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Business + Technology in the Exponential Economy

From Main Street to Wall Street—10 Things a Startup Should Do to Groom Itself for an Eventual IPO

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You've got the vision, the core team, and even a little money. You're prepared to devote enormous time and energy to your new startup. You're unsure what the future will bring but you want to preserve the possibility of going public some day. Here are 10 things you can do to put your startup on the path to an eventual IPO:

• *Protect Your IP:* In some sectors, intellectual property is the heart of the company, but even low-tech or no-tech startups routinely rely on confidential information, trademarks, domain names, and copyrights. You should fashion an IP protection program that matches your needs and budget. Basic IP protection includes: corporate name and trademark searches; non disclosure and invention assignment agreements with employees; confidentiality and IP ownership agreements with consultants and third-parties; limitation of internal access to confidential information to persons with a need to know; proper use of confidentiality legends, trademark symbols, and copyright notices; and domain name registration.

• *Respect Former Employers:* Sure, you've got a great idea and maybe some technology to get you started, but be certain your nascent technology isn't owned by a former employer, since a lawsuit can stop your new company in its tracks. Similarly, be mindful of any non competition or non-solicitation agreements you or your employees may have-these obligations can affect both the nature of your business and your ability to recruit talent from former employers.

• *Bootstrap to Avoid Dilution:* A founder's sweat equity is a crucial part of the startup package, and by granting equity incentives a startup can pay less cash compensation to employees (although minimum wage laws still apply). "Bootstrapping" can help delay substantial outside investment until significant milestones justify a higher valuation-and protect that equity from dilution. Bootstrapping might include founder resources, loans from friends and family, or cash flow from operations. Friends-and-family investments present both benefits (it is money) and disadvantages (it can be awkward to ask Mom for a loan), but may be the best funding alternative at inception.

• *Stay Out of the Woodwork:* An IPO can be "woodwork" time. People you've long since forgotten might show up looking for a piece of the company. Preempt these surprises by making sure your IP rights are properly documented and all equity arrangements are in writing.

• *Employ At-Will and Take Vacations:* Your employment policies will evolve with growth in your business. An essential one is an employment at-will policy-stating that the employment of any employee can be terminated at any time and for any reason, or for no reason. The policy's purpose is to negate any inference that an employee is entitled to continued employment or severance upon termination. Limits on vacation carryover should also be adopted early on, to avoid the buildup of accrued vacation on your books. Besides, annual vacations will keep key employees fresh and productive.

• *Pre-Wire the Company:* Financing arrangements should contemplate the possibility of going public. Set up your capital structure to become streamlined in an IPO, with preferred stock automatically converting into common stock. Make sure your investor agreements (other than registration rights) and investor board rights terminate in an IPO. These kinds of steps can minimize the need for amendments or waivers in the IPO process and facilitate the transition to public company life.

• *Lockup the Future:* In every IPO the underwriters require lockup agreements that prohibit pre-IPO stockholders from selling shares for a specified period of time-typically 180 days-following the IPO. Lockup agreements help maintain an orderly market while the distribution of shares is completed and initial trading develops. All pre-IPO stockholders and option holders are ordinarily asked to sign lockup agreements. IPO preparations will be easier if you include lockup provisions in your stock plans and agreements and financing documents from the beginning.

• *Remember the Securities Laws:* Many securities laws apply to startups long before they go public. Issuances of stock and options-whether to founders, employees, or investors-must comply with these laws. Violations can result in liability to the company, make it difficult to attract investors, and even jeopardize an IPO. With experienced counsel, securities law compliance is usually not particularly burdensome, but it must not be overlooked.

• *Discover Delaware:* If you hope to go public, incorporate in Delaware. More than 90% of all IPO companies call Delaware home, and for good reason: Delaware offers nationwide familiarity; a permissive and flexible corporation statute; and a well-developed body of case law. Reincorporation in Delaware prior to an IPO is possible but this step can be skipped by starting off in Delaware-and your financings and other corporate transactions will be facilitated in the meantime.

• *Keep Good House:* IPO preparations will proceed more smoothly if you attend to "corporate housekeeping" on a regular basis. This includes minute books, stock and option records, employee agreements, IP documentation, contracts, and other corporate records and formalities, as well as legal compliance. Many defects can be fixed as an IPO draws nearer, but the process will be helped if you start with a solid foundation of good housekeeping.

Finally, don't despair if the IPO market is not ready when you are. In recent years, far more startups have been acquired than gone public. Both possibilities can even be pursued simultaneously in a "dual track" strategy. The above preparation will serve both paths well.

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