ME Consult

THE FOUNDER'S STRATEGIC GUIDE TO EQUITY ALLOCATION: FROM STARTUP TO SCALE







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Introduction





Raising capital is exciting, but every investment decision changes the ownership of your business. Whether you are splitting equity with a co-founder, rewarding employees or bringing investors on board, every decision has long-term legal and commercial consequences.

Whether you are deciding how to divide ownership between co-founders, designing an employee equity scheme, or preparing for external investment, every equity decision should balance commercial objectives with legal compliance.

This guide explains how founders can allocate equity strategically while remaining compliant with Nigerian law and preserving long-term business value.This guide also helps founders navigate the complexities of ownership, from initial co-founder splits to scaling through multiple funding rounds.

SECTION 1

The Foundation - Co-Founder Splits

Disputes over equity are a leading cause of startup failure. Many startup disputes do not arise because the business failed, rather, they arise because founders never agreed on ownership, roles, or expectations from the outset. Poorly structured equity arrangements can damage relationships, discourage investors, and even bring promising businesses to an end. Determining how equity should be shared is, therefore, one of the earliest and most important strategic decisions founders will make. While many founders assume that equity should be divided equally, an equal split is not always the fairest or the most commercially sensible approach. Equity holdings should reflect both present contributions and future commitment to the business.

When determining how to split equity between co-founders, the division does not necessarily have to be equal, as various factors influence how equity ownership is structured

1.1 What is Equity?

- Equity simply represents ownership in a business. It determines who owns the company, who makes important decisions and who benefits when the business grows. Since early-stage startups often lack cash, they use equity to compensate founders, employees, and investors for the high risk they take. It provides stakeholders with voting rights, a claim to future profits, and decision-making influence.

Scenario: *A startup has two founders. Founder A develops the technology full-time, and continues to run the business. Founder B contributes ₦20 million and brings industry connections but is not invested in the day-to-day management and operation of the company. An equal 50:50 split does not reflect the full implications of their different contributions. An equitable, commercial, and long-term vision of the business, will have the founders consider and assess, not just the value of the initial contributions, but also the long-term value of the skills, commitment, capital invested and future responsibilities of both founders before agreeing ownership percentages.*

1.2 Key considerations for co-founder splits:

- **Skill sets and contributions:** What specialised knowledge does each person bring? Leadership and essential technical skills often warrant higher shares
- **Time commitment:** Is everyone full-time, or are some founders splitting their focus? Those contributing personal capital or leaving secure jobs take more risk
- **Financial investment:** Who contributed the initial capital?
- **Business connections:** Whose network is providing the initial credibility for the brand?
- **Intellectual Property:** Does one founder own the proprietary software, technology, patents, trademarks, research, or other intellectual property that forms the foundation of the business? Existing intellectual property can represent significant commercial value and should be considered when allocating equity.
- **Future Responsibilities:** Allocation of equity must take into consideration, the present contributions of each founder, and the responsibilities they will continue to undertake as the business grows. Equity should incentivise long-term commitment, not merely reward past effort.



1.3 Common Mistakes to Avoid When Allocating Equity

- **Ignoring the Future:** Only rewarding past work rather than incentivising future commitment.
- **Handshake Deals:** Failing to document equity agreements in writing can lead to crippling legal disputes.
- ***Failure to Document and/or Implement Vesting:*** *Granting equity upfront without a vesting schedule (e.g., a 4-year schedule with a 1-year cliff) is a major risk. If a co-founder leaves early, they retain their full stake, which can stifle the company's ability to attract new talent.*
- **Over-Dilution of Founders:** Giving away too much equity to early advisors, consultants, or non-essential hires too quickly. This can leave founders with insufficient 'dry powder' to incentivise future key hires or satisfy investors in later funding rounds.
- **Ignoring Tax Implications:** Failing to consult with tax professionals could expose employee recipients to unexpected and significant tax liabilities as their equity vests.
- **Equal Splits Without Merit:** Automatically defaulting to equal equity splits among co-founders regardless of their respective contributions, risk exposure, or expertise. This often leads to resentment and performance issues if one partner carries a disproportionate amount of the workload.
- ***Forgetting about 'Dead Equity':*** *Failing to include buy-back clauses in shareholder agreements. If a founder leaves the company, the business should have the right to repurchase their un-vested (and sometimes vested) shares to prevent 'dead equity' from being held by someone no longer contributing.*
- **No Exit Strategy:** Failing to discuss how equity will be handled during an acquisition or IPO.





1.4 Founder Governance Mistakes That Scare Investors

Investors often assess not just the business idea but also the startup's governance culture.

Poor governance practices can significantly reduce investor confidence and delay or even prevent funding opportunities. Common founder governance mistakes include:

- Failure to separate personal and company finances;
- Absence of proper board oversight or advisory structures;
- Informal decision-making without resolutions or proper records;
- Issuing equity without legal documentation or corporate approvals;
- Granting excessive founder control without accountability mechanisms;
- Failure to implement founder vesting arrangements;
- Failure to maintain statutory records and regulatory filings;
- Unequal access to company information among shareholders.

Strong governance structures reassure investors that the company is capable of managing growth responsibly and protecting shareholder interests.

1.5 Founder Equity Split Checklist

Before agreeing to any equity split, ask yourself:

- Have all founders agreed on their roles and responsibilities?
- Does the proposed allocation reflect both current and future contributions
- Have intellectual property contributions been considered?
- Will the business retain sufficient equity for future fundraising?
- Have vesting arrangements been considered?
- Have the equity arrangements been properly *documented?*

- Are the roles defined with measurable milestones (especially for early product/content delivery)?
- Have you agreed on how contributions are valued (cash vs services vs IP rights) and how disputes are handled?
- Is there a clear "share class" plan (ordinary vs preference shares) and what each class entails (rights, dividends, voting)?
- Have you addressed anti-dilution risk and future fundraising scenarios (e.g., how the split changes with new investors)?
- Have you reviewed investor expectations on cap tables (maximum dilution, pro rata rights, option pool size)?
- Has an "option pool" (or employee incentive plan) been considered so you can hire without constantly renegotiating founder equity?
- Are vesting and acceleration terms aligned (e.g., time-based vesting; what happens on termination or change of control)?
- Have you considered non-compete, non-solicit, exclusivity terms where appropriate, and enforceability?
- Have you ensured directors/founders comply with governance rules (board/shareholder approvals for share issuances)?
- Have you documented IP assignment/licensing so the company, not individuals, owns or has rights to the key assets (brand, logos, scripts, recordings, software, patent)?
- Have you considered securities/tax documentation and proof of consideration (what each founder paid/earned for shares)?
- Have you included "what happens if someone leaves early" in writing (claw-back of unvested equity; repayment of costs if any)?



If any of the founders already earns a salary (no matter how small), some additional questions to consider include:

- Is the salary level documented and approved (and do founders understand it is separate from equity)?
- Are salary payments treated correctly for tax/payroll purposes (PAYE/withholding where applicable)?
- Is there a clear employment/engagement agreement (or service agreement) stating duties, term, remuneration, and termination terms?
- Is equity granted independent of salary (no hidden "salary in exchange for shares" assumptions)?
- If salary is temporary, is the timeline clear (e.g., salary reduces/stops at a funding milestone)?
- Are any salary-related benefits (allowances, bonuses, reimbursements) consistent with company budgets and governance?
- Have you separated reimbursement/expense claims from salary so they don't create disputes over "true contribution"?
- In case of early exit, does the agreement address whether salary accrued/paid is recoverable and whether the person keeps vested equity?

1.6 Equity & Governance Checklist for Founders

Key Concept	Purpose/Why It Matters
Founder Vesting	Protects the company if a founder exits early while retaining a disproportionate ownership stake.
Employee Vesting	Encourages long-term commitment and aligns employee incentives with company growth.



Key Concept	Purpose/Why It Matters
Cliff Period	Ensures a minimum commitment period before any equity is earned.
Repurchase Rights / Buy-Back Clauses	Prevents “dead equity” from remaining with former contributors who no longer add value to the business.
Defined Performance Milestones	Reduces disputes by ensuring equity-linked targets are measurable and objective.
Pre-emptive Rights	Protects existing shareholders from unfair dilution during future share issuances.
Board and Shareholder Approvals	Ensures equity issuances comply with CAMA and proper corporate governance procedures.
Proper Documentation	Validates equity transactions and protects against future legal disputes.
Register of Members	Provides legal evidence of share ownership and ensures regulatory compliance.
Tax Compliance	Helps founders and employees avoid unexpected tax liabilities arising from equity grants or transfers.



Key Concept	Purpose/Why It Matters
Founder Governance Structures	Builds investor confidence and demonstrates operational maturity.
Accurate Regulatory Filings	Ensures transactions have legal recognition and withstand investor due diligence.
Conflict of Interest Controls	Prevents unfair treatment of shareholders and protects fiduciary integrity.
Equity Dilution Management	Preserves sufficient equity for future fundraising rounds and key hires.
Clear Financial Records	Improves transparency, accountability, and investor trust.
Advisor Equity Allocation	Ensures equity granted to advisors reflects genuine value contribution and strategic relevance.
Alignment of Interests ("Skin in the Game")	Encourages employees and founders to focus on long-term company value creation.
Governance Readiness	Positions the startup as investment-ready and capable of scaling responsibly.

SECTION 2

Building the Team – Employees and Advisors

2.1 For employees, the best time to grant equity is as early as possible to maximise their potential upside. It offers the founders a commercial advantage for rewarding exceptional performance and innovation, attracting highly skilled professionals where cash compensation is limited, and providing advisors with meaningful incentives without significant upfront financial commitments. Additional benefits include:

- **The Early Advantage:** Awarding equity as early as possible maximises the "potential upside" for the employee as the company's value grows over time.
- **Psychological Impact:** Receiving equity early fosters a sense of achievement and ownership, as employees can personally witness their shares gain value alongside the company's success.
- **Cash Flow Preservation (Cash Conservation):** For startups, cash is a finite resource. Offering equity allows you to attract high-calibre talent that the company might not otherwise be able to afford at current market salary rates.
- **Talent Retention and 'Golden Handcuffs':** Because equity usually vests over several years, it creates a powerful retention mechanism. Employees are financially incentivised to stay with the company until their shares are fully vested, reducing turnover costs.

- **Alignment of Interests (Skin in the Game):** Equity turns employees into shareholders. This shifts their perspective from 'completing tasks' to 'driving company value'. They are more likely to think like owners, focusing on long-term sustainability and profitability rather than short-term convenience.
- **Increased Focus on Company Valuation:** When employees have a personal stake in the company's success, they are more motivated to work toward specific valuation-enhancing events, such as achieving growth milestones, hitting revenue targets, or preparing for an exit.
- **Attracting 'Mission-Driven' Talent:** High-performing individuals often prefer equity over higher cash salaries because they believe in the long-term vision. This filter helps you identify team members who are genuinely invested in the company's success rather than those seeking only a paycheck.
- **Competitive Advantage in Recruitment:** In industries with fierce competition for talent (like AI, biotech, or SaaS), offering an equity package can be the deciding factor that wins a candidate over, even when larger companies offer higher base salaries.

2.2 Best Practices for Employee Equity

- **Vesting & Cliff Periods:** In most share or option schemes, equity is earned gradually over several years, often tied to reaching specific performance goals or milestones.Therefore, implement vesting schedules (usually over several years) and cliff periods to ensure long-term commitment and retention. But what exactly are vesting and cliffs? Vesting and cliffs are mechanisms used to ensure employees "earn" their ownership over time rather than receiving it all at once.



- **Vesting:** This is the process of gaining the legal right to "exercise" or own your stock. It usually follows a linear schedule, where you earn a set portion of shares every month or year over a fixed period (typically four or five years).
- **The Cliff:** This is a waiting period (usually one year) before any vesting happens. If an employee leaves before the cliff, they get zero shares; if they stay, they receive a "lump sum" of shares for that first year and then continue with the normal schedule.
- **Founder Vesting:** Founders should also be subject to vesting arrangements, particularly where there are multiple co-founders. Founder vesting protects the company if a founder exits early while retaining a disproportionate ownership stake. This is now considered a standard investor practice and helps maintain long-term commitment and fairness within the founding team.
- **Defined Criteria:** Distribute equity based on performance and direct contribution to growth.
- **Advisors:** Equity for advisors should be based on their specific expertise and the "gap" they fill in your current team. While it is a cost-effective way to attract high-level talent, be wary of "ownership dilution" and potential conflicts.
- **Choosing the Right Incentive Structure:** Issuing ordinary shares is not the only way to reward employees. Depending on the company's stage of growth and commercial objectives, founders may consider:



1. **Employee Share Option Plans (ESOPs):** Employees receive the right to purchase shares in the future, usually after meeting specified conditions. This allows businesses to incentivise employees without immediately diluting existing shareholders.

2. **Phantom Equity:** Rather than receiving actual shares, employees receive a contractual right to benefit from the company's growth in value. This can provide many of the economic benefits of equity without changing the company's ownership structure.
3. **Profit Interest / Profit Share Plans:** Employees receive a contractual right to a share of profits (or profit milestones) for a defined period, without issuing voting shares.
4. **Revenue/Performance-Based Bonus Units (Equity-Like Incentives):** Employees earn payouts tied to revenue, EBITDA, or specific performance metrics, structured like units (often with vesting/targets) rather than actual ownership.

2.3 Common Mistakes to Avoid

❌ Granting large equity stakes without defined responsibilities.
❌ Issuing shares immediately instead of using vesting arrangements.
❌ Ignoring tax implications of employee equity awards.
❌ Offering equity to every employee regardless of strategic contribution.
❌ Failing to review how new equity grants affect future fundraising and ownership dilution.
❌ Using vague valuation or contribution assumptions (no clear basis for how equity was determined).
❌ Not addressing "what happens if someone leaves" (cliff/vesting, treatment of unvested shares, and repurchase/clawback terms).
❌ Structuring awards so they conflict with employment contracts or ongoing compensation plans (creating disputes over salary vs equity).



SECTION 3

Navigating Funding Rounds — What the Law Says

Securing external investment is often a defining moment in a startup's growth journey. Whether raising seed capital from angel investors or pursuing institutional funding through Series A and subsequent rounds, founders must recognise that every investment transaction affects ownership, governance, and control of the company.

While Nigerian law does not prescribe the percentages of each funding cycle (they are driven by negotiations and market practice), the law regulates how shares are created, approved, allotted, and documented.Investors also expect founders to demonstrate sound corporate governance and legal compliance before committing capital.

Understanding these legal requirements early can help founders avoid costly delays during due diligence and build investor confidence.

3.1 Here are the key legal rules to keep in mind:

- **Directors Must Be Authorised to Issue Shares**

Under Section 141 of the Companies and Allied Matters Act 2020 (CAMA), directors cannot issue new shares just because they want to. They must first be authorised either by the company's Articles of Association or by a resolution passed at a shareholders' meeting. This ensures that equity is never issued without proper corporate approval.

- **Existing Shareholders Have Pre-emptive Rights**

Section 142 CAMA gives existing shareholders pre-emptive rights. This means that before offering new shares to an

outside investor, the company must first offer those shares to current shareholders in proportion to what they already hold. This is the legal foundation behind the concept of dilution management - the law protects founders and early shareholders by giving them the first opportunity to maintain their ownership stake. However, shareholders may waive these rights where permitted by the company's Articles of Association or Shareholders' Agreement. This is common in venture capital and institutional investment transactions.

- **Records of Every Share Issuance Must Be Filed with the CAC**

Once shares are issued, Section 154 CAMA requires the company to file a Return of Allotment with the Corporate Affairs Commission (CAC) within one month. This filing gives the transaction proper legal recognition. Without it, the investment may exist as a contract between parties, but it will lack regulatory standing, which could have a significant adverse effect for future fundraising activities.

- **Public Fundraising Triggers Securities Law**

If fundraising moves beyond a small, private circle, Section 95 of the Investment and Securities Act 2025 becomes relevant. A company cannot invite members of the public to buy its shares unless the offering is registered and approved by the Securities and Exchange Commission (SEC). For startups, this matters when:

1. Fundraising involves a large number of unrelated investors;
2. Investment is solicited publicly, such as through online campaigns or public advertisements;
3. Structured investment vehicles or public offer arrangements are being used.

Note: Investors routinely conduct legal and governance due diligence before committing capital to a startup. Good governance is not merely a legal requirement; it is a commercial asset that enhances credibility, protects shareholder interests, and improves access to capital.

SECTION 4

Compliance and Legal Guardrails – Getting It Right

4.1 Equity arrangements only hold up if they are legally valid, properly documented, and transparent. This section outlines the key compliance obligations every startup should understand.

4.2 Maintain Your Register of Members

Under Section 109 CAMA, every company is required to keep an up-to-date Register of Members. Nigerian courts have reinforced this in *Oilfield Supply Centre Ltd v Johnson*(1987) All N.L.R. 446; the court held that membership is proven by entry in the register, though it can be challenged with contrary evidence. Keep this record accurate and current at all times.

4.3 Document Every Equity Transaction

Every time equity is issued or transferred, it must be backed by proper legal documents. The key ones are:

- **Share Subscription Agreement:** Records the terms of the investment: how many shares, at what price, and the payment obligations. This is the legal foundation of any investment.
- **Board Resolution:** A formal decision by the directors approving transactions such as share transfers. This confirms the allotment was properly authorised at management level.
- **Shareholder Resolution:** The law requires that shareholders must vote to approve new share issues. This protects existing owners from unauthorised dilution.

- **Shareholders' Agreement:** Sets out the rules governing the relationship between shareholders, including voting rights, decision-making, exit provisions, and how disputes are resolved. Some common investor protection provisions found in Shareholders' Agreements include:

1. Reserved matters requiring investor approval
2. Anti-dilution protections
3. Drag-along and tag-along rights
4. Board representation rights
5. Deadlock provisions
6. Information and inspection rights
7. Pre-emptive rights on new share issuances
8. Rights of first refusal on share transfers
9. Restrictions on the issuance or transfer of shares
10. Dividend and distribution policies
11. Dispute resolution mechanisms
12. Exit arrangements

These are not optional formalities - they are necessary to for the satisfy the contractual, governance and legal requirements for the issuance of shares.

4.4 Directors Have Legal Duties

Under Sections 305 and 306 of CAMA, directors are bound by fiduciary duties. They must act in good faith, prioritise the best interests of the company, and avoid conflicts of interest. In the context of equity, this means that issuing shares to insiders at below-market value, or favouring certain shareholders unfairly, can amount to a serious breach of duty with legal consequences.

4.5 Tax Obligations Apply

From a tax perspective, equity is ***not free***. Two key obligations that readily come to mind, and are applicable:



- Under Sections 123, 125, and 126 of the Nigeria Tax Act 2025, instruments relating to share transfers and other dutiable transactions must be properly stamped. An unstamped instrument may be inadmissible in evidence and unenforceable until duly stamped.
- Under Sections 4, 13, and 14 of the Nigeria Tax Act 2025, equity granted as compensation — including shares, options, or other employee benefits — may constitute taxable employment income or a taxable benefit-in-kind. Both the company and the recipient may, therefore, have withholding, reporting, or income tax obligations."

The Nigerian Revenue Service (NRS) oversees these obligations, including companies' income tax, stamp duties, and withholding tax where applicable. We recommend seeking tax advice early.

4.6 Sector-Specific Rules May Also Apply

Startups operating in regulated industries, particularly fintech and financial services, face an additional layer of oversight. Under Section 7 of the Banks and Other Financial Institutions Act 2023 (BOFIA), significant changes in ownership or control of a financial institution may require prior approval from the Central Bank of Nigeria (CBN). If your startup operates in this space, factor regulatory clearance into your equity raise plan from the outset.

4.7 Governance Checklist for Investment-Ready Startups

To strengthen governance standards and improve investor confidence, startups should adopt the following best practices:

- Maintain accurate statutory registers;
- Hold regular board meetings and document decisions;
- Implement founder and employee vesting arrangements;
- Keep CAC filings and tax obligations up to date;
- Ensure all equity transactions are properly documented;
- Provide shareholders with timely and accurate company information;
- Regularly review governance and compliance processes.



Conclusion

Equity is far more than a percentage on a cap table. It represents ownership, control, opportunity, and long-term value. Every decision relating to equity has legal, commercial, financial, and governance implications that can shape the future of a business.

Founders who approach equity strategically by documenting transactions properly, complying with legal requirements, and planning for future growth place themselves in a stronger position to attract investment, retain talent, and build resilient businesses.

Whether you are allocating founder equity, designing employee incentive schemes, or preparing for your next funding round, obtaining appropriate legal advice at the outset can prevent costly disputes and protect the long-term interests of both the company and its stakeholders.

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