



# Starting Up: DO YOU NEED A **FOUNDERS' AGREEMENT?**

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If you plan to set up a business with other people, do you need a Founders' Agreement? The simple answer to this question is, yes!

When you come up with that brilliant idea for your startup, there is a tendency to want to hit the ground running. However, developing a founders' agreement is a vital next step, even before any formal corporate structures are put in place.

## What is a founders' agreement?

A founders' agreement is a contract between all the co-founders of a startup which sets out the key terms of their collaboration, including roles and responsibilities, equity distribution, vesting, intellectual property ownership, exit options, dispute resolution, etc. The essence of the founders' agreement is to protect the interests of each founder as well as the startup from the onset. A founders' agreement should not only assist with navigating the day-to-day operations of a startup, but should also act as a useful guide to resolving or addressing any unplanned issues that occur between the founders. This makes a founders' agreement very useful in ensuring that issues that may arise down the line are anticipated and effectively addressed in writing with a view to preventing unnecessary conflict in the future.

We have set out answers to some frequently asked questions relating to founders' agreements



## 1 At what stage do you need a founders' agreement?

A founders' agreement should be prepared at the pre-incorporation stage before you start putting any formal structures in place for the business.

## 2 What are the key provisions of a founders' agreement?

Key provisions of a founders' agreement include:

- (a) Roles and responsibilities – each founder's position in the team should be clearly set out, as well as their various duties and requirements defined at the onset.
- (b) Equity distribution – this refers to each founder's ownership stake in the startup. The parties may decide to split equity in the startup equally, or base ownership stake on their initial contributions, roles and responsibilities etc. This would determine each founders' decision-making power as well as their share in the profits of the startup.
- (c) Vesting – this refers to a process by which founders earn their equity in the startup over a period of time. Vesting encourages founders to remain in the company over a length of time. This is important because investors in startups do not only invest in the idea or the concept of the startup but in the founders themselves, and often look out for a vesting agreement between the cofounders. It also protects the company in the event of a “run-away” founder or a founder who is dismissed for misconduct or some other material breach, as they would not be entitled to any unvested shares. The vesting period may vary, however, it is typically over a 4-year period.



- (d) Intellectual property ownership – It is essential to establish that the intellectual property that is developed in relation to the startup belongs to the company and not to any of the founders.
- (e) Exit options – founders may exit the startup for any number of reasons, both amicable and contentious. It is therefore important to spell out the different scenarios that may result in the exit of a founder and what would happen to the founder's shares in the company were they to exit.
- (f) Dispute resolution – according to a report published by CB Insight, disharmony amongst cofounders is listed as one of the top 20 reasons startups fail. Therefore, it is important to ensure that a clear framework for resolving any dispute that may arise is agreed upon by the founders at the onset.

### 3 How long should your founders' agreement be?

This is entirely at your discretion. However, we would advise that your founders' agreement include all of the key provisions that we have highlighted above and at the same time is kept clear and concise.

### 4 Is a founders' agreement a legally binding document?

Yes, a founders' agreement is a legally binding contract that is enforceable against any of the parties that have signed the document.





## 7 Do you need a lawyer to draft a founders' agreement?

It is vital to seek the assistance of a lawyer to prepare your founders' agreement. Lawyers have in-depth knowledge about the legal principles that underpin these agreements and are therefore able to ensure that the agreement sufficiently protects your interests.

### Conclusion

The process of setting up a startup is usually not a one-man show; it requires a collaborative effort from people with different valuable skill sets. A founders' agreement ensures that each founder's interest is protected, and also that the startup is protected and can continue to develop even after the initial founders have exited.

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