidation preference effectively goes away and all shareholders are treated equally.
Conversion	Preferred shares are convertible into Common shares.	If the company creates sufficient value, investors will choose to convert to common shares. If the company does not create sufficient value, investors generally opt for their liquidation preference.
Anti-Dilution	Ownership for existing shareholders is reduced ("diluted") when company value declines and a new investor pays a lower price.	With "weighted-average" anti-dilution, investors and employees alike see their ownership % decline if new investors pay a lower price (i.e. company valuation declines).
Voting Rights	Specifies the decisions for which all shareholders are entitled a vote.	Company must seek approval from all shareholders in order to change ownership structure. Investors have veto power because they are minority owners and want to maintain protections.
Redemption	Investors can recoup their investment after a period of time if the company has not provided a return before that date.	If the company is successful, investors will not seek redemption since the return would be higher selling their ownership in an exit; if the company is not successful, investors have this backstop to avoid total loss, and the Company sees the equivalent of an unsecured, low interest loan.
Information Rights	Reporting requirements for management updates to investors.	Information rights provide both qualitative and quantitative metrics for company tracking and support. Regular reporting is just as important for internal decision-making as for investors.
Participation Rights	Investors have the right to invest in subsequent rounds.	For investors, spacing additional investments in the future allows for careful, milestone based investing over time. Not all investors will participate even if they have the right; companies should always be courting new potential investors.
ROFR & Co-Sale	Allows the company and investors the option to buy shares if Founders or other investors want to sell.	Company founders and investors can sell their shares to another private buyer, but first must offer those same terms to the company and existing investors. The intention is to keep ownership among "known entities" and protect decision-making integrity.
Drag Along	Prevents a minority of shareholders from vetoing a sale of the Company otherwise approved by the majority of shareholders and Board.	It is assumed that a majority of shareholders (includes common shareholders and investors), along with the Board, are in the best position to make significant decisions on behalf of the Company.
Registration Rights	The future right to sell shares in an Initial Public Offering ("IPO").	Requires a company to register the investor's shares with the SEC when certain conditions are met, ensuring that the investor has the opportunity to sell their shares in the public market.
Other Terms	Defines more general terms (Counsel, Disputes, Confidentiality, etc) more germane to any legal agreement.	

Maine Venture Fund invests in *Maine businesses that have the highest potential for growth and impact.*

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