

PRELIMINARIES PART I: FOUNDER'S EQUITY AND LEGAL STRUCTURE

Private Capital Insights



Summary: Three key preliminary considerations for a startup founding team are: founder's equity, legal structure and intellectual property. If you consider offshoring your local startups to the US (Delaware) or other tax neutral jurisdictions, the cautious approach is to consider key factors identified below and seek proper advice.

Many startups are founded by an individual, but quite a significant number have multiple founders. Two is the magic number, argues Naval (a respected voice in the VC community) [here](#). Be it as it may, there are three general preliminary points (excepting regulation) that founders must pay attention to before operation. These are:

- a. Founder's Equity;
- b. Legal Structure; and
- c. Intellectual Property

Founders Equity

Founder's equity refers to the ownership slice of the startup. If you are a single founder, this problem would not arise as you will own all the company's shares. *C'est fini.*



However, it becomes a challenge where there are multiple founders (say 2, 3, 4, or 5). How do you divide the company's ownership? Who has the highest say? How many directors should the company have, and importantly, who sits on the Board? How do you incentivise founders to discourage leaving before traction? And crucially, how are conflicts resolved?



The Founder's Agreement

The Founder's agreement exactly aims to answer these questions. The Founder's Agreement is the frame of reference that defines the founder's ongoing relationship with the startup, and must ideally contain these baseline terms:

- a. Founder's Information;
- b. Purpose;
- c. Company information;
- d. Equity Distribution;
- e. Roles and Responsibilities
- f. Board representation (decision making and voting rights)
- g. Confidentiality
- h. Dispute Resolution.
- i. Boilerplates (e.g., governing law, amendments and termination, assignment, etc.).

These terms and self-explanatory, and this partly explain why you should not hire a lawyer to draft one. Importantly, you will likely replace these agreement with a definitive Shareholders Agreement (and amendment to the company's constitutional documents) when institutional capital comes in.

But fundraising do take time and significant resources, hence putting in place a founder's agreement critically helps in defining parties relationship, allocating responsibility, and managing expectations while the business is still pre-institutional.

Incentives and Vesting



A common concern is how to incentivise co-founders to stay in the business long term (or at least, up until certain milestones are achieved). This is really important in the context of startups with multiple founders where for example a co-founder is focused on tech/product development while the other focuses on business development. 'Vesting' and (and reverse vesting) therefore is a standard way of aligning incentives with long term goals.

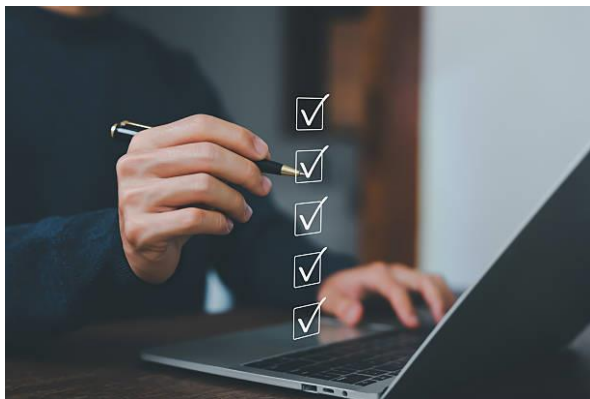
*In **vesting**, shares are issued incrementally over a period of time to a team. On the other hand, reverse vesting refers to where shares are issued wholly to founders, but can be reclaimed upon certain triggers and within specified period. This is particularly relevant where founders may have allotted shares to themselves at incorporation, and would lose it if they leave the firm within specified time.*

The key point to note is that reverse vesting is a particularly important tool to incentivise a founding team long-term, and we typically advice founders to consider implementing this at the earliest stage (independent of external funding round). Additionally, it reduces any risks of a departing partner acting opportunistically in the event of company acquisition.



Legal Structure

The legal structure for running your startup is pretty clear and straightforward in many countries. In Nigeria for example, all startups incorporate as a private company limited by shares. No exception. Doing it differently attracts legal and tax risks, and very importantly, the ability to attract external capital.



Incorporation Checklist

Incorporating a company is a two stage process. First, you *reserve* the proposed name of your company. There are certain rules regarding acceptable names, but the key factors to bear in mind is that such proposed name must not be identical to existing names or be misleading or offensive.

Once the name has been accepted by the Corporate Affairs Commission, then you

proceed with the *substantive incorporation*. You will need to furnish the following details:

- a. details of proposed directors (and their consent to act).
- b. details of proposed subscribers (i.e., original shareholder – founding team).
- c. objects of the company (i.e., proposed business activities).
- d. registered address.
- e. details of person with significant control.
- f. shareholding.

The above list is indicative and not exhaustive. As a founder, you can proceed with incorporation using the CAC portal, or employ the services of accredited agents or lawyers to support.



Directorship

One point worth careful consideration is the directorship of the startup. It is usually the case that the founding team are named directors at incorporation, and therefore *owe* key obligations to the company as a body (not to existing or future shareholders individually). Whilst still being a director during the company's solvency, you are required to act in the best interest of the company as a whole at all times. However, this duty is tinkered at the point of insolvency (i.e., where the company is unable to meet its debt obligations), and in which case, the interests of the creditors would take precedence.



Offshoring

At AHL & Co, we were recently asked for a steer by a founder aiming to incorporate company offshore ostensibly to attract US facing venture funds. Nigerian law requires anyone carrying on business must be locally registered, and therefore, the startup would need to be locally incorporated. Ownership of the Nigerian entity may be fully owned by offshore entity.

If you consider this approach (and there are plenty of approaches), you should carefully balance key considerations such as the (a) place of likely investors (b) tax implication of such offshoring to you and *your investors* (this is really important) (c) potential to earn significant revenue outside the local market and (d) *corporate control* and governance mechanisms available. This list is only indicative and not exhaustive, and the cautious approach is to always seek competent advice before offshoring.

This edition considers founder equity and legal structure as the first two preliminary considerations. Intellectual property, the third preliminary, warrants a full thesis and will be addressed in the next edition.

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