

# The Founder's Guide to Managing Concentrated Equity

## A Strategic Playbook for Diversification & Tax Efficiency

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As a founder, executive, or early employee, your single greatest asset is likely your equity position in your company. While this concentration is a testament to your success, it also represents a significant and often unmitigated financial risk. A well-structured plan to manage this position is not just a matter of portfolio theory; it is a critical component of securing your personal financial future. This guide provides a high-level overview of the primary strategies used to manage a large, single-stock position. The goal is to move from a position of concentrated risk to one of diversified wealth in the most deliberate and tax-efficient manner possible. Each strategy has distinct benefits and trade-offs, and the optimal approach will depend on your specific circumstances, including your liquidity needs, tax situation, and long-term goals.

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# Strategy 1: Systematic Selling (Rule 10b5-1 Plans)

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For insiders (such as executives and board members) who possess material non-public information, selling company stock is highly restricted. A Rule 10b5-1 plan is a pre-arranged, automated trading plan that provides a safe harbor from insider trading allegations.

**How it Works:** You establish a written plan with your broker that specifies the dates, prices, and amounts of future stock sales. This plan must be created during an "open window" when you are not in possession of material non-public information. Once the plan is in place, the trades are executed automatically by your broker, regardless of any subsequent information you may learn.

- **Best For:** Insiders who need to regularly sell shares for liquidity and diversification over a long period.
- **Key Advantage:** Provides a clear, compliant method for insiders to systematically diversify their holdings without fear of insider trading liability.
- **Primary Consideration:** Sales are subject to capital gains tax. A 10b5-1 plan manages the *\*timing\** of sales, but not the tax impact.

## Strategy 2: Hedging (Collars & Options)

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Hedging strategies are designed to protect your concentrated position from a significant drop in price without requiring an immediate sale. The most common institutional-grade strategy is an equity collar.

**How it Works:** A "cashless collar" involves two simultaneous options trades. First, you buy a protective put option, which gives you the right to sell your stock at a predetermined "floor" price, protecting you from any downside below that level. To fund the purchase of this put, you simultaneously sell a call option, which obligates you to sell your stock at a predetermined "ceiling" price. This caps your potential upside but uses the proceeds to make the downside protection free of charge.

- **Best For:** Individuals who want to protect their wealth from a major decline but are not yet ready or able to sell their shares.
- **Key Advantage:** Provides significant downside protection without triggering an immediate capital gains tax event.
- **Primary Consideration:** You give up any potential appreciation above the "ceiling" price of the call option you sold.

## Strategy 3: Tax-Efficient Diversification

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For founders with a very low cost basis in their stock, selling can trigger a massive tax bill. Advanced strategies exist to achieve diversification while deferring the capital gains tax.

**How it Works:** One common method is an Exchange Fund (or Swap Fund). In this strategy, you contribute your appreciated stock to a partnership alongside other investors with their own concentrated positions. In return, you receive an interest in a new, diversified portfolio of all the contributed stocks. Because this is a transfer to a partnership, it is generally not considered a taxable event, allowing you to defer the capital gain.

- **Best For:** Qualified purchasers with highly appreciated stock who want to diversify without an immediate tax impact.
- **Key Advantage:** Achieves immediate diversification and defers capital gains tax.
- **Primary Consideration:** These are complex, illiquid investments with high minimums, suitable only for sophisticated investors.

## Conclusion: A Bespoke Strategy is Essential

Managing a concentrated equity position is one of the most critical and complex challenges a founder will face. The optimal strategy is never one-size-fits-all. It requires a deep analysis of your personal financial situation, your goals for the future, and your specific tax circumstances. We encourage you to consult with your financial and tax advisors to design a bespoke plan that is right for you.

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