Introduction – "*The Investment Is More Than the Valuation*"

For a founder, raising investment is a significant milestone. The focus is usually on the investment amount, valuation and percentage of equity being offered. However, the long-term relationship between the founder and investor is governed by the Shareholders' Agreement ("SHA").

An SHA is not merely a record of ownership. It is the rulebook that determines who controls important decisions, how future fundraising affects ownership, who gets paid first on an exit and what happens if the founder and investor disagree.

A founder may hold a majority of the shares and still require investor consent for important decisions. Therefore, before signing an SHA, the key question is not merely **"How much equity am I giving away?"** but also **"What rights and control am I giving away with it?"**

1. Share Transfer Restrictions

This clause determines when, how and to whom shares may be transferred. It may include lock-ins, ROFR, ROFO, permitted transfers and restrictions on transfers to competitors.
Example: If an investor proposes selling his shares to a competitor, existing shareholders may have the first right to purchase those shares.

🚨 **Founder Alert:** Check whether the investor enjoys greater freedom to transfer shares than the founder and whether a competitor can become a shareholder.

2. Reserved Matters and Decision-Making Rights

Reserved Matters are important decisions requiring the consent of specified investors or shareholders, even if the Board or majority shareholders approve them. These may include borrowings, new securities, acquisitions, alteration to Memorandum and Article of Association, conduct of meetings of Board and Members, etc.
Example: A founder holding 70% of the shares may still require investor approval before borrowing above an agreed threshold.

🚨 **Founder Alert:** A broad Reserved Matters list can make a founder a majority shareholder without having corresponding decision-making control.

3. Exit Rights – Tag-Along and Drag-Along

Tag-Along Rights protect minority shareholders by allowing them to participate in a sale by a majority shareholder. Drag-Along Rights allow specified shareholders to require others to sell their shares when a buyer seeks to acquire the entire company.

Example: If an acquirer wants 100% of the company, a valid Drag-Along provision may enable the transaction even if a minority shareholder refuses to sell.

🚨 **Founder Alert:** Check who can trigger the Drag-Along Right, whether a minimum price applies and whether your warranty liability is appropriately capped.

4. Dividend Policy and Profit Distribution

This clause establishes how the company's profits may be distributed or retained for growth. Investors may prefer reinvestment in the business, while certain securities may carry preferential dividend rights.
Example: Even where the company generates substantial profits, the SHA may require profits to be retained for expansion rather than distributed as dividends.

🚨 **Founder Alert:** Ownership percentage does not automatically determine the timing or amount of dividends.

5. Dispute Resolution and Deadlock Mechanism

A well-drafted SHA should provide a clear process for resolving disagreements through negotiation, escalation, mediation, expert determination or arbitration. A deadlock mechanism should address situations where shareholders cannot agree on a critical decision.
Example: If the founder wants international expansion while the investor wants to conserve cash, the SHA should provide a solution if the Board is unable to decide.

🚨 **Founder Alert:** "The parties shall discuss the matter in good faith" is not a complete deadlock mechanism.

6. Interim Covenants

Interim Covenants apply between signing the investment documents and closing the transaction. They may restrict unusual borrowings, significant business changes, new securities or transactions outside the ordinary course of business.
Example: If an acquisition opportunity arises between signing and closing, the founder may require investor consent before proceeding.

🚨 **Founder Alert:** Ensure these restrictions do not unnecessarily prevent ordinary business decisions or genuine commercial opportunities.

7. Interpretation

Interpretation clauses define how the SHA should be read, but the real commercial impact often lies in the definitions. Terms such as "Control", "Affiliate", "Investor Majority" and "Fully Diluted Basis" can materially affect rights and ownership.
Example: The meaning of "Investor Majority" may determine whether the lead investor can exercise a right alone or requires support from other investors.

🚨 **Founder Alert:** Never skip the definitions section. A single definition can change the effect of several operative clauses.

8. Voting Rights

Voting rights determine how ownership translates into control. Investors may have special approval rights, affirmative consent rights or enhanced rights attached to particular securities.
Example: An investor holding only 15% of the equity may still veto a future fundraising or a change in the company's business.

🚨 **Founder Alert:** Always distinguish between **economic ownership** and **actual control**.

9. Closing Actions

Closing Actions are the legal and corporate steps required to complete the investment, including receipt of funds, allotment of securities, appointment of directors, regulatory approvals and statutory filings.
Example: An investor may transfer funds, but the transaction remains incomplete if the shares are not validly allotted and required filings are not completed.

🚨 **Founder Alert:** Signing the SHA is not necessarily the end of the transaction. Maintain a clear closing checklist.

10. Non-Compete and Non-Solicit

These provisions restrict founders from competing with the company or soliciting employees, customers and business partners. Their duration, scope and geographical application should be carefully reviewed.
Example: A founder may face significant restrictions if prohibited from working in any similar business anywhere in the world for several years after exit.

🚨 **Founder Alert:** Be cautious of broad phrases such as "directly or indirectly", "anywhere in the world" and "any business similar to the company".

11. Material Breach

A Material Breach clause identifies serious violations such as fraud, wilful misconduct, serious confidentiality breaches or unauthorised share transfers. The consequences may include damages, loss of rights or compulsory transfer of shares.
Example: A founder committing a specified breach may be treated as a Bad Leaver and required to transfer shares at a discount.

🚨 **Founder Alert:** Understand what constitutes a Material Breach, whether a cure period exists and who determines the breach.

12. Confidentiality

Confidentiality provisions protect sensitive information such as financial data, technology, customers, business plans and investment terms. Modern agreements may permit disclosure to fund managers, investment committees, advisers and regulators.
Example: An investor may need to share company information with its investment committee before approving additional funding.

🚨 **Founder Alert:** Ensure permitted disclosures are limited to legitimate purposes and confidentiality continues after exit.

13. Conditions Precedent and Conditions Subsequent

A Condition Precedent ("CP") must be satisfied before closing, while a Condition Subsequent ("CS") is completed after closing. These may include approvals, due diligence, corporate actions and statutory filings.
Example: An investor should not have an indefinite right to delay investment because a CP has been drafted without a clear deadline or objective completion criteria.

🚨 **Founder Alert:** Every condition should have a clear timeline, responsible party and measurable completion requirement.

14. Deed of Adherence

A Deed of Adherence requires a new shareholder to agree to be bound by the SHA before acquiring shares. It is particularly important when shares are transferred to a new investor, affiliate, employee or third party.
Example: A new fund acquiring an investor's shares should not receive shareholder rights without accepting the existing governance and transfer obligations.

🚨 **Founder Alert:** Adherence should be a condition to becoming a shareholder under the SHA.

15. Capital Structure – Pre and Post Investment

The capitalisation table shows how ownership changes after investment. Founders should understand the pre-money and post-money valuation, fully diluted share capital, ESOP pool, options, warrants and convertible securities.
Example: A founder expecting to retain 70% may discover that an enlarged ESOP pool and convertible instruments reduce the actual ownership percentage.

🚨 **Founder Alert:** Always review a fully diluted capitalisation table before signing.

16. Terms of Securities

The rights attached to the securities issued may be more important than the number of shares themselves. These may include conversion, voting, dividend, redemption, transfer and liquidation preference rights.
Example: An investor holding preference shares may receive proceeds before ordinary shareholders on an exit, even if the founder owns more shares.

🚨 **Founder Alert:** Do not ask only, "How many shares is the investor receiving?" Ask, **"What rights are attached to those shares?"**

17. Governing Law and Dispute Resolution

The governing law determines which legal system applies, while the dispute resolution clause determines how disputes will be resolved. Cross-border investments require careful consideration of the governing law, arbitration seat, venue and court jurisdiction.
Example: An Indian company may face significant cost and complexity if disputes with an overseas investor must be resolved through arbitration outside India.

🚨 **Founder Alert:** Governing law, arbitration seat, venue and court jurisdiction are different concepts.

18. Liquidation Preference

Liquidation Preference determines how exit proceeds are distributed among investors and other shareholders. The economic impact depends on whether the preference is participating or non-participating and whether it ranks ahead of other securities.
Example: An investor may receive its agreed preference amount before the remaining sale proceeds are distributed among other shareholders.

🚨 **Founder Alert:** Do not ask only, **"What is the sale price?"** Ask, **"After applying the liquidation preference, how much will each shareholder actually receive?"**

19. Management of the Company

Management provisions govern Board composition, investor nominee directors, founder directors, Board observers, quorum and appointment or removal of key management.

Example: Although the founder owns 60% of the company, an investor may have nominee directors and quorum rights that give it significant practical influence.

🚨 **Founder Alert:** Pay particular attention to Board quorum provisions. A quorum requirement can effectively create a veto mechanism.

20. Pre-emptive Rights and Anti-Dilution

Pre-emptive Rights allow investors to participate in future issuances to maintain their ownership percentage. Anti-Dilution provisions protect investors when a subsequent funding round occurs at a lower price.

Example: If an investor invests at ₹100 per share and a later round takes place at ₹50, the anti-dilution formula may adjust the investor's economic position.

🚨 **Founder Alert:** Broad-based weighted average, narrow-based weighted average and full-ratchet protection can have very different consequences for founder dilution.

The Founder's SHA Checklist

Before signing, every founder should be able to answer:

Who controls the company? Which decisions require investor consent?

What happens in the next funding round? How much will the founder's ownership be diluted?

Who gets paid first on an exit? Is there a liquidation preference?

What happens if the founder leaves? Are there lock-ins, leaver provisions or restrictive covenants?

What happens if shareholders disagree? Is there a genuine deadlock and dispute resolution mechanism?

Conclusion: Do Not Negotiate Only the Percentage

The valuation determines the price of the investment. The Shareholders' Agreement determines how the relationship will function after the investment.

It determines who controls the Board, which decisions require investor approval, how future fundraising affects ownership, who receives money first on an exit and what happens when the founder and investor disagree.

The best SHA is not necessarily the one that gives the founder every right or the investor every protection. It is the one that creates a clear and commercially workable framework for ownership, control, growth and exit.

The central lesson for every founder is simple:

> ***"Do not negotiate only the percentage of equity you are giving away. Negotiate the rights, restrictions and economics attached to the equity you retain."***

Because in modern investment transactions, **ownership percentage and actual control are not always the same thing**.

Before signing, every founder should read the SHA not merely as a legal document—but as a map of the company's future.

Key Legal References

The SHA should be read alongside the **Companies Act, 2013**, **Indian Contract Act, 1872**, **Arbitration and Conciliation Act, 1996**, **Insolvency and Bankruptcy Code, 2016**, and applicable SEBI and other regulatory frameworks, depending on the company, securities and investor involved.