

Tips for raising venture capital: stockholder and equity issues

By Jeff Lehrer

Prospective investors will always want to know who owns the company they are about to finance. This article outlines common stockholder/equity issues that all startup founders should know when positioning themselves to raise venture capital.

Before starting the process, **familiarize yourself with VC term sheets**, including liquidation preferences, veto rights, anti-dilution protection, pay-to-play provisions, dividends, redemption and preemptive rights. Refer to an article that goes into [more detail about these terms](#), and for [an overview of the differences between authorized shares, outstanding shares and reserved shares](#).

Pay special attention to board composition. Consider the potential impact of strategic investors, customers or ex-employees having seats on your company's board. Refer to our article for tips on your [initial board composition](#) and for information on [initial officers and roles](#).

Making sure that each issuance of stock (including stock options) is **properly authorized at the time of issuance** will help you avoid future headaches and even the possible loss of thousands of dollars. For more information about who gets what in the world of stock option grants, [refer to our article](#). See our article for [an overview of granting options vs. issuing restricted stock](#).

Similarly, make sure to properly **paper founder stock ownership**; otherwise, the founder risks potential forfeiture of all or a portion of such stock should he or she leave the company. Refer to our articles for information about [founder shareholders agreements](#), for [founder stock allocation and vesting](#), and for [founder stock alternatives](#).

Carefully consider stockholder rights. From the founder's perspective, it may be advantageous to have stockholders subject to a drag-along provision or IPO lock-up provision. Also, consider restricting transfer by existing stockholders and implementing a right of first refusal (RoFR) in favor of the company. Along the same vein, avoid stockholder agreements with unanimous amendment provisions or overly broad stockholder veto rights.

Don't overpromise. A common example is granting preemptive rights or rights to participate in future financings – an obligation that may end up being difficult to uphold. Another example is issuing or otherwise promising to issue non-dilutable equity ownership to stockholders. Similarly, prioritize your company's growth by avoiding the issuance of fully vested stock to employees and founders, despite a promise of future performance.

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