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Venture Capital Investment Agreements: A broad perspective

1. Introduction. In this note [1], we propose to discuss typical terms and conditions that are customarily sought by venture capitalists ("**Investor(s)**") when they invest into target companies ("**Target**"). We also discuss certain key rights that the founders ("**Founders**") should ask for. There is a significant mysticism around these terms and it is commonly perceived that many of these terms are solely for bankers and lawyers to understand and negotiate. This is not the right approach. It is important that Founders understand and negotiate these terms because they play out during the growth of the Target, further financing rounds and at the time of the exit of the Investors. More often Founders look back and say that they ought to have paid more attention to the financing documents.[2]

2. Jurisdiction. The manner in which venture capital agreements are structured in India is very different from the manner in which these are structured in the United States. In this note, we propose to discuss the terms and conditions that are commonly used in India.

3. Basic Premise. A plain reading of this note suggests that these terms are one-sided and Investor friendly. There are a few reasons as to why the agreements are one-sided; (a) as the Investors trust Founders with their money, the agreements need to protect them, (b) as the Founders have control over the day-to-day management, Investors need some degree of control and leverage; and (c) Investors typically have a minority shareholding and the majority in any case is protected by law.[3]

4. No Standards. Having said what we have above, it must be remembered that it is not necessary that Founders accept all these terms. Some Founders have the ability to negotiate better terms than the other. There are transactions where the terms discussed below are either not included or are included in a more diluted form.

5. Exclusions. This note is not intended to be a comprehensive guide to investment terms and conditions. We have only discussed the broad terms that are included. The transactions are complex in nature and the requirements of each transaction may require additional terms and conditions.

6. Buckets. For ease of reading and understanding, we have broken up the terms into broad buckets. Each of the Buckets have multiple terms and conditions and these are discussed under the relevant heads:

- Instrument, Valuation, Capitalization and Ratchet.
- Key Financial Terms
- Founder Commitments.
- Governance Structure.
- Information Rights.
- Other Terms.

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- Founder and Target Rights.

It is important to note that this document is not an exhaustive analysis of all relevant issues in relation to each bucket. We have attempted to identify the key issues in relation to each bucket.

7. Instruments, Valuation and Capitalization Structure.

- Instruments. Broadly speaking there are three kinds of instruments that can be used; (a) equity shares or common shares, (b) compulsorily convertible preference shares and (c) compulsorily convertible debentures.[4] We refer to compulsorily convertible preference shares and compulsorily convertible debentures as "**Compulsorily Convertible Instruments**" in this Note.

    - ❖ Ordinary equity shares of a company need no explanation

    - ❖ Compulsorily Convertible Instruments are required in transactions where the valuation is not fixed but will determined subsequent to the investment.[5]

    - ❖ Investors prefer to make investments using Compulsorily Convertible Instruments to enable them to enforce anti-dilution rights and liquidation preference rights. These rights are discussed further below.

    - ❖ It is preferable to use Compulsorily Convertible Instruments if Investors expect preferred dividend rights.

- Valuation. The valuation is not really a term but is an expression of the value of the Target for the purposes of determining the Investor's shareholding percentage in the Target. The number of (a) equity shares to be issued, or (b) the number of equity shares that the Compulsorily Convertible Instruments convert to, will be dependent on the valuation of the Target.

    - ❖ Valuation could refer to (a) the pre-money valuation of the Target, i.e., the value of the Target as agreed to between the Investor and the Target for the purposes of the transaction or (b) the post-money valuation of the Target; the post-money valuation is nothing but the pre-money valuation of the Target plus the amount of money that the Investor invests.

    - ❖ The shareholding percentage of the Investor will be determined by the following formula: $(X/Y)*100$ where X is the amount invested by the Investor and Y is the post-money valuation of the Company. The basis is simple; the value of the Company is really the pre-money valuation plus the amount invested and the Investor's share in this is the amount of money that it has invested.

- Ratchet. In most venture capital financing transactions, the valuation of the Target is fixed. However, where the Investors and Founders are unable to agree upon the valuation, the determination of the valuation is postponed to a subsequent point of time. Typically this occurs because the Investor does not agree with the projections that are presented by the Target. In these situations the valuation is determined based on the actual performance of the Target during the agreed period, which could be one, two or three years after the investment. The

metrics for performance are negotiated for each transaction and could be (a) revenues, (b) EBITDA margins, (c) PAT margins, (d) securing orders / contracts, or other parameters.

- Capitalization Structure. The capitalization structure refers to the shareholding structure of the Target. This would include the shares held by the Founders, shares held by the Investor and any shares held by angel investors. In addition, Investors require that the stock option pool is created prior to their investment, i.e., the Investor does not dilute for the issuance of stock options upto an agreed extent. The requirement of the option pool varies from 5% to 15% and is dependent on the nature of the business and the requirement of stock options for an agreed period, which could vary from one to three years.

8. Key Financial Terms. The key financial terms that Investors typically look for are (a) liquidation preference, (b) anti-dilution protection, (c) right to maintain capital, (d) exit, (e) drag along rights, (f) right of first refusal, (g) tag along or co-sale rights and (h) dividend rights. While this is not an exhaustive list of items, these are broadly what are sought.

- Liquidation Preference. In a liquidation event (described below) Investors expect some preference on the allocation of the proceeds amongst the shareholders of the Target. This could be in the form of (a) capital protection, i.e. Investors receive the higher of their pro-rata share based on the shareholding or the amount they have invested, (b) a double dip where the Investors first receive the amount they have invested and the surplus is distributed amongst all shareholders (including the Investor) based on the pro-rata shareholding, (c) the Investors receive the higher of the amount of capital invested with a return at an agreed rate or their pro-rata entitlement based on their shareholding. There is no hard and fast rule on what is actually negotiated and it varies from transaction to transaction. Founders must note that any thing other than capital protection actually affects the valuation that has been agreed upon. A liquidation event has a wide definition and typically includes (a) liquidation, dissolution, merger, acquisition, sale or other transaction or series of transactions in which the Target's shareholders will not retain control over the Target (b) a sale, lease, license or other transfer of all or substantially all the Company's assets.[6]

- Anti-Dilution Protection. This is a provision where the Investors are given protection against issuances of shares after the investment by the investors at a price lower than the price at which the shares have been issued to the Investors. The anti-dilution protection can be in three forms: (a) full ratchet, (b) broad-based weighted average anti-dilution protection and (c) narrow based weighted average anti-dilution protection.[7]

    - In a full ratchet, the price per share is adjusted downwards to the same price as the price at which the new issuances is made. For instance, if the Investor has a negotiated a price per share of Rs. 100/-, and a new issuance is made at say Rs. 50/- per share. The Investors price per share is reduced to Rs. 50/-.

    - In a narrow based weighted average anti-dilution protection, the Investors' price per share is reduced based on the weighted average price of the new issuance taking into consideration only the preferred shares in respect of which the anti-dilution protection is available.

    - In a broad based weighted average anti-dilution protection, the Investors' price per share is reduced based on the weighted average price of the new issuance and the entire pre-issue capital of the Company assuming all the preference shares and all

warrants, options and other convertible instruments have been converted to equity shares.

Relatively speaking, full ratchet is the most investor friendly and the broad based weighted average anti-dilution protection is the most common equity holder friendly. The formula for determining the impact of a "down round" on the price per share based on broad based weighted average anti-dilution protection and narrow based weighted average anti-dilution protection is the same. It is the old price multiplied by the following factor:

[Equity shares outstanding before new round] + [Equity shares issuable for amount raised at old conversion price] divided by

[Equity shares outstanding before new round] + [Equity shares issuable at new price]

The only difference is what constitutes "Equity shares outstanding before the new round". If the protection afforded is a broad based weighted average anti-dilution protection the "Equity shares outstanding before the new round" refers to the entire equity capital base of the Target including common equity shares and assuming all options, warrants, and equity shares issuable on conversion of the preference shares. If the protection afforded is a narrow based weighted average anti-dilution protection the "Equity shares outstanding before the new round" refers to only the equity shares issuable upon conversion of the preference shares in respect of which the impact is being determined.

By way of example: Company A –

Number of common equity shares: 100

Number of Investor Preference Shares: 100 convertible to 100 equity shares.

Price Per Share: Rs. 100

Total Investment: Rs. 100 x 100 = Rs.10,000

Total Number of stock options and warrants 100.

New Issuance: 100 equity shares

Price per share: Rs. 50

❖ Full Ratchet. In a full ratchet, the price of the Investor shares is reduced to Rs. 50. Consequently the Investor would be entitled to 100 equity shares.

❖ Narrow Based Weighted Average Anti-Dilution:

100 x [(100+50) /(100+100)]. The new Investor price would be Rs. 75 per share. Accordingly, the Investor would be entitled to 133 shares (rounded off).

❖ Broad Based Weighted Average Anti-Dilution:

100 x [(300+50) / (300+100)]. The new Investor price would be Rs.87.5. Accordingly, the Investor would be entitled to be 114 equity shares (rounded off).

❖ Typically there are exceptions negotiated to the trigger of the anti-dilution rights. These include (a) issuance of stock options to employees and advisors, (b) issuances to strategic partners approved by the Investor, (c) issuances where the Investor exercises the right to maintain capital, (d) issuances pursuant to conversion of outstanding warrants and other convertible instruments. The other way of negotiating the anti-dilution protection is to say that it applies only in capital raise transactions and not to any other issuance.

- Right to Maintain Capital. This is a right that Investors seek so that they can maintain their shareholding percentage when the Company proposes to raise further capital. The terms applicable to the Investor are the same as the terms determined by the Company for the new round. The Investor does not get any preferential terms. It is important to ensure that this right is not available in relation to issuances of stock options and issuances to advisors.

- Exit Rights.

❖ Given that the Investors are financial investor, they need to make an exit from the investment at some point. They therefore negotiate appropriate rights that gives them the exit. The exit Rights take various forms including (a) listing of the securities, (b) sale of securities held by the Investor, (c) commitment of Target to buy-back the securities held by the Investor and (d) a commitment by the Founders to buy-back the securities held by the Investor. Typically, listing of the securities held by the Investor, sale of the securities and a Founder buy-back are not guaranteed and failure to provide such exits do not constitute a breach. Having said that, some Investors negotiate put options on Founders if other exits are not provided. We would like to add that there are many transactions where this right is provided to Investors. The only commitment, if at all, is a Target buy-back. Notwithstanding the language of the documents, A Target buy-back is always subject to (a) the Target having sufficient cash and (b) the regulations relating to buy-back being satisfied. Therefore, this in effect translates to a priority for the Investor over all the other shareholders. It is, in a way strange that there is no guarantee that an exit will be provided or that the exit will provide any particular return to the Investors. This is because a venture capital investor takes what is referred to as "an equity risk".

❖ Investors, usually do not bear any costs relating to (a) the exit including listing fees, investment banking fees etc and (b) make no representations and warranties to any buyer except that their title to the securities they are transferring is unencumbered.

❖ Since one cannot guarantee that there would be any liquidity for the investment, the only concrete right that an Investor gets is a drag along right, which is discussed below.

- Drag Along Right. A drag along right is literally what it means; the Investor is given the right to drag along the other shareholders when they initiate a sale of their shares in the Target. This is a distress right that is exercisable if the Target or the Founders have not been able to provide any viable exit to the Investor. This right is required because the Investor is typically a minority shareholder and buyers may wish to control the Target. It must be remembered that this is only a right and Investors are not obliged to drag along the Founders or the other shareholder. The issues that are negotiated by Founders in a drag along sale are as follows:

❖ The period after which this right may be exercised. The period varies from transaction to transaction. The range that we have seen is three to seven years and is usually linked to the time that is agreed upon by the Founders and Investors for building the business. The earlier the stage at which the investment is made, the longer the period before which the drag along right can be exercised.

❖ The number of shares that may be dragged along. While the Investors would like to drag along as many shares as required to complete the sale which could vary from the buyer wanting a simple majority in the shareholding to 100%, the Founders would like that they sell all their shares (given that they are losing control over the Target) or retain a sizable number of shares; representing say at least greater than 25% of the capital.

❖ Whether the Investors can drag along the Founders only or other shareholders as well?

❖ What is the consideration payable on sale of the Founder's shareholding: (a) whether the liquidation preference applies and (b) whether the consideration has to be cash or listed securities only or whether it can be shares of an unlisted entity.

❖ Whether there is parity in the terms for transfer by the Investor and other shareholders.

❖ Whether the Investor must sell its entire holding before dragging along other shareholders?

❖ Whether the sale has to be to an third party not affiliated to the Investors?

❖ Whether it is necessary that the transaction qualifies as a bona fide transaction?

❖ Whether the drag along right is lost if the Founders present an exit opportunity to the Investor that provides a return at an agreed rate and the Investors refuse to accept such exit. Opportunity?

- Right of First Refusal. A right of first refusal is a right that provides to the Investor an opportunity to purchase any shares that the Founders wish to transfer on the same terms as are agreed to between the Founders and any third party buyer. The Founders may sell to a third party only if the Investor does not exercise the right to buy the shares proposed to be transferred. Founders must consider negotiating with the Investors that they exercise the right to purchase all shares proposed to be transferred and not just a part because purchase of a part of the shares may frustrate the sale.

- Tag Along Rights. A tag along or co-sale right is a right that enables the Investor to participate in a sale of shares by the Founders on the same terms as the Founders. Typically this is a right to participate on a pro-rata basis. However, if the buyer of the shares will be acquiring control over the Target, the Investors expect to have a right to sell their entire shareholding. This enables the Investor to seek an exit if they are not comfortable with the buyer controlling the Target.

- Dividend Rights. Generally speaking Investors do not expect to receive any dividend. However, they expect parity with the equity shareholders, meaning that they get dividend on the same basis as equity shareholders based on their equity shareholding in the Target. Having said that, some Investors expect preferred dividend rights at an agreed percentage. This dividend is payable only if the Target is able to generate profits and is usually not cumulative.

9. Founder Commitments. Investors expect Founders to make the following commitments: (a) employment commitment, (b) lock-in of shares and (c) non-compete and non-solicit commitments.

- Employment commitments.

  ❖ Each Founder undertakes to remain in the employment of the Target for a minimum agreed duration. This could vary from three to six years. During the employment term, the Founders commit not to be involved in any other business or other venture. While the Founder commits to remain in the employment of the Target, there is no guarantee that the Target will continue the employment of the Founder. The Target's board of directors will have the right to terminate the employment of the Founder either for cause or without cause. There may or may not be any consequences to such termination. Some Investors negotiate that some or all of the Founders' stock is subject to vesting. Essentially the Founders' shareholding or at least some portion of the shareholding is subject to vesting in the same manner as the shareholding of the employees. This right is typically negotiated in very early stage companies in order to ensure that such shareholding can be provided to a key employee who is brought in to replace such Founder. Given that Founders already own the shares, Founders agree to give up some of their shares in the event that their employment is terminated. To enable enforcement of this provision, the stock subject to vesting is placed in escrow.

  ❖ The Founders are also expected to give a commitment to the Investors that in a drag along situation, they will continue to work with the buyer of the Target for an agreed duration. The period may vary from one to two years.

- Lock-In. Founders agree to refrain from selling their shares in the Target till the Investor remains a shareholder without the Investor's approval. The exception to this rule that is sometimes negotiated is the ability of the Founders to sell a small percentage of their holding to

provide some liquidity. Investors expect that the Founders shares are locked in because they invest in view of the Founder commitment to work with and build the business. Once they sell their shares, the incentive may not exist.

- Non-Compete and Non-solicit. Non-compete and non-solicit obligations are self-explanatory. These restrictions usually apply during the period when the Founders own any shares in the Target and for a particular agreed period beyond that. This period typically varies from twelve to twenty-four months. This is in addition to the non-compete covenants in the employment contracts.

10. Governance Structure. The governance structure has three broad components, (a) Board structure and related provisions, (b) affirmative vote rights and (c) shareholder meetings and related provisions.

- Board and Related Provisions.

  ❖ The composition of the board of directors is an important part of the governance structure of the Target. Some Investors seek Board representation without any more rights. Some Investors like to see a balanced board structure; (a) the Investors and the Founders having the right to appoint the same number of directors and (b) the Board having one independent director acceptable to the Founders and the Investors. Sometimes Investors also require that the Founders seek approval of the Investor in respect of the people they wish to nominate to the Board. The Founders are expected to remain on the Board so long as they are in employment. Some Investors also expect that if the Board decides to bring in a new CEO, the CEO would be treated as a Founder nominee on the Board.

  ❖ Apart from the structure of the Board, provisions relating to quorum, notice of meetings, length of notice of meetings, circular resolutions, appointment of alternate directors etc., are also carefully crafted. From a Founder perspective, the only item that must be ensured is that if the Investor nominee on the Board does not attend a meeting, the Target must have the ability to proceed with business at an adjourned meeting, even if the nominee of the Investor is not present at the meeting.

- Affirmative Vote Items. Apart from the right to nominate members to the Board, Investors normally negotiate a right that their approval is procured for a list of items that they consider "significant decisions". Essentially this means that a Target needs the affirmative approval of the Investor in respect of these significant decisions. An illustrative list of such items is set forth below:

  mergers, restructurings, arrangements, amalgamations, consolidations and divestments of or by the Target; (ii) voluntary commencement of winding up proceedings for insolvency or bankruptcy of the Target or general assignment for the benefit of its creditors or any consent to the entry of a decree or order for relief from creditors under any applicable laws or any admission by the Target of (A) its inability to pay its debts, or (B) any other action constituting a cause for the involuntary declaration of insolvency or bankruptcy; (iii) acquisition of other businesses (by way of purchase of shares, business transfer, slump sale, asset purchase or any other mode of acquiring a business); (iv) creation of joint ventures or partnerships, or creation of a subsidiary; (v) sale of all or substantially all the Target's assets or closure of an existing business or commencement

of any business beyond the purview of the annual plan or business plan of the Target; (vi) increase, decrease, buy back or other alteration or modification of authorised or issued share capital, or creation or issue of other securities (including equity shares, preference shares, non-voting shares, warrants, options, debentures, bonds and such other instruments) and terms thereof by the Target; (vii) amendments to the constitutional documents of the Target; (viii) any appointment, engagement, termination or increase in compensation of directors, chief executive officer, chief operating officer, chief financial officer, chief technology officer, heads of department, vice presidents (by whatever name called) of the Target and other persons whose remuneration is in excess of Rs. [•]/- per annum; (ix) any disposal, transfer, encumbrance or any dealing with the intellectual property of the Target other than in the ordinary course of business; (x) availing any debt by the Target, where "debt" includes short and long-term debt and guarantees); (xi) declaration or payment of any dividend or distribution of profits or commissions to shareholders, employees, or directors of the Target; (xii) change in the name of the Target, or its trading style, or any transfer of brand names, service marks and trademarks or any other intellectual property used by the Target, unless such transfer is between the Target and its wholly owned subsidiary, and except where such transfer is necessitated in terms of a contract with a customer; (xiii) increase or decrease the size of the Target's board of directors; (xiv) adopt or amend the terms of the Target's employee stock option plan or any other similar plan or the issue of options or rights under such plan; (xv) any decision with regard to the listing of the Target's shares; (xvi) any strategic, financial or other alliance with a third party which results in investments by the Target or offer certain exclusive rights to such third party; (xvii) any material variation in capital expenditure and operating expenditure of the Target approved by the Investor for each quarter; (xviii) entering into any related party transactions including transactions with the Founders, other shareholders, directors or their relatives or affiliates; (xix) approval of any business plan or annual plan; and (xx) changes in terms relating to vesting of Founders' shareholding;

- Shareholder Meetings. The provisions relating to holding of Board meetings (discussed above) are typically applicable to meetings of shareholders as well to the extent they are applicable. Provisions relating to alternate directors and circular resolutions would not apply. The other provisions typically apply. In addition Investors will have voting rights in respect of the securities that they own on a pro-rata basis, i.e., if any Investor owns 10% of the capital, they would have voting rights equal to 10%.

11. Information Rights. Information Rights can broadly be classified into the right to get information on a regular basis and inspection rights.

- Information Rights. Investors expect to be provided (a) monthly, (b) quarterly, (c) half-yearly and (d) annual, financial reports. Investors also expect the Target to keep them informed about materially decisions including litigation, material contracts, governmental claims etc. In addition Targets are also required to provide information as required by the reporting requirements.

- Inspection Rights. In addition to the information rights, Investors also expect that they or their representatives have a right to inspect the Target's facilities, books, records etc.

12. Other Legal Terms. In addition to the above, typical investment documents include the following:

- Conditions Precedent. Various conditions that the Target and Founders must satisfy before the investment is made. These include (a) items relating to compliance with law, (b) internal corporate approvals, (c) regulatory approvals, (d) non-compliances that are identified during due diligences, (e) third party approvals, (f) investment committee approvals, etc.

- Closing Items. Provisions relating to issuance of the securities to the Investors and post-investment filings.

- Target and Founder representations and warranties. Customarily the Founders and the Target make various representations and warranties relating to the business, financial position and operations of the Target. Except as is disclosed, Investors expect that (a) the Target is in compliance with law, (b) the financial position of the Target is as presented to the Investors, (c) the assets of the Target are unencumbered, (d) the Target is not subject to any pending or threatened litigation or third party claims, (e) the Target or the Founders do not have any non-compete obligations that could affect the Target's business, (f) the Target is not in breach of any law, (g) the Target has full ownership of all intellectual property rights that it claims and that it is not infringing any third party intellectual property rights, etc.

- Indemnification.

    - The indemnification that Investors expect is threefold (a) indemnity against the representations and warranties being untrue or false, (b) indemnification against breach of covenants made to the Investors and (c) indemnification for the nominee directors against legal claims. While it is customary to have such indemnification, it is also customary for the indemnification to be capped in respect of breach of representations and warranties. The cap is usually the investment amount.

    - An important issue that is often not addressed is the liability of a Founder for breach by another Founder. This is an issue that must be debated. In our view, when there is a breach by one Founder, an indemnification requirement may cause the other Founders to conceal the infringement owing to the fear that they have to provide indemnification. At the same time, it is also possible that Founders keep an eye out fearing the liability. Different investors have different views on the issue.

- Business Plan and End-Use. Investors and Founders usually agree upon the business plan and agree that unless the Investor agrees otherwise, the funds invested would be utilized as set forth in the agreed business plan.

- Superior Rights. While Investors negotiate their term sheets based on current terms, they are uncomfortable with other investors in the Target having superior rights. Therefore, Investors typically expect to have a right to get the same rights as are granted to other investors in future.

- Assignment Rights. Investors typically expect that they are able to assign the rights that they have to any buyer of their shares in the Target.

- Expenses. Investors expect that the expenses incurred by them in completing the investment is borne by the Target, including legal, financial and travel related expenses.

Customarily this is payable only at the time the investment is actually made. From the Founders side, this is subject to a cap.

- Termination Provisions. A termination clause in the event of a breach by the Founders is not useful for the Investor given that the agreements provide more protection to the Investors. Therefore, the termination provisions usually only relate to termination of the rights of the Investors and the entire investment documents.

13. Founder and Target Rights. We have discussed above, the right and terms that Investors expect and the conditions that Founders may negotiate in relation to these rights and terms. It is also important that Founders negotiate rights for themselves. The rights that Founders could consider negotiating are as follows:

- Thresholds. As can be seen above, Investors negotiate fairly drastic rights. It is important to negotiate with the Investors the threshold where rights such as board representation, affirmative vote provisions, drag along rights, right of first refusal, lock-in requirements, promoter put if given) fall away. The threshold may vary for different rights and is also dependent on the initial shareholding of the Investor. We have seen thresholds varying from 5% to 15%.

- Sale to competitor. Again given the nature of the rights that Investors have, Investors typically agree that they will not sell the shares that they own in the Target to any competitor of the Target for an agreed duration. A Target would not want to permit a competitor to sit on its board and exercise rights such as affirmative vote rights. Typically this is the same period as agreed upon for the drag along right to kick in. In addition to this restriction, Founders at times negotiate that they can sell their shares in the Target along with the Investor in case the Investor sells their shares to a competitor.

- Confidentiality Obligations. Financing documents contain the usual confidentiality obligations. Apart from these, Founders should consider asking Investors to ensure that Chinese walls are maintained within the organization of the Investor so that team including the nominee director Target is not representing the Investor in any other investment that is competing with the Target.

- Right of First Offer. This is a right that a Founder seeks to have when an Investor proposes to sell their shares in the Target. While Investors typically do not agree to grant a right of first refusal, Investors are usually comfortable letting the Founders set the price at which they offer to buy the Investors shares. While Investors are not bound to accept any offer made, they agree that they will not sell the shares at a price below the price set by the Founders. This right may seem meaningless at first thought. However, it is important because it gives the Founders the ability to identify a buyer whom they are comfortable with.

- Termination Protection. Typically the employment of the Founders with the Target is at the pleasure of the Board and the Board always has the right to terminate the services of the Founders. However, the Founders should consider including an appropriate termination process. This becomes particularly important when the Founders shareholding is subject to vesting as discussed above.

14. Conclusion. As we have indicated at the beginning of this note, we have attempted to provide information and a brief explanation about the various provisions included in typical venture financing documentation. It is important to recognize that this note is not exhaustive.

There could be variants to the rights discussed above. There could also be different rights that investors ask for.

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[1] We do not propose to call this an article because this document is more a list of clauses and an explanation of the clauses.

[2] It is important to note that the quality of any legal document depends as much on the ability and attentiveness of the counsel as the time that a client spends on the same.

[3] These terms should not be confused with terms that are typically included in investments by private equity investors, hedge funds and other such investors. At each stage of a company's growth, (a) the founder's ability to negotiate terms is very different and (b) the need to negotiate terms is different. In the early stage, there is not much value and therefore venture capital investors would like to protect themselves in a very tight manner. In a mature company, the founders have proven their ability and there is also a need to protect the value they have already created. From an investor's perspective, the risks are significantly different and therefore the protection they seek is very different.

[4] Overseas investors are not permitted to acquire optionally convertible preference shares or debentures unless all conditions as are applicable to external commercial borrowings are also satisfied. We do not propose to discuss these instruments and the related issues in this note.

[5] Discussed below.

[6] Certain of these exits involve complex implementation issues. We do not propose to address them in this note.

[7] We don't propose to discuss the mechanics of implementation in this note. There are also other variants of the anti-dilution protection that we do not propose to discuss in this note