

6 Startup Mistakes That Cost Founders Everything (And How to Avoid Them)

From 83(b) Elections to IP Nightmares and Beyond

Resource

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There's a well-worn cliché in the startup world that starting a business is like assembling a plane while flying it, hoping everything holds together long enough to reach your destination.

Some turbulence is inevitable when you're constructing your aircraft at 30,000 feet. I can tell you, however, after 15 years of serving as an outside counsel to startups at Gundreson Dettmer, and as General Counsel at Social Capital, that certain mistakes are entirely avoidable with proper preparation. You do not want to be like one of the founders we work with, who do all the hard things right when building their business, only to be held back by legal errors they could have easily avoided. It happens more often than you think.

Here are some common errors that can ground promising startups before they ever reach cruising altitude, along with practical guidance on how to steer clear of them.

1. An Unwanted Tax Surprise - Missing an 83(b) Filing

When Maya co-founded her AI startup, she was thrilled to receive 1.5 million shares of founder stock subject to vesting. Focused on building her product, she forgot to do anything to plan for the taxes she would owe on her shares.

Two years later, when her company raised a Series A at a \$50 million valuation, Maya faced a crushing reality: she owed taxes on millions worth of vested shares but

couldn't sell any to cover the bill. The oversight drained her personal savings and forced her to take a loan just to pay the IRS.

When founders receive stock subject to vesting, they have 30 days to file an 83(b) election with the IRS, a crucial opportunity to minimize future tax liability that's easy to miss.

Why it matters

Stock compensation is taxable income. Without an 83(b) election, you'll pay taxes on shares as they vest, based on their value at vesting (which we all hope will be much higher than at the time it's first purchased). This creates multiple taxable events over your vesting period, potentially 37 separate tax bills with a standard 4-year schedule, all while you can't sell restricted shares to cover the tax burden.

The 83(b) advantage

Filing an 83(b) accelerates your tax timeline, letting you pay taxes on the full grant based on its initial, lower value and eliminating future tax events when you vest. This also starts the clock on long-term capital gains treatment, potentially saving you significant money if your startup succeeds.

How to avoid this mistake

- File immediately after receiving your stock grant and in any event within 30 days of acquisition
- Consult a tax advisor to ensure correct paperwork
- Keep certified mail receipts as proof of filing

The IRS grants no extensions or late filings, making this critical for any founder receiving equity.

2. Three Friends and One Costly Exit: Not Vesting Founder Stock

Alex, Priya, and Sam launched their fintech startup as equal partners, splitting equity evenly with no vesting schedule. They figured vesting was just for employees, not founders. Six months in, Sam lost interest and left to pursue a new opportunity in crypto, but he retained his full 33% stake.

When Series A investors came knocking, they balked at the idea of a non-contributing founder holding such substantial equity. Alex and Priya spent three

months and thousands in legal fees negotiating with Sam to buy back his shares at fair market value, money and time they desperately needed for product development.

Skipping vesting might seem founder-friendly, but it creates serious risks that outweigh the perceived benefits.

Why vesting protects everyone

Without vesting, a departing founder keeps their full equity stake while not contributing to future value creation. This “free rider” problem hurts remaining founders, employees, and investors. Even solo founders benefit from vesting because it demonstrates commitment to future investors and team members.

Investor expectations

VCs virtually always require founder vesting, and often require founders to revest when investing fresh capital. They won't invest in companies where key stakeholders might walk away with substantial ownership. By implementing reasonable vesting proactively, founders maintain control over their equity structure rather than accepting potentially harsher terms imposed by investors.

How to avoid this mistake

- Implement a standard four-year vesting schedule with a one-year cliff for all founders
- Remember that vesting protects everyone's interests, including your own

3. When 50-50 Becomes Zero-Zero: Establishing Governance That Allows Deadlocks

Jamie and Chris, co-founders of a promising e-commerce platform, each owned 50% of their company and sat on a two-person board. When a major retail partnership opportunity arose that could triple their revenue, they disagreed on the exclusivity terms. Jamie wanted to accept the deal as-is, while Chris insisted on negotiating for non-exclusive rights. With no tie-breaking mechanism, they reached an impasse. The partner grew impatient and signed with a competitor instead. Word spread among investors that the company was paralyzed by indecision, and their next funding round stalled for months.

Poor governance structures can paralyze your company at critical moments, causing missed opportunities and lost investor confidence.

The deadlock danger

Equal ownership or poorly defined voting rules create situations where evenly divided boards or shareholders can't make decisions. This is particularly damaging during time-sensitive opportunities like your first funding round.

Benefits of early planning

Thoughtful governance demonstrates maturity to investors while ensuring decisions move forward even during disagreements. Well-structured voting rights and board composition protect founder control while balancing stockholder needs. Clear governance structures signal that your company is well-organized and prepared to handle challenges, a strategic advantage when securing funding.

How to avoid this mistake

- Define voting rights, tie-breaker mechanisms, and decision-making protocols in bylaws
- Consider appointing independent directors or advisors to mediate disputes

4. Ethan's IP Nightmare: Starting Before Cleanly Exiting from Your Current Job

While still employed as a software engineer at a big, public tech company, Ethan began coding his SaaS app during evenings and weekends, using his work laptop for convenience.

When his startup gained traction and attracted investor interest, his former employer claimed ownership of the entire codebase, citing their broad IP agreement that covered any software development during employment. The legal dispute dragged on for eight months, during which investors backed away and Ethan's co-founder left for another opportunity. By the time he settled and could move forward, the opportunity was gone.

Beginning work on your new startup while still employed elsewhere risks entangling your new company's intellectual property with your former employer, a potentially devastating mistake.

Understanding IP agreements

Most employment contracts include broad IP assignment clauses covering anything you develop during employment that uses company resources or relates to their

business. This isn't limited to work hours or current business lines, and you can't assign IP to your startup that you don't actually own.

The transfer challenge

If your former employer owns IP you've developed, your startup won't own it unless your previous company formally assigns it. This requires disclosure, negotiation, and legal fees, assuming your former employer is willing to cooperate. Disputes over IP ownership is the most common red flag with early-stage investors and it can delay or kill deals.

How to avoid this mistake

- Review your employment contracts and IP agreements before starting any startup work
- Never use employer time, equipment, or confidential information for your venture
- Formally assign all IP to your startup only after leaving your previous employer

5. Ivan's Premature Funding Trap: Taking Financing Before You're Ready

Ivan's team landed a \$10 million seed round at a high valuation based on an impressive idea and strong credentials, but before they'd validated the technical feasibility of the idea or understood their go-to-market strategy.

The impressive funding announcement generated buzz, and flush with cash, they hired aggressively, growing from 3 to 30 employees in just 6 months. They tried to launch multiple products simultaneously without validating user demand and spent lots on customer acquisition before achieving product-market fit. Eighteen months later, their burn rate had soared, progress had stalled, and they had no revenue to show for it. When it came time for their Series A, new investors questioned their execution and forced Ivan to accept a down round, significantly diluting his ownership and control.

Raising capital too early or without a clear plan leads to unnecessary dilution and expectations that can hinder long-term success.

Too much capital, too early

Too much early-stage funding creates investor expectations for rapid growth that may be unrealistic. Excess capital without clear strategy leads to inefficiencies like over-hiring or pursuing initiatives misaligned with core business goals (aka, lack of focus).

Excess early fundraising can also complicate future rounds if later investors question your valuation.

How to avoid this mistake

- Develop detailed business plans with realistic financial projections and business milestones before seeking funding
- Raise only what you need from sources aligned with your vision and growth stage

6. The Vanishing Scientist: Forgetting to Get IP Assigned to Your Company

The founders of a promising biotech startup worked with Dr. Sarah Chen, a biochemist, to develop an early prototype. They never had her sign an IP assignment agreement, assuming her work was automatically owned by the company.

Two years later, during acquisition talks with a pharmaceutical giant, the buyer's due diligence revealed the oversight. Dr. Chen had since moved to Singapore and was difficult to reach. When they finally contacted her, she demanded a king's ransom to assign her rights to her IP. The acquisition nearly collapsed, and the founders had to accept a reduced purchase price to cover the unexpected payout.

Failing to secure IP assignment agreements from early contributors can leave the company without clear ownership of its most valuable asset.

Why it matters

Without these agreements, founders, employees, or contractors who helped build your product may retain ownership rights to critical intellectual property, creating ownership uncertainty that can derail fundraising rounds or acquisitions. Investors and buyers require clear IP ownership, and missing assignment agreements can trigger significant expenses to fix, reduced valuations, or even deal failures during due diligence.

How to avoid this mistake

- The solution is simple: implement IP assignment agreements from day one, ensuring every founder, employee, contractor, and early contributor formally assigns their IP rights to the company before they begin any work
- Don't wait until later stages to address this issue; the earlier you establish clear IP ownership through written agreements, the stronger your legal foundation will be

for attracting investors and protecting your company's most valuable asset

Minor mistakes can derail the most promising businesses

Each of these mistakes might seem minor, but they can derail even the most promising ventures. Take the time to address them proactively, so that you can focus your energy on building your business rather than fighting preventable problems. When selecting service providers, meet with those who specialize in representing venture-backed companies. Ask them who will be on your team, how they will engage with you, and how the work they will do with your company early on will best position you for long-term success. Do not rush through this. The upfront investment will pay dividends throughout your startup's journey, creating a stronger foundation for sustainable growth and success. And if you've unfortunately already encountered one of the mistakes outlined here, don't panic. Reach out to experienced startup counsel; they can help you address the issue and set you and your startup back on the right path.

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