Preparing for Investment – How Organized are your Corporate Documents?

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Preparing for another round of venture capital or an exit event? Make sure your corporate records are ready for prime time.

Whether you're approaching your first round (or third round) of venture capital fundraising, or you're starting to think about a potential exit event or acquisition, approaching large-scale business transactions such as these can have you feeling apprehensive. You may be concerned about your valuation, how to structure the deal, and how to best protect your employees' interests, but you can also take solace in knowing there are some simple, organizational steps you can take to make the future transaction less stressful in the long run.

Getting Your Documents in Order

It's not unusual for us to begin helping clients with a fundraising or exit event, only to find out that their corporate records are a little haphazard. Maybe they have stock option agreements with employees that are signed only by one party, their capitalization table does not account for equity they granted to a board member, or they don't have a good handle on what customer contracts require them to give notice prior to an acquisition (or sometimes, all of the above). Running a startup is tough enough as it is – and the average startup likely does not have *every* single document they've executed in an organized fashion. However, when the time comes to raise money or get acquired, the investor or purchasing company is going to want access to every piece of paper that has ever bore your company's signature. This process ensures that they know exactly what their investing in or buying. Disorganized paperwork or consultants with equity that is unaccounted for could potentially slow the deal and ultimately, delay you getting money.

For early stage companies seeking their seed stage or Series A, investors will typically be understanding of the absence of corporate records. They know you have a limited number of employees and customers. For later stage companies with a history of ARR, cash flow, and customers, investors will be keener on all of these points. At this point, a startup will likely have issued equity and/or stock options to employees, and there will be multiple investors on the capitalization table.

Pre-Investment / Pre-Exit Event Checklist

All that said, here are some things to keep in mind before you seek a new round of financing or start putting feelers out for a potential sale or acquisition:

Make sure that all Stock transfers or membership interest transfers are fully executed.

That means that an authorized representative of the company has signed and dated it, and the person receiving the stock or interest has signed and dated it.

- Each time this occurs, update your capitalization table. Doing this in an Excel spreadsheet is fine or using Carta software is even better. This will give you a running basis of all equity holders in the company, what class of shares they own (and what rights they possess), and what is the fully diluted basis each person owns in the company.

- This helps speed up time of deal, keeps your legal fees down, and ultimately, gets you your money faster.
- Additionally, this mitigates any concern the investor or buyer may have that the company doesn't maintain proper records. They'll know that there won't be any surprises later as a result of poor record keeping.

Ensure that all Stock options have corresponding stock option plans.

- Giving out stock options to employees granting them equity in the company is great. However, without a stock option plan to lay out the vesting schedule for how the stock will accumulate, be distributed, at what price, and any rights associated with it, the employee is left with very ambiguous ownership in the company.
- When it comes time to get acquired, it creates additional problems for all parties to have to determine the rights that this minority shareholder has. Without a stock option plan, consent may be required by the Board, stockholders, or the employee holding the option. All of this could mean amending the company's Charter or Operating Agreement, both of which are otherwise unnecessary steps that could cost you money.

Explicitly name each document and make the contents of that document match.

- Early stage companies may have consultants, advisors, independent contractors, part-time employees, full-time employees, and so on. It is not unusual for those providing essentials services to the business to be compensated in cash, equity, or both. Where companies run into trouble is when the agreement acts as a "catch-all" and simply lists every role that the person will be responsible for. If you do have people in the company in various roles, it is best practice to have definitive, separate agreements for each role to keep things organized.

Pre-Financing Best Practices

Here are some additional best practices to ensure that when the time comes for an investor to "open the hood of the car," they won't find a jumbled mess of wires and leaking oil.

- As a preliminary basis, memorialize every transaction and agreement in writing, whether it is:
  - Company to employee
  - Company to consultant
  - Company to advisor
  - Company to friend/family
  - Employee to employee
  - Employee to outside entity
- Do not assign equity or stock options without talking to legal counsel. This could potentially allow issues to bubble up regarding the number of authorized shares the company has to issue, and if an actual dispute arises, this will likely have to be disclosed to investors.
- Date and sign everything – we recommend using RightSignature or DocuSign, even if it's just for a simple Employment Agreement.
- Prior to acquisition (in your infinite amounts of spare time!) review these items and address any red flags you may find with your attorney. By catching a mistake early in the process, it will reduce your expenses in the long run and help speed up the process for closing and moving

onto the next step.

For more information about preparing for a corporate financial transaction, please contact a member of our Corporate Team.