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FOR CANDIDATES AND FOUNDERS

Startup Equity 101

What your offer actually means before you decide what it is worth.

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NOT LEGAL, TAX OR FINANCIAL ADVICE

This explains how startup equity generally works so you can ask better questions. It is not advice on your situation. Equity treatment varies by company, instrument and jurisdiction. Before making a decision that affects your finances, speak to your own legal or tax adviser, particularly on exercise, tax treatment and timing.

01

What startup equity is

Startup equity compensation can give you ownership now, or the right to acquire ownership later, depending on the instrument.

That is different from cash compensation. You are not being handed a fixed amount of money. You are being given an interest whose future value depends on what the company becomes, the rights attached to your security and whether a liquidity event ever occurs.

A large-sounding grant can still be worth nothing. A smaller grant in a company that becomes valuable can be worth a great deal.

The first rule is therefore simple:

> Do not evaluate an equity offer from the share count alone.

You need to understand what the instrument is, what percentage of the company it represents and what could happen to that percentage and value over time.

02

Shares, options and percentage ownership

A startup equity offer can take several forms.

You may receive shares outright, options giving you the right to buy shares later, or another form of equity award such as restricted stock or restricted stock units. The exact instrument matters because ownership, exercise and tax treatment differ.

For an option grant, the option itself is not the same thing as owning the underlying shares. You normally become a shareholder only when you exercise vested options and acquire the shares.

The raw number is also not enough.

Ten thousand options could represent a meaningful stake in one company and a negligible stake in another.

> KEY PRINCIPLE
>
> ### Always ask for the denominator
>
> Ask what percentage of the company the grant represents on a fully diluted basis, and ask how the company calculated that denominator.

03

Fully diluted ownership

“Fully diluted” is the basis most useful for comparing an equity grant with the company’s broader capital structure.

A fully diluted share count typically includes outstanding shares plus securities and equity awards that can become shares, such as outstanding options, warrants and the option pool. Convertible instruments may also be included depending on the company's cap-table methodology and the stage of the financing.

That last point matters.

There is not one universally useful number if two companies are calculating the denominator differently. Ask what is included.

> KEY PRINCIPLE
>
> The useful question is not simply "What is my percentage?"
>
> Ask: "What is my percentage on the fully diluted basis you use internally, and what is included in that total?"

04

Basis points

One basis point is one hundredth of one percent.

1 basis point = 0.01%

So:

- [ ] 10 basis points = 0.10%
- [ ] 25 basis points = 0.25%
- [ ] 50 basis points = 0.50%
- [ ] 100 basis points = 1.00%

Basis points are simply a convenient way to discuss small percentages. They are not a different type of equity.

05

Vesting and cliffs

Vesting determines when you earn the right to keep the equity award.

A common startup arrangement is four-year vesting with a one-year cliff. Under that structure, nothing vests during the first twelve months. At the first anniversary, 25% vests, and the remainder then normally vests in regular instalments over the following three years.

That is common, not universal. Read the actual grant documents.

The cliff matters.

If you leave before the cliff date, you will typically leave with none of the grant vested. If you leave later, you usually keep only the portion that has vested, subject to the terms of the plan and any exercise deadline.

Also ask what happens if the company is acquired.

Some grants include acceleration provisions. Others do not. Where acceleration exists, it may depend on both a change of control and a subsequent termination rather than the acquisition alone.

06

Exercise price

If you receive stock options, the exercise price, also called the strike price, is the amount you must pay per share to exercise the option and acquire the underlying shares.

For US private-company options, the strike price is commonly set at no less than the fair market value of the common shares on the grant date, often using a 409A valuation.

That is not the same thing as the price investors paid for preferred shares in the latest financing round.

Those are different securities with different rights.

Ask for both numbers:

- [ ] the strike price on your grant
- [ ] the current fair market value of the common shares used for option purposes

EXERCISING CAN COST REAL MONEY AND CAN HAVE TAX CONSEQUENCES

The tax treatment depends on the instrument and jurisdiction. In the United States, non-qualified stock options can create ordinary income on the spread between strike price and fair market value when exercised. Incentive stock options follow different rules and can create alternative minimum tax considerations. Do not make an exercise decision from a generic internet guide.

Also ask how long you have to exercise vested options after leaving the company. The deadline can materially change the practical value of the grant.

07

Dilution

Dilution happens when the company creates additional shares or securities that become shares.

Your number of shares or options may stay the same while the total fully diluted share count grows. Your percentage ownership therefore falls.

That is normal in venture-backed companies. A financing can dilute existing holders while also giving the company capital to become more valuable.

A worked example

Suppose you receive 50,000 options when the company has 10,000,000 fully diluted shares.

Your starting ownership is:

50,000 / 10,000,000 = 0.50%

Later, assume a financing and related cap-table changes increase the fully diluted share count to 12,500,000 shares.

You still hold 50,000 options, but your percentage becomes:

50,000 / 12,500,000 = 0.40%

You have been diluted from 0.50% to 0.40%.

That does not tell you whether you are economically better or worse off.

If the company's headline valuation also increased materially, the arithmetic "paper value" attached to the smaller percentage might be higher than before. But that figure is still not what you would necessarily receive in an exit. It ignores the strike price, share class, liquidation preferences, tax and the actual terms of any future liquidity event.

BEFORE THE FINANCING

0.50%

50,000 of 10,000,000 fully diluted shares

AFTER THE FINANCING

0.40%

50,000 of 12,500,000 fully diluted shares

WHAT CHANGED

Your holding: 50,000 options

Denominator: 10,000,000 to 12,500,000

Your share: 0.50% to 0.40%

WHAT IT DOES NOT TELL YOU

Whether you are economically better or worse off. Percentage and value are related, but not the same question.

The worked example

The same 50,000 options before and after a financing. The holding does not change; the denominator does.

KEY PRINCIPLE

A smaller percentage can still represent a more valuable stake

Percentage ownership and economic value are related, but they are not the same question.

08

Valuation versus actual realisable value

A headline financing valuation is not a cash price for your employee equity.

The latest round usually prices a particular class of preferred shares. Employees commonly hold or acquire common shares, which may have different rights.

Investors may also have liquidation preferences. Those preferences can affect how exit proceeds are distributed, particularly when the exit value is not dramatically higher than the capital invested.

	PAPER VALUE	REALISABLE VALUE
What it is	A rough arithmetic estimate based on a percentage and a headline company value	What you could actually receive in a particular liquidity event
Depends on	The denominator and the valuation used	Exit value, share class, preference stack, strike price, tax, vesting and transaction terms
Is it cash today?	No	Only if a liquidity event actually occurs and proceeds are available to you

Treat paper value as a scenario, not a promise.

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Future fundraising

Future financing can change the cap table in several ways.

A round may:

- [ ] issue new preferred shares
- [ ] increase or refresh the employee option pool
- [ ] convert SAFEs, notes or other convertible securities
- [ ] introduce or change liquidation preferences and other investor rights

The exact ranking of investor rights varies. Do not assume every new round simply sits "ahead" of the previous one in the same way.

What matters to you is understanding the current shape of the cap table and asking how your grant is expressed within it.

If the company expects to raise substantial additional capital, assume further dilution is possible.

That is not automatically bad. The relevant question is whether the capital increases the probability and scale of the outcome enough to justify it.

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Questions to ask before accepting an equity package

UNDERSTAND THE INSTRUMENT

- [ ] What exactly am I receiving: shares, options, RSUs or another award?
- [ ] If these are options, what type are they?
- [ ] What is the vesting schedule?
- [ ] Is there a cliff?
- [ ] What happens to unvested equity if the company is acquired?
- [ ] Is there any acceleration provision?

UNDERSTAND THE DENOMINATOR

- [ ] How many fully diluted shares are there today?
- [ ] What percentage of that fully diluted total does my grant represent?
- [ ] What securities are included in the company's fully diluted calculation?
- [ ] Does that calculation include the current option pool and convertible securities expected to convert?

UNDERSTAND THE ECONOMICS

- [ ] What is my exercise price?
- [ ] What current fair market value is being used for the common shares?
- [ ] When was that value determined?
- [ ] What was the price per share in the most recent preferred financing?
- [ ] Roughly how much cash would it cost me to exercise all vested options?
- [ ] How long do I have to exercise after leaving?

UNDERSTAND THE CAPITAL STRUCTURE

- [ ] How much capital has the company raised to date?
- [ ] Can you explain the current liquidation preference stack in plain English?
- [ ] Has the company completed any employee or shareholder secondary sales?
- [ ] If so, who was eligible and under what conditions?

A strong company should be able to explain the grant clearly without pretending it knows what the equity will eventually be worth.

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One-page offer checklist

Before accepting the offer, I can answer all of these:

- [ ] I know what type of equity award I am receiving.
- [ ] I know the number of shares or options in the grant.
- [ ] I know the fully diluted percentage the company says the grant represents.
- [ ] I know what is included in that denominator.
- [ ] I understand the vesting schedule and cliff.
- [ ] I know the strike price if the award is an option.
- [ ] I know the current common-share fair market value used for option purposes.
- [ ] I understand roughly what exercising would cost.
- [ ] I know the post-employment exercise deadline.
- [ ] I understand that the latest preferred financing valuation is not the cash value of my grant.
- [ ] I have asked about liquidation preferences.
- [ ] I know whether acquisition acceleration exists.
- [ ] I have taken specific tax or legal advice where the decision warrants it.
- [ ] I would still want the role if the equity eventually proved to be worth nothing.

KEY PRINCIPLE

The last question is the useful one

Equity can create extraordinary upside. It can also end up worth nothing. The role, people, mission and cash compensation should make sense without requiring you to treat the equity as guaranteed future wealth.

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Legal and tax disclaimer

Nothing here is legal, tax or financial advice.

Equity treatment varies materially by jurisdiction, company structure, award type and individual circumstance. Tax rules can also change over time.

Use this guide to ask better questions. Use a qualified adviser to make decisions about your own equity, exercise timing and tax position.

Building a team for
something that has not been
built before?

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