

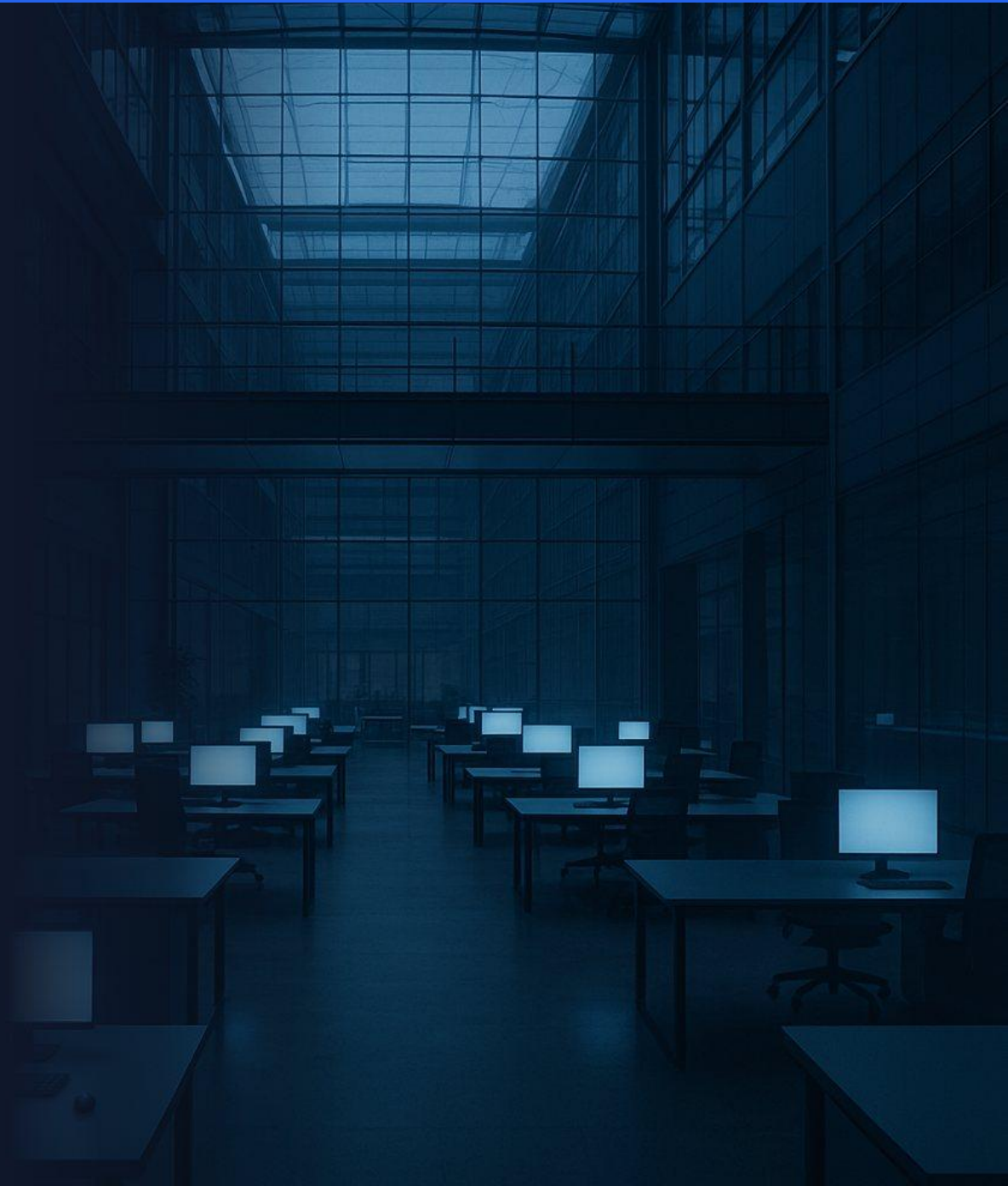
Engineer Equity Financing Terms

How priced rounds, preferred rights, dilution and liquidation preferences determine who actually receives what.

Theory session

Intermediate

Running case: AeroWeave Materials



Where this session sits

3.1 covered debt; 3.2 covers what you give up when the money is equity

MODULE 1

Build Reliable
Financial Foundations

MODULE 2

Manage Cash
and Uncertainty

MODULE 3

**Choose and
Manage Funding**

SESSIONS IN THIS MODULE

3.1

Structure Debt for Growth

Matching instrument, covenant and security to repayment capacity

3.2

Engineer Equity Financing Terms

Priced rounds, preferences, dilution and investor returns

YOU ARE HERE

3.3

Maintain the Post-Round Cap Table

Ownership through a financing event and beyond

What this session explains

Reading a term sheet for what it does, not what it says

01 Valuation is two numbers

Pre-money and post-money, and confusing them transfers real ownership.

02 Preference decides the exit split

Who gets paid first, and whether they also share in what remains.

03 Dilution is structural

The option pool, anti-dilution and future rounds each reduce ownership differently.

04 Control travels separately from ownership

Board seats and consent rights can matter more than the percentage.

What a priced round actually establishes

Three things are fixed at once, and only one is discussed publicly

WORKING DEFINITION

A priced equity round sets a share price, issues new shares at that price, and attaches a set of rights to them — so the headline valuation describes only the first of the three things being agreed.

1

The price

Pre-money valuation $\div$ fully diluted shares before the round. Post-money = pre-money + amount raised.

2

The dilution

New shares divided by total shares after. Existing holders keep their share count and own less of the whole.

3

The rights

Liquidation preference, anti-dilution, consent rights, board composition. These decide outcomes; the valuation decides headlines.

Gompers, P. & Lerner, J. (2004). The Venture Capital Cycle (2nd ed.). Cambridge, MA: MIT Press.

A worked priced round

Every line follows from the two inputs at the top

Line	Calculation	Value
Pre-money valuation	Negotiated.	£12.0m
Amount raised	Negotiated.	£4.0m
Post-money valuation	Pre-money + amount raised.	£16.0m
Investor ownership	Amount ÷ post-money.	25.0%
Existing shares (fully diluted)	Before the round.	8,000,000
Price per share	Pre-money ÷ existing shares.	£1.50
New shares issued	Amount ÷ price per share.	2,666,667
Founder holding	Was 60% of 8m; now of 10.67m.	45.0%

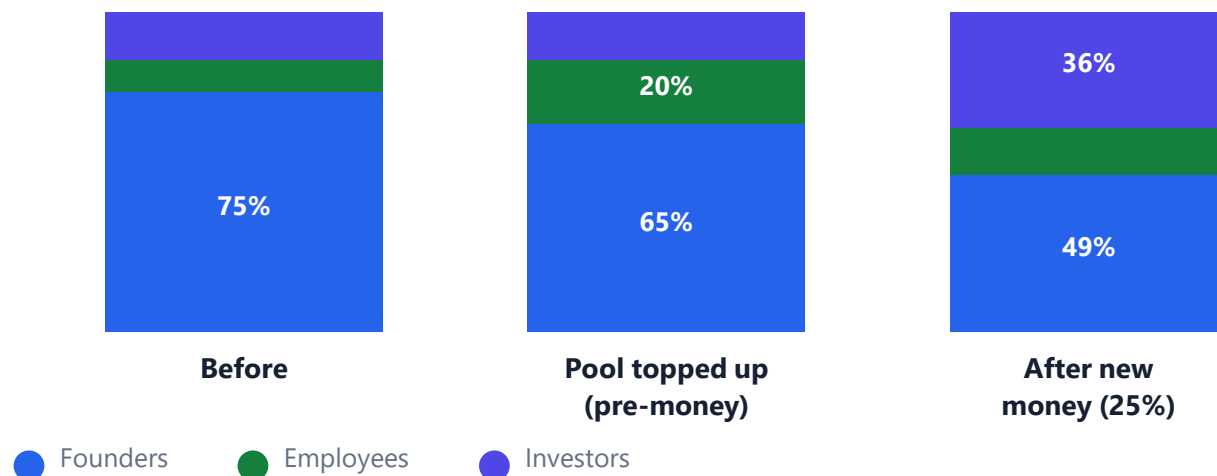
THE AMBIGUITY THAT COSTS THE MOST

Agreeing “£4m at a £16m valuation” without specifying pre- or post-money is a difference of 25% versus 33% of the company. It is the most expensive ambiguity in the document.

Where ownership actually goes

The option pool is usually created from the pre-money, which means founders fund it

FOUNDER, EMPLOYEE AND INVESTOR OWNERSHIP THROUGH THE ROUND



Topping the pool up before the round means the dilution falls on existing holders, not on the incoming investor.

THE POOL SHUFFLE

Pre-money or post-money?

A pool created pre-money lowers the effective price you received. Negotiate its size against an actual hiring plan.

THE DEFENCE

Justify the size

"18 months of planned hires, costed by role" beats an investor's standard 15%.

ALWAYS COMPARE

Fully diluted

Percentages only mean something on a fully diluted basis, including options and convertibles.

Participating and non-participating preference

The single term with the largest effect on founder proceeds

NON-PARTICIPATING

Take the preference or convert

HOW IT WORKS

The investor takes their money back, or converts to ordinary and takes their percentage — whichever is greater.

AT A £40M EXIT ON £4M FOR 25%

They convert and take £10m. Everyone else shares £30m.

WHY IT IS THE FAIRER STANDARD

It protects the downside without taxing the upside twice.

PARTICIPATING

Take the preference and share

HOW IT WORKS

The investor takes their money back first, then also shares pro rata in what remains.

AT THE SAME £40M EXIT

£4m back, then 25% of £36m = £9m. Total £13m; £3m less for everyone else.

WHERE IT BITES HARDEST

Modest exits. At £8m, participating leaves ordinary holders almost nothing.

WHAT TO NEGOTIATE FOR

Ask for non-participating, or participating with a cap at 2–3× invested. A 1× non-participating preference is the common market standard for a healthy round.

What each party receives at different exits

A 1× participating preference on £4m for 25%

PROCEEDS TO ORDINARY SHAREHOLDERS (£M)
TO ORDINARY HOLDERS



The gap is constant in cash terms and largest in proportion at modest exits — which are the most likely ones.

THE READING

Low exits hurt most

At £8m, participating removes a quarter of what ordinary holders would otherwise receive.

STACKING

Preferences accumulate

Each round's preference sits on top. After three rounds, the ordinary stack can be under water at a respectable exit.

ALWAYS MODEL IT

Build the waterfall

Before signing, compute proceeds at four exit values. The term sheet will not do this for you.

Five clauses that decide outcomes quietly

None of them appear in the headline number

Term	What it does	What to negotiate
Anti-dilution	Re-prices earlier shares if a later round is cheaper.	Broad-based weighted average, never full ratchet.
Pro-rata rights	Lets the investor maintain their percentage in future rounds.	Reasonable, but it constrains who you can bring in later.
Board composition	Who controls decisions between shareholder meetings.	Keep founder–investor balance with an agreed independent.
Consent rights	A list of actions requiring investor approval.	Confine it to genuinely major matters, not routine operations.
Drag-along	Forces minorities into a sale approved by a defined majority.	Set the threshold to include founders, not only preferred.

WHERE THE ATTENTION SHOULD GO

A term sheet is mostly non-binding on price and entirely binding in effect on these clauses. Negotiate them with the same energy you spend on valuation.

Before a priced round

Convertible instruments defer the valuation, they do not avoid it

SAFE / CONVERTIBLE NOTE Fast and cheap. Converts at the next priced round, usually with a discount and a cap.	PRICED ROUND Slower and more expensive to document. Everything is settled, and everyone knows what they own.	STACKED CONVERTS Several instruments with different caps. Dilution at conversion is frequently far larger than founders expect.
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THE TRAP IN CONVERTIBLES

What happens	Why it surprises
A £3m cap on a £12m round	The noteholder converts at the cap — four times the ownership the headline implied.
Several notes, several caps	Conversion dilution compounds, and is only visible once modelled.
Interest accruing on notes	The converting amount is larger than the cash that was received.

Three negotiations that optimise the wrong variable

Each produces a good headline and a worse outcome

Valuation over terms

Looks like A high valuation with participating preference and full ratchet.

Why it fails A lower valuation on clean terms leaves founders better off at most exits.

Fix Model the waterfall at four exit values before comparing offers.

Accepting the standard pool

Looks like A 15% pool created pre-money.

Why it fails Founders fund it entirely, and it lowers the effective price received.

Fix Size it from a costed 18-month hiring plan.

Ignoring the stack

Looks like Each round negotiated in isolation.

Why it fails Preferences accumulate until ordinary shares are worthless at plausible exits.

Fix Re-model the full waterfall at every round — Session 3.3.

CASE STUDY

Advanced Electric Machines

A university spin-out that raised £16m by combining equity backers with a debt provider for a manufacturing scale-up.

A headline total that hides the terms

Instrument mix and rights decide what the number means

THE RAISE

A blended package

THE AMOUNT

£16 million in 2026, combining equity and debt in one financing.

THE EQUITY SIDE

Barclays Climate Ventures, PXN Ventures, Northstar Ventures and Low Carbon Innovation Fund.

THE DEBT SIDE

Innovate UK provided the debt component.

THE USE

Tied to industrial scale-up

CAPACITY

Expansion of production capacity at the company's plant — rare-earth-free electric motors.

PRODUCT

A higher-torque commercial vehicle platform, and roll-out of passenger-vehicle motor technology.

WHAT IS NOT PUBLISHED

The split between equity and debt, and the terms. A headline total conceals both.

READING THE CASE

A headline raise is a financing mechanism, not an achievement. Without the instrument split and the terms, the number says very little about what the founders now own.

Drawn from the session case pack.

Bringing the theory to AeroWeave Materials

Evaluating a term sheet properly

Step	What you check	AeroWeave example
Fix the definitions	Pre- or post-money; fully diluted of what.	£4m at £12m pre-money — 25% post, stated explicitly.
Size the pool honestly	From a costed hiring plan.	8% covers six named roles over 18 months, not the 15% offered.
Model the waterfall	Proceeds at four exit values.	£8m, £16m, £24m, £40m — with and without participation.
Read the control terms	Board, consent rights, drag threshold.	Two founders, one investor, one independent; consents limited to six matters.
Check anti-dilution	Broad-based weighted average only.	Full ratchet declined; broad-based accepted.
Compare offers on outcome	Not on headline valuation.	Lower headline, non-participating — better at every exit below £40m.

WHAT COMES NEXT

Session 3.3 records the result and keeps it accurate through everything that follows.

What to carry out of this session

1

Say pre-money or post-money, every time.

The same headline can mean 25% or 33% of the company.

2

Terms decide outcomes; valuation decides headlines.

A lower valuation on clean terms usually beats a higher one with participation.

3

The option pool is usually founder-funded.

Created pre-money, it lowers the effective price you received.

4

Model the waterfall before you sign.

Compute proceeds at four exit values; the term sheet will not.

5

Preferences stack across rounds.

Each new preference sits on top of the last, and ordinary shares can end up under water.

Sources for this session

Primary references behind each concept

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