UK Term Sheets for Start-Up Founders

What should you be thinking about?

Summary

A term sheet is a document that outlines the main terms and conditions of an equity investment – key terms include (i) the company's valuation, (ii) the amount and type of funding, (iii) the rights and obligations of the investor(s) and the founder(s), and (iv) leaver provisions. It is not a legally binding contract, but it sets the basis for the negotiation and drafting of the long form agreements.

Key points of a term sheet:

Valuation and dilution

This is the amount of money that the investor(s) are willing to pay for a certain percentage of the company's equity. It determines how much the founder(s) and existing shareholders will own after the investment, and how much their ownership will be diluted. There are no fixed rules on valuation – usually it will be based on agreed multiples of various metrics (i.e. revenue, customers, etc).

Funding structure and terms

This is the type and amount of funding that the investor(s) will provide, and the conditions and milestones that the company has to meet to receive it. The funding can be in the form of equity (such as preferred shares or ordinary shares), debt (such as convertible notes) or equity instruments (i.e. advance subscription agreements of SAFEs).

Investor rights and protections

These are the rights and protections that the investor(s) will have in relation to the company, such as consent right rights, board representation, information rights, anti-dilution rights, warranties and liquidation preferences. These rights and protections are designed to give the investor(s) control and influence over the company's decisions and operations, and to protect their investment from being diluted or devalued by future events or actions.

Exit strategy

This is the plan and timeline for the investor(s) to realise their return on investment, by selling their shares to a third party or through an initial public offering. The term sheet may include clauses that give the investor(s) the right to initiate or participate in an exit, or to veto or approve an exit proposed by the founder(s) or other shareholders (exit rights or consent rights).

Leaver provisions

Leaver provisions are clauses in investment documents that determine what happens to the shares or options of a founder or key employee who leaves the company. Leaver provisions typically classify leavers as good, intermediate, or bad leavers or bad leavers, depending on the reason and timing of their departure.

Option Pool

An option pool is a portion of the company's shares that are reserved for current and future employees, advisors, or other stakeholders. The option pool is typically created or increased before the valuation of the company is determined, which means that the existing shareholders (founder(s) and previous investor(s)) bear the dilution of their ownership.

Any questions? Get in touch

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