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Founder stock vesting

"I am one of the founders of this company, and the founders are supposed to control the company; why should my stock be subject to vesting?" This is a question that we often hear from entrepreneurs, especially those who may be starting their first company. The founders have their sights on growth, success and expansion, but they also need to remember that most startups are founded by several people, and any of them might leave, either voluntarily or involuntarily. Without vesting, a departing founder walks away with all of his or her stock, leaving the other founders to do all the work, and take all the risk, to make the company successful.

When a company is formed, the stock the founders receive is in effect "payment" for work they may already have done or will complete in the short term, but it is also intended to reward them for the all the work over the ensuring several years to get the company up and running, funded and successful. If one of the founders doesn't stick around, for whatever reason, they could walk away with more than their fair share. Making a thoughtful decision to require vesting allows the founding team to avoid that problem, ensuring that each founder can only keep a portion of her or his stock that has been "earned."

How is the vesting schedule determined?

When determining how and when founder's stock should vest, the executives on the founding team typically look at how much has been accomplished by the time of the company's formation. A common vesting schedule is for all members of the founding team to have a certain amount of stock vested at formation, with 25 percent being typical. The rest usually vests monthly over a fixed period, usually three or four years.   However, it's reasonable to consider whether that percentage should be the same for each "founder" since the contributions of each may be different. Also, there is often an underlying problem of who is a "founder": a group of five people who come together to form a company may think of themselves as the "founders" and believe that they should be treated equally. In reality, the risks they are taking, the time they are joining or their initial contributions may be very different.

The following factors are among those considered in allocating stock among the founders, but they are also useful in considering what the appropriate vesting schedule should be, and whether it should be the same for each "founder":

- Have one or more of the founders made a substantial contribution to intellectual property that is highly valuable (*eg*, important work already completed, a strong potential patent position or even an issued patent)?
- Have any of the founders invested substantially more time prior to formation in developing the business plan?
- Will each founder be working on the same basis? Are some part-time, while others are all-in and working full time without compensation? Are some intending to join only later, while holding down another job?
- Are some expecting to be paid in the short-term (however modestly) while others are unpaid and possible covering some expenses?

These considerations could lead to a conclusion that the whole team should be vested the same (and that is always a good solution when justified), or result in some adjustments being made. They might even lead the team to conclude that it is reasonable and fair for a founder to have more than 25 percent of his or her shares vested at formation.

What is the impact of founder stock vesting on future funding?

Another reason to consider vesting for founders shares at the time of formation is that it can simplify later negotiations with investors. When money is raised, the investors will expect that the founders will hold a significant amount of stock that is still subject to providing an incentive for the each founder to stay for at least through the stock vesting period. When there is no significant amount of unvested stock, the investors will see a substantial problem that will have to be resolved before they invest. The negotiation that will occur over vesting will become more complex if one or more of the founders refuses to agree to a new vesting schedule that the investor and the other founders find acceptable. It is advisable for the founders address this issue up front by coming up with a reasonable vesting schedule at the time the stock is first issued.

What happens when a founder leaves?

Not all founder departures are equal. If any founders are terminated, a vesting schedule that is equivalent to what non-founder employees typically receive would result in those founders losing their unvested stock. This is usually something that founders try to avoid. The founder agreements can provide that if a founder is terminated (as opposed to when the founder leaves on their own voluntarily), he or she will get some additional vesting (for example three to six months). If this provision is included, the founder should be required to sign a release of claims in order to get the additional vesting. In the case where a founder chooses to leave, it is customary for the founder to lose all of his or her unvested stock. There are some special situations that can arise in the context of an acquisition where some vesting may be accelerated.