WINDSOR DRAKE

WINDSOR DRAKE RESEARCH · 2026

The Net-Proceeds Report

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Windsor Drake is a sell-side M&A advisory firm focused on software, financial technology, artificial intelligence, cybersecurity, and other technology-enabled businesses in the lower middle market. The firm publishes research on transaction activity, deal structure, and valuation for founders, boards, and investors.

About this report

This report explains the gap between what a founder owns and what a founder receives at exit. It walks the liquidation waterfall, shows how liquidation preferences and other terms reallocate proceeds away from common stock, quantifies the ownership-payout gap across exit values, and traces the path from headline price to after-tax take-home. It introduces the Windsor Drake Net-Proceeds Framework and argues that terms agreed years before a sale often matter more to a founder's outcome than the sale price itself.

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OVERVIEW

What you own is not what you get

A founder who owns forty percent of a company assumes they will receive forty percent of the proceeds when it sells. They will not. The liquidation waterfall, and the preference terms agreed in financing rounds years earlier, sit between the cap table and the bank account, and they routinely deliver common shareholders far less than their ownership implies.

The gap can be severe. In one documented case, founders and employees who owned forty-seven percent of the cap table received only twenty-three and a half percent of the proceeds, because a participating-preferred structure transferred roughly ten million dollars from common to investors relative to clean terms.[1] That reallocation was not a function of the sale price or the negotiation at exit; it was written into the company's terms rounds earlier, and it executed automatically when the company sold. The founders' ownership percentage was real. Their payout percentage was something else entirely.

This report explains why, and what a founder can do about it. It walks the liquidation waterfall step by step, dissects the preference terms that reallocate proceeds, quantifies the ownership-payout gap across different exit values, and traces the full path from headline price to after-tax take-home, including the tax lever that can swing the result by millions. The argument is that a founder's outcome is determined as much by terms agreed in financing as by the price achieved at sale, and that understanding the waterfall is essential both when raising and when selling.

> *The reallocation is not negotiated at exit. It is written into the terms rounds earlier, and it executes automatically when the company sells.*

The good news within this is that the waterfall is knowable in advance. A founder can model it at any exit value, can see exactly how much their terms reallocate, and can negotiate those terms when raising capital, when leverage to do so is greatest. The founder who understands the waterfall raises on better terms, sets realistic expectations, and at exit knows what they will actually keep, rather than discovering the gap only when the proceeds are distributed. This report is built to make that gap visible before it matters.

THE MARKET IN BRIEF

The numbers behind the waterfall

47→23% In one case, owners of 47% of the cap table received just 23.5% of proceeds under a participating structure.[1]	**98%** Share of recent venture deals carrying a 1x liquidation preference, the market standard.[2]	**95%** Share using non-participating preferred, the founder-friendly standard, when it holds.[2]
30→47% Rise in deals with senior (stacked) preferences from 2022 to 2023, a less visible risk.[1]	**~$10M** Transferred from common to investors in one deal by participating versus 1x non-participating terms.[1]	**≠** The relationship between a founder's ownership percentage and their share of proceeds.[1]

Windsor Drake view: the headline price gets the attention, but the terms decide the split. A founder who negotiates a clean term sheet in financing can keep more from a modest exit than one who accepts dirty terms and sells for more.

The liquidation waterfall

When a company sells, the proceeds do not split by ownership. They flow through a waterfall defined in the company's charter, paying claims in a strict order, and common shareholders, the founders and employees, sit at the bottom of it.

The waterfall pays in sequence. Debt and transaction costs come first. Then preferred shareholders receive their liquidation preference, the amount they are contractually entitled to before common sees anything, typically one times their investment. Only after every preference is satisfied does the remaining money flow to common stock and options, split by ownership. If the company sells for enough, everyone shares proportionally and the waterfall barely matters. If it sells for less, the preferences consume a large share of the proceeds before common participates, and the founders receive far less than their ownership suggests, or in a low outcome, nothing.[3]

EXHIBIT 1

The order of the waterfall

ORDER	CLAIM	EFFECT ON COMMON
1	Debt and transaction costs	Paid before any equity
2	Liquidation preferences (preferred)	Paid in full before common participates
3	Participating preferred (if any)	Double-dips: preference plus a share of the rest
4	Common stock and options	Receive only what remains

Source: Windsor Drake, from standard liquidation-waterfall mechanics.[3]

Why the waterfall favors investors at modest exits

The waterfall's design means investors are protected and common is exposed precisely when the exit is modest. Because preferences are paid first and in full, a sale that is small relative to the capital raised can return investors their money, or a multiple of it, while leaving little for common. The founders, whose value is entirely in common stock, absorb the shortfall. This is the deliberate purpose of the preference, to protect investors on the downside, and it is why a founder's outcome at a modest exit depends far more on the terms than on the headline.[3]

Everyone shares proportionally only if the exit is large enough. Below that, preferences consume the proceeds first, and the founders absorb the shortfall.

The waterfall is the engine of the ownership-payout gap, and the terms that govern it, the size of the preferences, whether they participate, how they stack, are what determine how much it favors investors over founders. The next section examines those terms, because they are where the gap is created and where, at financing time, it can be negotiated.

02 · THE TERMS

Liquidation preferences

Three features of a liquidation preference decide how much it costs common shareholders: its multiple, whether it participates, and how it ranks against other preferences. Each is set in financing, and each can move a founder's exit by millions.

The multiple

The preference multiple is how many times their investment the preferred receive before common participates. The market standard is one times, and recent data shows roughly ninety-eight percent of venture deals at a one-times preference.[2] Higher multiples, two or three times, are rare in healthy markets but appear in distressed or down rounds, and they are punishing for common, because they multiply the amount that must be paid before founders see anything. A founder should treat any preference above one times as a serious cost and resist it where leverage allows.

Participating versus non-participating

This is the single most impactful term in most term sheets.[1] Non-participating preferred, the founder-friendly standard used in about ninety-five percent of recent deals, requires the investor to choose: take the preference, or convert to common and share proportionally, whichever is greater, but not both.[2] Participating preferred lets the investor take the preference and then also share in the remaining proceeds alongside common, a double-dip that can dramatically reduce the common payout. The forty-seven-percent-to-twenty-three-percent case in this report was driven by exactly this, a participating structure transferring roughly ten million dollars to investors relative to clean terms.[1] Whether the preferred participates is, for many companies, the term that matters most to the founder's eventual take-home.

Seniority and stacking

When a company has raised multiple rounds, the preferences can rank against each other in two ways. Pari passu means all preferred share the preference pool proportionally; senior, or stacked, means later investors are paid in full before earlier ones, who are paid before common. Stacked preferences are a quieter risk than participation but a growing one: the share of deals with senior preferences rose from under thirty percent in 2022 to forty-seven percent in 2023.[1] A deeply stacked cap table can mean that at a modest exit, the entire proceeds are consumed by senior preferences before earlier investors or common see anything. Founders raising multiple rounds should track how the preferences stack, because the structure compounds with each round.

Participation is the term that most often decides a founder's take-home. A participating preferred double-dips; a non-participating one chooses. The difference can be millions.

How SAFEs and notes enter the waterfall

Many early-stage companies raise on convertible instruments, SAFEs and convertible notes, rather than priced preferred rounds, and founders sometimes assume these are simpler and gentler than preferred stock. They are not, at the waterfall. These instruments convert into preferred stock, usually at the next priced round and often at a discount or a valuation cap that gives the holder more shares than their dollars alone would buy, and once converted they carry the same preference rights as the preferred they become. A company that raised several SAFEs at low caps can find, at conversion, that early investors hold more preferred, and therefore more preference, than the founders expected, deepening the waterfall ahead of common. The convertible instruments that felt founder-friendly when raised become ordinary preferences at exit, and a founder should model their conversion to understand the preference stack they actually create.

The crucial point is that all three features are negotiated in financing, not at exit. By the time a company sells, the terms are fixed and the waterfall simply executes them. A founder who negotiated clean terms, a one-times, non-participating, unstacked preference, will keep far more of a given exit than one who accepted participation and stacking to reach a higher valuation in an earlier round. The valuation a founder optimizes when raising is visible; the terms that will govern the exit are not, and the terms often matter more.

03 · THE FINDING

The ownership-payout gap

The ownership-payout gap is the difference between the share of the company a founder owns and the share of the proceeds they receive. It is the central, under-appreciated fact of exit economics, and it is largest exactly where founders least expect it.

47% → 23.5%

Ownership versus payout in one documented exit, the gap created entirely by preference terms.

The gap arises because the waterfall pays preferences before common, and widens as those preferences grow more aggressive. In the documented case, a forty-seven percent ownership stake translated to a twenty-three and a half percent share of proceeds, a gap of more than twenty points, driven by a participating-preferred structure.[1] The founders did nothing wrong at exit; the gap was built into terms agreed earlier, and it executed mechanically when the company sold. Their cap-table stake described what they owned; it badly overstated what they would keep.

When the gap is largest

The gap is not constant. It is largest at modest exit values and with aggressive terms, and it narrows as the exit grows. At a high exit, preferences are a small fraction of the proceeds, non-participating investors convert to common, and ownership and payout nearly converge. At a modest exit, preferences consume a large share before common participates, participating investors double-dip, and stacked preferences compound, so the founder's payout falls far below their ownership. The same cap table can show almost no gap at a large exit and a chasm at a small one, which is why a founder cannot judge their likely outcome without modeling the specific exit value.[3]

> *The gap is largest at modest exits and with aggressive terms. The same cap table can show almost no gap at a high exit and a chasm at a low one.*

This is the report's central, out-of-the-box conclusion: a founder's ownership percentage is a poor guide to their payout, and the difference is governed by terms set years before the sale. The implication is twofold.

When raising, a founder should negotiate the terms that govern the gap, not only the valuation, because the terms will decide the exit split. And when selling, a founder should model the waterfall at the realistic exit value before celebrating a headline, because the number that matters is what flows to common after the preferences are paid, and that number is often far smaller than the cap table suggests.

WORKED EXAMPLE

The waterfall, with numbers

The mechanics are clearest with a concrete case. Consider a company that sells for thirty million dollars, having raised twenty million across two rounds, with founders and employees owning half the equity and investors the other half.

On a pure ownership basis, the founders and employees would expect fifteen million dollars, half of thirty. The waterfall says otherwise, and how much otherwise depends entirely on the preference terms. Under clean one-times non-participating terms, the investors compare their twenty-million preference against their fifty-percent share of the proceeds, fifteen million, and take the larger, the twenty-million preference. That leaves ten million for common, a third of the proceeds for a group that owns half. Under participating terms, the investors take their twenty-million preference and then also share in the remaining ten million, taking another five, for twenty-five million in total. That leaves just five million for common, one-sixth of the proceeds for a half-owner.

EXHIBIT 2

A $30M exit, $20M raised, founders own 50%

TERMS	INVESTORS RECEIVE	COMMON RECEIVES	COMMON SHARE
Ownership basis (no preference)	$15M	$15M	50%
1x non-participating	$20M	$10M	33%
1x participating	$25M	$5M	17%

Source: Windsor Drake illustration. Simplified to show the mechanism; real cap tables have multiple rounds and additional terms.

The example makes the gap unmistakable. The same company, the same thirty-million exit, the same fifty-percent ownership, produces a common payout of fifteen million, ten million, or five million depending only on the preference terms. Moving from clean to participating terms halves the founders' take, and the founders had no say in it at exit; the terms were fixed years earlier. The difference between the term sheets, invisible in the ownership percentage, is the difference between keeping a third of the proceeds and keeping a sixth.

Same company, same exit, same ownership. The founders keep fifteen, ten, or five million depending only on terms set years earlier. That is the whole report in one table.

Now imagine the exit is lower, twenty million rather than thirty. Under any of these structures the twenty-million preference consumes the entire proceeds, and common receives nothing, while investors are made whole. The founders, who built the company and own half of it, walk away with zero, not because the company failed, it sold for twenty million, but because the preferences were paid first. This is the waterfall at its most punishing, and it is exactly the scenario a founder must model before assuming a sale, even a substantial one, will be life-changing.

04 · THE FULL PATH

From headline to take-home

The waterfall is only the first of several deductions between the headline price and what a founder banks. The full path runs through the preferences, then the deal structure, then fees, then tax, and the founder's real number sits at the very end.

Following a founder's proceeds from the headline requires combining two reports' worth of mechanics. First, the structure of the deal, examined in the firm's companion report, removes value before anything reaches the equity: cash at close is certain, but earnouts, escrows, holdbacks, and rollover are contingent or delayed. Then the waterfall examined here distributes what reaches the equity, paying preferences before common. Then transaction fees come out. And finally tax is applied to what the founder receives. Each stage subtracts, and the founder's take-home is what survives all of them.[3]

EXHIBIT 3

The full path for a founder's proceeds

STAGE	WHAT IT DOES TO THE FOUNDER'S NUMBER
Headline price	The announced figure
Deal structure	Earnouts, escrow, rollover removed or deferred
Liquidation waterfall	Preferences paid before common
Option pool	Common pool shared with option holders
Transaction fees	Advisory and legal costs deducted
Tax	Applied to what the founder receives; QSBS may reduce it
Take-home	**What the founder actually keeps**

Source: Windsor Drake Net-Proceeds Framework. Each stage is cumulative; the founder's number is the residual.

The compounding of these deductions is what produces the surprise founders so often describe. A headline that sounds life-changing passes through contingent structure that may not all be realized, a waterfall that pays investors first, an option pool that shares the common proceeds, fees, and tax, and what lands can be a fraction of the number announced. None of this is hidden, but it is rarely modeled in full until the proceeds are distributed, and by then it is too late to do anything about it.

> *A headline that sounds life-changing passes through structure, the waterfall, the option pool, fees, and tax. What lands can be a fraction of the number announced.*

The Net-Proceeds Framework exists to model this path in advance. By running the headline through every stage, structure, waterfall, pool, fees, and tax, a founder can see their realistic take-home before agreeing to anything, compare offers on what they would actually keep rather than on the headline, and identify which levers, cleaner structure, a better waterfall, tax planning, would most improve the result. The headline is what is announced; the take-home is what the founder lives on, and the framework makes the second visible.

The exit-value sensitivity

Because the gap depends on the exit value, the single most useful exercise a founder can do is model the same cap table at several exit values. The pattern it reveals is consistent and counterintuitive: clean terms can beat a higher price.

Modeling a cap table at a range of exit values, a low, a middle, and a high outcome, exposes how the ownership-payout gap moves. At a high exit, preferences are small relative to the proceeds, non-participating investors convert to common, and the founder's payout approaches their ownership. At a middle exit, the gap is meaningful, with preferences consuming a real share. At a low exit, the gap is severe, and with aggressive terms the founder may receive little or nothing while investors are made whole.[3]

EXHIBIT 4

The ownership-payout gap across exit values, illustrative

EXIT VALUE	FOUNDER SHARE, CLEAN 1X NON-PARTICIPATING	FOUNDER SHARE, PARTICIPATING / STACKED
Low	Reduced; near or below ownership	Severely reduced; possibly little
Middle	Approaching ownership	Meaningfully below ownership
High	At or near ownership	Below ownership, but closer

Source: Windsor Drake illustration of waterfall sensitivity. Directional; specific outcomes depend on the exact cap table and terms.

Why a lower price can pay more

The most important insight from the sensitivity is that terms can outweigh price in the mid-market. A founder choosing between a higher exit governed by participating, stacked preferences and a lower exit governed by clean one-times non-participating terms may keep more from the lower one, because the clean terms leave a far larger share for common. Modeling exits at several values often reveals that a lower valuation with clean terms yields a significantly higher founder payout in mid-market scenarios than a higher valuation with dirty terms.[3] The headline is a poor guide; the modeled take-home is the truth.

A lower exit with clean terms can pay the founder more than a higher exit with participating, stacked preferences. The headline is a poor guide; the modeled take-home is the truth.

The practical takeaway is to model before deciding, both when raising and when selling. When raising, modeling shows how a proposed term would affect outcomes across exit scenarios, turning an abstract term sheet into concrete dollars and arming the founder to negotiate. When selling, modeling shows what the founder will actually keep at the realistic exit value, and lets them compare offers on take-home rather than headline. The exercise is straightforward, the tools are widely available, and the founders who do it are never surprised by the distribution.

06 · THE LEVER

The tax lever

The final stage of the path, tax, is also one of the largest and most overlooked levers on a founder's take-home. For some founders, tax planning is worth more than another turn on the price, and it depends on decisions made years in advance.

Tax applies to what a founder receives, and how much applies depends heavily on structure and planning. The form of the deal, a sale of stock versus a sale of assets, affects the tax treatment for the seller, as does whether consideration is taxed as capital gain or ordinary income, and whether any of it can be deferred, for example through a tax-deferred rollover of equity. These choices can move the after-tax result substantially, and they are squarely the domain of tax counsel, but a founder should understand that the after-tax number, not the pre-tax one, is what they keep.

Qualified small business stock

The most powerful tax lever available to many technology founders is the qualified small business stock exclusion under Section 1202 of the tax code. For eligible stock in a qualifying company, held for the required period, a founder may exclude a large amount of capital gain from federal tax, historically up to the greater of ten million dollars or ten times basis, and recent 2025 legislation expanded the benefit, raising the caps and introducing tiered holding periods.[4] The eligibility rules are detailed and fact-specific, covering the type of company, the nature of the stock, the holding period, and asset thresholds, and they must be assessed with tax counsel. But where it applies, the exclusion can shelter a very large share of a founder's gain, and it is among the most valuable planning opportunities in a sale.

> *For some founders, tax planning is worth more than another turn on the price, and the most powerful lever, the QSBS exclusion, depends on decisions and holding periods set years before the sale.*

Why it must be planned early

The decisive feature of the tax lever is that it is set early. Qualified small business stock requires a holding period and a qualifying structure that must be in place well before the sale, and a founder who incorporates in the wrong form, or sells before the holding period is met, can forfeit a benefit worth millions. Other tax-planning moves, gifting, trusts, the timing of the sale, similarly require lead time. A founder who thinks about tax only at exit has missed the window for the most valuable planning, while one who plans years ahead can keep a far larger share of the same proceeds. As with the preference terms, the decisions that most affect the founder's outcome are made long before the sale.

The lesson of the tax lever reinforces the report's theme. The founder's take-home is shaped by choices made years in advance, the preference terms agreed in financing, the corporate structure and holding period that govern tax, far more than by the negotiation at exit. A founder who attends to these early, with legal and tax counsel, can keep dramatically more of a given sale than one who optimizes only the headline at the end. The take-home is built over years, not won in a week.

07 · APPLICATION

What it means for founders

The waterfall, the terms, and the tax lever translate into a clear set of actions, most of which a founder should take long before a sale is contemplated.

Negotiate terms, not just valuation, when raising

The preference terms agreed in financing, the multiple, participation, and seniority, will govern the exit split. A founder should treat them as seriously as the valuation, resisting participation and high multiples and tracking how preferences stack across rounds, because a higher valuation bought with worse terms can cost more at exit than it gained in the round.

Model the waterfall at realistic exit values

Before celebrating any headline, model the take-home at the realistic exit value, and ideally at a range of values. The model reveals the ownership-payout gap, shows how the terms reallocate proceeds, and often reveals that a lower-priced, clean-terms outcome beats a higher-priced, dirty one. The exercise is cheap and the surprise it prevents is expensive.

Compare offers on take-home, not headline

When offers arrive, run each through the full path, structure, waterfall, pool, fees, and tax, and compare the after-tax take-home rather than the headline. Because the deductions differ by deal, the highest headline is not always the highest take-home, and only the modeled number reveals which offer is actually best.

Plan tax years in advance

The most valuable tax planning, qualified small business stock in particular, requires structure and holding periods established long before a sale. A founder should engage tax counsel early, ensure the company and the stock are positioned for available benefits, and avoid actions that would forfeit them. Tax planned at exit is tax largely missed.

Set expectations honestly

Finally, a founder should understand, and help their team understand, that ownership percentages overstate payouts, especially at modest exits and with aggressive terms. Setting honest expectations, for the founder, the team, and the family, avoids the painful surprise of a distribution that falls far below what the cap table seemed to promise.

The unifying message is that a founder's take-home is built over years, in the terms they accept when raising, the structure and holding periods they establish, and the planning they do well before a sale, far more than in the price they negotiate at the end. The founder who attends to the waterfall and the tax lever early keeps a dramatically larger share of the same exit than one who learns of the gap only when the money is distributed. What you own is not what you get, but what you do years in advance largely determines the difference.

THE TEAM

A note for employees and option holders

The ownership-payout gap falls hardest on employees, who hold the most junior equity of all and often understand the waterfall least. A founder who cares about the team should understand how the gap reaches them, and what can be done about it.

Employees typically hold common stock or options, which sit at the very bottom of the waterfall, behind every preference and behind the founders' common. When preferences consume the proceeds at a modest exit, employees are among the first to be wiped out, and option holders face a further hurdle: their options have a strike price that must be covered before they see any value, so at a low exit an option can be worthless even when the company sold for a meaningful sum. An employee who joined for the upside of equity can find, at a disappointing exit, that the equity delivered nothing, while investors were made whole.

Why employees are surprised

Employees are surprised because they were sold, and often genuinely believed in, an ownership story that the waterfall quietly overrides. They were told their options represented a share of the company, and they do, but a share of the common that is paid last, not a share of the proceeds paid first. Few employees see the certificate of incorporation that governs the waterfall, and fewer model it, so the gap between the equity they were promised and the payout they receive arrives as a shock at exit. The same mechanism that surprises founders surprises employees more, because they have less information and a more junior claim.

What a founder can do

A founder who wants the team to share in the outcome has several levers. Negotiating clean preference terms protects common, and therefore employees, as much as founders. Structuring a sale to carve out a pool for employees, or negotiating with the buyer for retention and incentive payments outside the waterfall, can deliver value to the team even at an exit where common is thin. And being honest with employees about how equity works, rather than overselling it, sets expectations that protect trust. The founder cannot change the seniority of the waterfall, but can act, in the terms and in the deal, to ensure the people who built the company are not the ones the waterfall leaves behind.

Employees were sold an ownership story the waterfall quietly overrides. They own a share of the common that is paid last, not a share of the proceeds paid first.

The treatment of the team is, in the end, a choice the founder makes through the terms they accept and the deal they structure. The waterfall is fixed, but the founder's response to it is not, and a founder who negotiates clean terms, carves out value for employees, and sets honest expectations can ensure that a good outcome for the company is a good outcome for the people in it. The gap is a feature of the structure; whether it falls on the team is, in part, a decision.

CHECKLIST

Preference terms to watch in a term sheet

The terms that govern the waterfall are negotiated when raising, and a founder reading a financing term sheet should know which provisions will cost them most at exit. Each below is a prompt to push back, weighed with counsel.

Participating preferred	The investor double-dips at exit. The single most costly term for common; resist it.
A preference above 1x	Multiplies what must be paid before common; a serious red flag outside distress.
Senior (stacked) preference	New investors rank ahead of earlier ones and common; compounds across rounds.
No participation cap	If participation is unavoidable, a cap limits the double-dip; uncapped is worse.
Cumulative dividends	Accruing dividends increase the preference owed over time, ahead of common.
Full-ratchet anti-dilution	A down round can sharply reprice earlier shares, diluting common heavily.
A large or expanding option pool	Dilutes common before the round; the pool shuffle is often borne by founders.

Source: Windsor Drake. Each item is a prompt to negotiate, evaluated with experienced counsel against the whole financing.

The reason to scrutinize these at financing is that they cannot be changed at exit. A founder who accepts a participating, stacked, above-one-times preference to win a higher headline valuation in a round has, in effect, pre-committed a large share of the eventual exit to investors, and will discover the cost only when the company sells. Reading the term sheet for its exit consequences, not just its valuation, is how a founder protects the take-home years in advance. The valuation is what the round is about; the terms are what the exit will be about, and the terms outlast the round.

> *The valuation is what the round is about. The terms are what the exit will be about. The terms outlast the round, and cannot be changed once the company sells.*

08 · OUTLOOK

Outlook

The forces shaping the waterfall are shifting, and a founder raising or selling in the next few years should watch how terms and tax are moving.

Terms harden in tougher markets

Liquidation-preference terms move with the market. In founder-friendly markets, clean one-times non-participating terms dominate, as recent data shows; in tougher markets, investors push for participation, higher multiples, and seniority, and the rise in stacked preferences in recent down-market years is the warning.[1,2] A founder raising in a harder market should expect more aggressive terms and should defend against them deliberately, because the terms accepted in a difficult round will govern the exit just as firmly as those from a good one. The market that sets the terms is not the market that sets the exit, and the terms outlast the conditions that produced them.

The tax landscape is in flux

Tax treatment of exits, and the qualified small business stock benefit in particular, is subject to legislative change, and recent 2025 changes expanded the benefit.[4] Because the most valuable planning depends on holding periods and structures set years in advance, a founder must plan against the rules as they are while staying alert to change, and must work with tax counsel to capture benefits whose value can run to millions. The flux makes early, expert planning more important, not less, because the windows to qualify are defined by time.

The gap becomes better understood

The ownership-payout gap is becoming more widely understood, as modeling tools spread and as more founders experience or hear of the surprise. Windsor Drake expects sophisticated founders increasingly to negotiate terms and model waterfalls as a matter of course, and to treat the gap as a known variable to manage rather than a shock to absorb. The founders who internalize this earliest will raise on better terms and keep more of their exits, widening the advantage of understanding the waterfall.

> *The terms accepted in a difficult round govern the exit as firmly as those from a good one. The market that sets the terms is not the market that sets the exit.*

The conclusion mirrors the report. A founder's outcome is determined by the waterfall and the tax treatment as much as by the price, and both are shaped by decisions made years in advance. As terms move with the market and tax rules shift, the founder who understands the mechanics, negotiates the terms, models the waterfall, and plans the tax will keep far more of their exit than one who attends only to the headline. The gap between owning and getting is real, durable, and, with foresight, largely manageable.

IN PRACTICE

Modeling the waterfall

Knowing the waterfall matters only if a founder actually models it. The practice is straightforward, the tools are widely available, and the discipline of doing it, repeatedly and at several exit values, is what turns awareness into protection.

A waterfall model combines two inputs: the cap table, who owns what, and the payout terms from the company's charter, the preferences, participation, seniority, and any caps or accruals. With those, a founder can compute the distribution at any exit value, seeing exactly what flows to each class of stock and what reaches common. The essential discipline is to run the model at a range of exit values, a disappointing outcome, a base case, and an optimistic one, because the ownership-payout gap moves so sharply with the exit that a single figure misleads. A founder who has seen the distribution at a low, middle, and high exit understands their real exposure in a way no ownership percentage conveys.

The model should be built and maintained over time, not assembled in the rush of a sale. Each financing round changes the cap table and the preference stack, and a founder who updates the model after every round always knows where they stand, can see the exit consequences of a proposed term before accepting it, and is never surprised at a sale. Treating the waterfall model as a living document, refreshed with each round and consulted before each major decision, is the practical habit that protects the take-home. It is inexpensive, it is well within the reach of any founder with competent advisers, and it is the single most reliable defense against the gap this report describes.

> *Build the model, run it at several exit values, and update it after every round. The waterfall is knowable in advance; the surprise is optional.*

CONCLUSION

The exit is decided before the sale

A founder's payout feels like it is determined at the moment of sale, in the price and the negotiation. In truth it is largely determined years earlier, in the terms accepted when raising and the structures established for tax.

The waterfall is the proof. Proceeds flow through it in a fixed order, paying preferences before common, and the terms that govern it, the multiple, participation, and seniority, were set in financing rounds long before the sale. Those terms can deliver a founder far less than their ownership implies, most severely at modest exits, and the gap between owning forty-seven percent and receiving twenty-three is created not at the closing table but in a term sheet signed years before. Add the deductions of structure, fees, and tax, and the headline a founder celebrates can resolve to a take-home that bears little resemblance to it.

The remedy is foresight. Negotiate the terms that govern the waterfall when raising, when leverage to do so is greatest. Model the take-home at realistic exit values before agreeing to any sale. Compare offers on what is actually kept, not on the headline. And plan tax, especially the qualified small business stock benefit, years in advance, because its value depends on time. A founder who does these things keeps far more of the same exit than one who learns of the gap only when the proceeds are distributed. What you own is not what you get, and the difference is decided long before the sale, by a founder who understood the waterfall in time to act on it.

What you own is not what you get. The difference is decided years before the sale, by the founder who understood the waterfall in time to act.

REFERENCE

Waterfall terms, defined

The terms below recur throughout this report and across exit economics.

Liquidation waterfall	The order in which sale proceeds are distributed, paying preferences before common.
Liquidation preference	The amount preferred investors receive before common, usually one times their investment.
Non-participating preferred	Investor takes either the preference or converts to common, whichever is greater, not both.
Participating preferred	Investor takes the preference and also shares in the remaining proceeds; the costliest term for common.
Participation cap	A limit on how much a participating investor can take before converting to common.
Seniority / stacking	Whether later preferences rank ahead of earlier ones in the waterfall.
Ownership-payout gap	The difference between a founder's ownership percentage and their share of proceeds.
QSBS	Qualified small business stock; eligible stock whose gain may be partly excluded from federal tax.
Take-home	What a founder actually keeps after structure, the waterfall, fees, and tax.

Source: Windsor Drake. Definitions are for general orientation, not legal or tax definitions.

THE EARLY READ

Into 2026: bigger deals, the same waterfall

The 2026 market did fewer deals at larger sizes and leaned harder on structure, and both shifts make the lesson of this report more urgent, not less: what a founder owns is not what a founder gets, and the gap between the two is set by a waterfall the headline never shows.

As private-equity deal count fell in early 2026 while aggregate value rose, the deals that cleared were larger and more structured, with a greater share of consideration carried in earnouts and other contingent forms. A bigger headline number is not a bigger guaranteed payout; it is a larger figure distributed through the same liquidation waterfall, and where preferences, participation, and contingent consideration stack up, the distance between a founder's ownership percentage and the founder's cash percentage widens with the size and complexity of the deal.

A bigger headline is not a bigger payout. In 2026's larger, more structured deals, the same waterfall sits between what a founder owns and what a founder gets.

Structure compounds the waterfall

The rise of contingent consideration in 2026 compounds the dynamic this report dissects. Liquidation preferences are paid first and in cash at close; earnouts pay the founder last and only on performance. A founder holding common stock behind a stacked preference and ahead of a long earnout can find that a large announced price resolves into a modest, deferred, and uncertain personal outcome. The mechanics have not changed; the larger, more structured deals of 2026 simply make their consequences larger.

What it means for founders

The practical conclusion is to model net proceeds, not headline value, and to do it before terms are set rather than after. In a market of bigger, more structured deals, the cap-table waterfall and the structure of the consideration decide the founder's outcome more than the price does, and the time to understand and shape that outcome is during negotiation. This report's frameworks exist to turn an opaque waterfall into a number a founder can see in advance.

Sources for this section: PwC, “Private capital 2026 mid-year outlook” (fewer, larger deals); Cooley 2025–2026 review (contingent consideration); Windsor Drake net-proceeds analysis.

Methodology and sources

This report draws on published venture-financing and deal-terms studies, on guides to liquidation-preference and waterfall mechanics, and on Windsor Drake analysis, covering 2024 through mid-2026. The market-standard figures for preference terms come from a recent venture-financing report; the documented ownership-payout case and the figures on participating and stacked preferences come from published waterfall analyses. These describe samples and specific examples and will not match any individual company, whose outcome depends entirely on its own terms. The worked illustrations of exit-value sensitivity are directional and built to demonstrate the mechanics rather than to benchmark any deal.

The Net-Proceeds Framework and the ownership-payout gap are Windsor Drake analytical tools for making a founder's likely take-home visible in advance. References to tax, including qualified small business stock, are general and illustrative; tax law is complex, fact-specific, and subject to change, and any tax position must be assessed with qualified tax counsel. Nothing in this report is investment, legal, tax, or accounting advice.

Endnotes and sources

1. Liquidation-preference impact and trends (the 47%-to-23.5% case; ~$10M transferred under participating terms; senior preferences rising from ~30% to 47% of deals): Allied Venture Partners, "Modelling Cap Table Liquidation Preferences"; Horizon Capital, "The Waterfall Impact"; Fiscallion, "Liquidation preference in startups."
2. Market-standard preference terms (98% 1x; 95% non-participating): Cooley LLP, "Q2 2025 Venture Financing Report."
3. Waterfall mechanics, participation caps, and exit-value sensitivity: Allied Venture Partners (above); Charles Yu, "The Ultimate Guide to Liquidation Preferences"; Crowley Law, "Liquidation Preferences Guide"; The Scenarionist, "What is an Exit Waterfall?"
4. Qualified small business stock (Section 1202) and its 2025 expansion: general tax commentary on Section 1202 and the 2025 legislative changes; to be confirmed for any specific situation with qualified tax counsel.

ABOUT

About Windsor Drake Research

Windsor Drake is a sell-side M&A advisory firm for founders and boards of software, financial technology, artificial intelligence, and cybersecurity companies in the lower middle market.

The firm advises technology founders through the full arc of a sale, from positioning the company and building the buyer universe to negotiating terms and modeling what a founder will actually keep. Its research program exists to make the dynamics that decide outcomes legible to the people on the selling side, who face these transactions once or twice in a career against buyers and investors who do them constantly.

This report is part of the Windsor Drake Research series, a set of independent studies on valuation, deal structure, process, and consolidation across the firm's sectors. Companion titles examine the structure of private deals, why deals die, the sale timeline, the most active acquirers of software companies, the strategic-versus-sponsor choice, the cross-sector valuation premium captured by the Rule of 40, the talent-led acquisition of AI companies, the consolidation of the cybersecurity industry, and the roll-up of vertical software. The series is intended to be read by founders, boards, investors, and the journalists and analysts who cover these markets.

Contact

Windsor Drake maintains offices in Toronto and New York. Founders considering a transaction, and members of the press citing this research, can reach the firm through windsordrake.com.

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