

The Seven Terms That Destroy Founder Value

Contractual provisions that have transferred millions from founders to investors-and how to identify them before signing.

Every one of these terms has appeared in real transactions. Every one has transferred millions from founders to investors. The pattern is consistent: founders sign without fully understanding the implications, then discover the impact years later at exit.

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Introduction

A founder can do everything right-identify a real market need, build a product that works, assemble a capable team, raise capital from reputable investors, and guide the company to a successful exit-and still walk away with nothing. This is not a hypothetical scenario. It happens routinely, and it happens to founders who believed they understood their ownership position.

The disconnect between ownership percentage and actual payout is one of the least understood dynamics in venture-backed entrepreneurship. Founders often focus on headline valuation and dilution while overlooking the contractual terms that determine how exit proceeds are actually distributed. These terms-embedded in term sheets, stock purchase agreements, and certificates of incorporation-create a waterfall structure that can redirect value from common shareholders to preferred shareholders in ways that simple ownership math does not reveal.

The seven terms outlined in this document are not obscure edge cases. They appear in the majority of venture financings and are often described as "standard" or "market" by lawyers and investors alike. That characterization is accurate-these terms are genuinely common. But their prevalence does not diminish their impact on founder economics. Individually, each term shifts value from founders to investors. In combination, they can eliminate founder proceeds entirely in all but the largest exits.

The purpose of this document is not to suggest that these terms are illegitimate or that investors are acting improperly by requesting them. Capital has its own logic, and investors are accountable to their limited partners for protecting downside risk. The purpose is to ensure that founders understand what they are agreeing to-and can calculate, negotiate, and monitor the impact of these provisions on their personal outcomes.

Structural literacy begins with recognition. The seven terms that follow are the provisions most likely to determine whether a founder captures the value they create-or watches it transfer to others at the moment of exit.

1. Participating Preferred Stock

Investors receive their liquidation preference first, then participate pro-rata in remaining proceeds as if holding common stock. This "double-dip" structure means investors are compensated twice from the same exit. In a \$100M acquisition where investors contributed \$20M, they may receive their \$20M preference plus their pro-rata share of the remaining \$80M—significantly compressing the pool available to common shareholders.

Key indicator: "Participating" language without a cap or conversion threshold

2. Cumulative Dividends

An annual dividend (typically 6-8%) accrues on preferred stock and compounds over time. These dividends are not paid currently but accumulate until a liquidity event, at which point they are added to the liquidation preference stack. After seven years at 8% compounding, an investor's effective preference has grown by approximately 71% before common shareholders receive any distribution.

Key indicator: "Cumulative" in dividend provisions; calculate the 7-year impact

3. Full Ratchet Anti-Dilution

If the company raises a subsequent round at a lower valuation, early investors' conversion prices are adjusted as if they had invested at the lower price—regardless of the down round's size. A modest \$100K bridge at a reduced valuation can trigger substantial dilution to founders and employees, effectively transferring ownership without any new capital contribution from the protected investors.

Key indicator: "Full ratchet" vs. "broad-based weighted average" anti-dilution

4. Stacked Liquidation Preferences

Each financing round adds its own liquidation preference on top of previous rounds, creating a cumulative "stack" that must be satisfied before common shareholders participate. In a moderate exit, the combined preferences across Seed, Series A, and Series B can consume the entire proceeds, leaving founders and employees with nothing despite building a company valuable enough to attract acquisition interest.

Key indicator: Multiple rounds of preferred without pari passu treatment

5. Multiple Liquidation Preferences

Rather than a standard 1x preference, investors negotiate for 2x or 3x multiples, meaning they receive two or three times their investment before common shareholders see any proceeds. A \$10M investment with a 2x preference removes \$20M from the top of any exit waterfall, fundamentally shifting the risk-reward calculus against founders in all but the largest outcomes.

Key indicator: Any preference multiple greater than 1x non-participating

6. Redemption Rights

Investors can force the company to repurchase their shares after a set period (typically 5-7 years), regardless of whether a liquidity event has occurred. If the company cannot fund the redemption, it can trigger default provisions, board control shifts, or force a sale at an inopportune time. These provisions create a ticking clock that may not align with the company's natural trajectory.

Key indicator: Mandatory redemption clauses with fixed timelines

7. Excessive Board Control Provisions

Protective provisions that give investors veto power over routine business decisions—including future fundraising, executive hiring, spending above certain thresholds, or even selling the company. While some investor protections are reasonable, expansive provisions can leave founders unable to act on critical strategic decisions without investor approval, effectively ceding operational control despite holding significant equity.

Key indicator: Expansive "protective provisions" lists beyond standard minority protections

THE STRUCTURAL TRUTH

These terms rarely feel consequential at signing—they appear as standard provisions, the cost of accessing capital. Their true impact emerges years later, at the moment of exit.

Structural literacy means understanding these mechanics before they determine your outcome.

About AEIOU Academy

AEIOU Academy is an advanced education platform focused on structural literacy for founders navigating outside capital, governance, and scale. Our curriculum targets the systemic blind spots that drive preventable founder failure, providing rigorous frameworks for capital architecture, negotiation, governance, and exit decision-making.

Learn more at aeiouacademy.org