Equity basics: vesting, cliffs, acceleration, and exits

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As a cheatsheet, the “normal” equity structure is:

- **Founder terms:** 4 year vesting, 1 year cliff, for everyone, including you
- **Advisor terms** (0.5–2.0%)**:** 4 (or 2) year vesting, optional cliff, full acceleration on exit

Getting equity structures right

When it comes to equity terms, there are only 3 things to understand: vesting, cliffs, and acceleration. For these examples, let’s say that I’ve got a co-founder and we’re splitting the company 50/50.

The problem we want to avoid is if one of us decides to quit early on, taking half the company’s stock with us. In that case, the other founder is then totally screwed, because they don’t have enough equity left to incentivize new team members. And even if they succeed, it’s super unfair that the guy who left still has half the company.

Cliffs & vesting

Vesting is how we fix that. Everyone who has equity should really, *really* be vested.

Vesting means that instead of each getting our 50% immediately, it gets given to us regularly over some period — usually 4 years. So if we quit after 6 months, we’d have earned 1/8th of our total 50%, or 6.25%. If we quit after 3 years, we’d get 3/4 of our total 50%, so we’d keep 37.5%.

A problem this can lead to is that you can end up with loads of people who each own a tiny percentage of the company. That makes future legal work more painful, and it’s what cliffs are designed to solve.

Cliffs basically allow you to “trial” a hire or partnership without an immediate equity committment. You agree on the equity amount and vesting period immediately, but if you part ways (via either quitting or firing) during the cliff period, then the leaving party gets no equity. Apart from that, it acts like normal vesting.

Remember our 50/50 split, 4 year vesting? Now let’s add a 1 year cliff.

With those terms, if I quit after 6 months, I’d actually have nothing. But then at 1 year in (as soon as my cliff is over) I immediately get a full quarter of what I’m entitled to (since I’ve made it through 1 of the 4 years of vesting). And after that, I get my remaining equity dripped to me smoothly as time passes.

Once I stay for the full vesting period (in this case 4 years), I’ve paid my dues to the company, and can choose to either stay or leave. The equity I’ve earned is mine in either case.

Advisors, acceleration, and triggers

Advisors get an extra term which is “full acceleration on exit”. That basically means that if you sell the company (or IPO), they immediately get 100% of the equity you promised them, even if the full vesting period hasn’t finished yet.

This one is standard and makes good sense. They did a great job advising you, you built a successful company, they get what they were promised, and their job is done. Hooray.

However, you can also get too complicated with equity triggers. For example, a hired-gun tech team might get their equity based on product deliverables instead of time passing. Or sales guys might have triggers from hitting revenue

targets.

I'd would strongly advise **against** getting fancy, at least for now. When you add too many rules to your equity system, folks find wacky workarounds. Plus, if you're new at this, you don't have to justify yourself and don't risk getting out-negotiated when you stick with the standard format.

Exits, investors, and re-vesting

It's tempting as a founder to give yourself a "better" deal by picking a shorter vesting period, like 1 or 2 years. It seems good ("more equity faster!"), but typically leads to disaster since it allows someone to walk away with too much of the company.

And even if it doesn't kill the company, it doesn't actually help you. If you have an overly generous vesting structure, investors will only fund you if you "fix" it back to a normal 4 year period. And when you sell the company, the acquirer will usually "re-vest" you over another 4 years.

So speeding up your vesting now doesn't actually help you cash out faster later. It's all downside (co-founder problems) with no upside.

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I'm a tech entrepreneur, author, and partner at FounderCentric, where we help accelerators and universities design and deliver better startup education programs. I've successfully bankrupted 3 companies, am a YCombinator alum, and have built products used globally by brands like MTV & Sony. I've raised funding in the US and UK and recently crowd funded a card game. I wrote The Mom Test book about the practicalities of early stage customer development and sales. It's full of jokes. I live in Barcelona mostly.