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Introduction to Founders' Agreement

This online publication provides an introduction to Founders' Agreement, their importance, key provisions included in them, and how they can be used to attract investors.

Why having a Founders' Agreement is important
A founder refers to one or more persons that start a business. Where you have more than one founder, entering into a Founders' Agreement can provide a baseline for your relationship. A Founders' Agreement is a legal framework. It is a flexible agreement, which can be used to cover the most important aspects of your relationship as co-founders. For example, it can establish how your business will be structured, clarify the responsibilities of each founder, provide dispute resolution mechanics and set-out the process for how founders may enter or exit the business. If one founder holds a minority stake in the business, a Founders' Agreement may also provide protection to the minority founder.

What to include in your Founders' Agreement
The Founders' Agreement can be tailored to cover the most relevant and important aspects of your business relationship with your co-founders. It is recommended to consider including the following provisions:

The Business – start out by listing the names of each founder and the name of your business (bear in mind that establishing the legal form of business must be undertaken separately from the Founders' Agreement, whether it is as a company registered at Companies House, a partnership or a sole proprietorship). Also describe the business idea/sector, purpose and goals of the business.

Founder roles and responsibilities – this provision explains how each person's roles and responsibilities are separated. Depending on the type of business, the co-founders' roles and responsibilities may, for example, be divided into operations, technology, sales and marketing, administration and finance, among other roles depending on the business.

Intellectual Property (IP) ownership and assignment – IP refers to creations, such as inventions, literary and artistic works, designs and symbols, names and images used in commerce, which is protected in law and may include patents, copyright and trademarks. IP protection enables the IP creator to earn recognition or financial benefit from what they invent or create.

If IP is a crucial part of the new business and/or a co-founder is bringing their IP to the business, the Founders' Agreement should address IP issues indicating who the IP belongs to (i.e., the business or an individual co-founder).

Decision-making – this provision describes how the founders should make decisions about the business and establish a procedure to use if there is a deadlock when deciding on an issue.

Ownership – co-founders may choose to share ownership of the business between themselves equally or may agree a different split of the equity if, for example, one co-founder invests more cash in the business than the other. In the Founders' Agreement, this provision determines what percentage of the business each co-founder owns. How much equity each co-founder will hold may be determined on the basis of multiple factors, including each co-founder's monetary investment in the business, experience, owned intellectual property, technical know-how, and industry network.

Other aspects of ownership to consider covering in the Founders' Agreement are:

1. **Capital Contribution** reflects the amount of cash that a co-founder has injected in the business. The Founders' Agreement would therefore be used to cover how that capital contribution is used.

2. **Vesting** – you may decide from the outset that founders will be granted a delayed right to buy shares *provided that* certain conditions are met in the future. The Founders' Agreement can establish the mechanics for this: a founder would be granted a right to buy shares in the future and they would be incentivised to stay and build the business. When agreed conditions (i.e., time-based or milestone-based conditions) are met, the founder can buy the shares (i.e., the shares then vest in him/her).

3. **Future investors** may be drawn to the business as it grows. Having a Founders' Agreement with a clearly established ownership structure and how they as a new investor would slot in may be beneficial for attracting investors (see further on this below). It may be helpful, therefore, to consider how existing equity may be diluted when future investors join the business and what terms the co-founders may wish to apply to the new investment (although typically this will be negotiable with the new investor).

Removal of a Founder – a Founders' Agreement may also provide for removing a founder from the business (whether by individual choice, mutual agreement between the founders' or as a forced exit). It may be worth considering how roles and responsibilities would be dealt with if one founder exits the business and how any equity held by the exiting founder is to be dealt with.

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Dispute resolution and governing law – it can be helpful to establish up-front what process co-founders will follow should a dispute arise. The founders may choose which dispute resolution mechanism would work for them (i.e., mediation, conciliation, arbitration or litigation). The Founders' Agreement can include a provision requiring the chosen method of dispute resolution to be used and would explain how that procedure will work.

The Founders' Agreement may also include which country's laws, and courts (i.e., English law with disputes resolved in the English courts) will be used in the event that a dispute arises.

Termination of the Agreement – it can be helpful to decide at the outset how long the Founders' Agreement will last for and in what circumstances the agreement will terminate. Termination provisions may describe what happens if a co-founder is ill, under-performing or wants to leave; and also consider what happens if the business is under-performing. The Founders' Agreement may also allow for termination by written agreement between the founders' or after a particular length of time has passed.

Attracting investors through and updating the Founders' Agreement

When trying to attract investors, having a clear vision of your initial goals for the business can be helpful. However, you should also be open to accommodate the business ideas and aspirations that potential investors may have for the business. The Founders' Agreement is important in both these respects. Here is what could make Founders' Agreements attractive to Investors and what to consider in revising a Founders' Agreement to facilitate new investors' wishes:

Clarify goals and way of functioning of the business – when asking someone to invest in your business, you need to be able to persuade them why doing so is a good idea and the Founders' Agreement can be helpful in showcasing your business and goals. This is aided by having a Founders' Agreement that identifies the essential elements of your business and its management structure, the goals for the future of the business and, crucially for investors, the ownership structure and any agreed mechanics to protect an investor's rights. For example, if a new investor will hold a high percentage stake in the business, the Founders' Agreement may help set-out how that stake is protected against dilution and what, if any, decision-making rights an investor will have.

Clarify key executive roles and the role of new investors in decision-making – an important part of investing in a business is determining the key executive roles. The investors may want more information about, for example, how key senior management roles such as Chief Executive Officer (CEO), are appointed. You will need to be clear on whether all co-founders choose the CEO together, or whether the primary founder is going to be leading the business. Investors can also be incentivised by being allowed under the Founders' Agreement to have a say in who should take on senior management roles.

Consider the investors' aspirations and goals when investing – an investor's focus will typically be on generating a good return on the money they put in to your business. When you're considering what to include in the Founders' Agreement to encourage investment, it may be useful to provide incentives or other allowances for investors (for example a higher equity stake and protections on their rights).

Updating the Founders' Agreement – once an investor agrees to invest in your business, it may be a good idea to have another look at the Founders' Agreement and update it (as needed) to reflect, among other things, new business goals or different ownership stakes.

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