READING A TERM SHEET

The key terms in an investment offer, what's normal, and what to question before you sign.

TYPE: GUIDE REVIEWED: NOVEMBER 2026 TIME: 10 MINUTES LEVEL: INTERMEDIATE

AT A GLANCE

- A **term sheet** is a short summary of the main terms of an investment, agreed before the full legal documents are written.
- Most of it is **not binding**, except a few parts like confidentiality and sometimes a no-shop clause.
- **Valuation gets the attention, but terms like liquidation preference, control and board seats** can matter just as much.

WATCH OUT

Always have a lawyer who works on startup or business investments review a term sheet before you sign. This guide is general education only.

Why it matters

Once you sign a term sheet, the main deal is set. Changing it later is hard. Some terms that seem small can decide who gets paid first when the company is sold, and who controls key decisions.

The key terms

Term	What it means	What's common / what to watch
Amount and valuation	How much is invested, at what pre-money value	Check pre- vs. post-money, and whether an option pool is included. See **R-16 Ownership and Dilution: The Cap Table Explained**.
Security type	What the investor gets: preferred shares, a SAFE or a note	Preferred shares are standard in priced rounds
Liquidation preference	Who gets paid first if the company is sold	1× non-participating is common; be careful with higher multiples or "participating" preferences
Board seats	Who sits on the board	Early boards are often founders plus one investor
Protective provisions	Decisions that need investor approval	Normal for big decisions (selling the company, new shares); watch for day-to-day control
Anti-dilution	Protection for investors if future rounds are at a lower price	"Broad-based weighted average" is common; "full ratchet" is harsh
Pro rata rights	Investor's right to invest in future rounds to keep their share	Common
Option pool	Shares reserved for employees	Size should match your hiring plan
Founder vesting	Whether founders' shares vest	Investors often ask for it. See **B-10 Co-Founder Agreements: Splitting Ownership Fairly**.
Information rights	Reports investors will receive	Common: regular financial updates
No-shop	You agree not to talk to other investors for a set time	Keep it short, often 30 to 60 days

Liquidation preference, in plain words

> EXAMPLE
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> An investor puts in **$1 million** for **20%** with a **1× non-participating** preference. If the company sells for **$3 million**, the investor can take either their $1 million back, or their 20% share ($600,000). They'll take the $1 million. Founders and others share the remaining $2 million. If the company sells for $20 million, the investor would rather take 20% ($4 million), and the preference doesn't matter.
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> With a **2×** preference, the investor would get the first **$2 million** of a $3 million sale, leaving only $1 million for everyone else.

Step by step

1. **Read the whole term sheet** and list every term you don't understand.
2. **Ask a lawyer** with investment experience to review it.
3. **Model outcomes**: what you'd receive at several sale prices.

4. **Negotiate** the terms that matter most to you, respectfully and in writing.
5. **Check what's binding** before you sign.

Common mistakes

- **Only negotiating valuation.**
- **Agreeing to unusual or harsh terms** to get a higher number.
- **Long no-shop periods.**
- **Signing without a lawyer.**

Your checklist

- ☐ Highlight every term you don't understand
- ☐ Model payouts at three sale prices
- ☐ Have a lawyer review it
- ☐ Decide which terms to negotiate
- ☐ Confirm what's binding before signing

Key words, explained

Word	What it means
Term sheet	A summary of proposed investment terms.
Liquidation preference	The order and amount investors get paid in a sale.
Protective provisions	Decisions requiring investor approval.
Anti-dilution	Investor protection if shares are later sold at a lower price.
Pro rata	The right to invest in future rounds.

Where to go next

- **R-15 Valuation: What Your Business Is Worth to Investors**
- **R-16 Ownership and Dilution: The Cap Table Explained**
- **R-20 Getting Ready for Due Diligence**

IMPORTANT
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