

Common Terms in Investment Deal Documents

Investment terms in deal documents are critical to defining the rights, obligations, and returns for both investors and companies. All terms should be negotiated to balance the risk and rewards for both investors and founders/company.

Some typical terms found in investment documents:

Valuation Terms

- Pre-Money Valuation: The company's value before the investment is made.
- Post-Money Valuation: The company's value after the investment, calculated by adding the investment amount to the pre-money valuation.

Equity and Ownership Terms

- Ownership Percentage: The percentage of the company the investor will own after the deal.
- Dilution: Provisions that describe how ownership stakes may decrease if more shares are issued in the future.
- Anti-Dilution Protection: Terms that protect investors from dilution in the event of future down-round financing (i.e., issuing shares at a lower price).

Types of Securities

- Preferred Stock: Investors typically receive preferred stock, which gives them preference over common stockholders in dividends and liquidation.
- Convertible Notes: A debt instrument that can convert into equity under certain conditions, often used in early-stage financing.
- SAFE (Simple Agreement for Future Equity): An agreement where the investor provides capital in exchange for the right to purchase equity in a future priced round.

Control and Governance

- Board Seats: Investors may secure the right to a board seat, giving them influence over key decisions.
- Voting Rights: The level of voting power the investor has, especially in key decisions like issuing new shares or selling the company.
- Protective Provisions: These grant investors veto power over certain company decisions, such as changing the company's structure or raising more capital.

Economic Terms

- Liquidation Preference: Specifies how the proceeds from a sale or liquidation will be distributed, often giving investors the right to receive their invested capital (plus any accrued dividends) before common shareholders receive anything.
- Dividends: Terms related to whether and how investors will receive dividends, including cumulative or non-cumulative dividends.
- Participation Rights: Determines whether investors receive their liquidation preference and continue to participate in distributions alongside common shareholders (called "participating preferred").

Exit and Liquidity Terms

- Redemption Rights: Terms that allow investors to sell their shares back to the company after a certain period.
- Tag-Along and Drag-Along Rights: Tag-along rights allow minority investors to sell their shares if a majority shareholder is selling theirs, while drag-along rights force minority shareholders to sell if the majority agrees to a sale.
- Exit Rights: Provisions around an investor's right to sell their shares or exit the investment during certain events, such as an IPO or acquisition.

Warrants and Options

- Warrants: A security that gives the investor the right to purchase shares at a certain price in the future.
- Stock Options: Terms related to the issuance of stock options to founders, employees, and investors, often defining vesting schedules and strike prices.

Information Rights

- Reporting Requirements: These terms dictate how often and in what form the company must report financial or operational information to investors (e.g., quarterly reports, audited financials).
- Inspection Rights: Investors may have the right to inspect company books and records.

Investor Rights Agreement (IRA)

- Right of First Refusal (ROFR): Grants existing investors the right to participate in future financing rounds before new investors are brought in.

- Pro Rata Rights: Gives investors the right to maintain their ownership percentage by purchasing additional shares in future rounds.

Other Key Provisions

- Founder Vesting: Terms that dictate when and how founders earn their equity stake, often over a multi-year period.

- Non-Compete/Non-Solicit: Restrictions on the founders or key employees from competing with the company or soliciting employees after leaving.

- Indemnification: Terms related to the company's obligation to protect investors and directors from legal claims.