Who gets what? The importance of a sensible equity split among cofounders

From all the decisions a startup founder needs to make, the decision on how to split equity is one of the most important decisions on the company's journey. It is a decision that can literally make or break the company. It is also a decision which is very difficult to change later.

Temps de lecture : minute

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If done right, you will be able to attract the right talent, keep your team motivated and performing, and convince your investors. If done wrong, your company can end up among the ⅔ of startups that die because of cofounder disputes.

There is plenty of one size fits all - and / or "because I did it and it worked for me - it is the way to do it - for everybody", advice out there which is not easy to navigate through.

It is an important decision, but it does not have to be difficult. And it is not one, where one size fits all! The equity split needs to fit you as a founder, and your cofounding team.

The essentials of the 'right' equity split

So how to get to the equity split that will support, not hinder, your cofounding team? You need to get 2 things right:

- The equity split needs to be fair - meaning you need to achieve (subjective) fairness perception for all the shareholders throughout the company journey.
- The equity split needs to be future proof - it needs to be able to stay fair when circumstances change. Here is actually where your biggest challenge as a founder lies. Typically, you need to decide on equity allocation by the time you incorporate your company. However, to build a profitable company takes on average between 2-5 years. So if you believe - as most founders do - that equity should be somewhat proportionate to the cofounders' contributions - your challenge is to be able to accurately forecast what happens in the future.

That is, until recently.

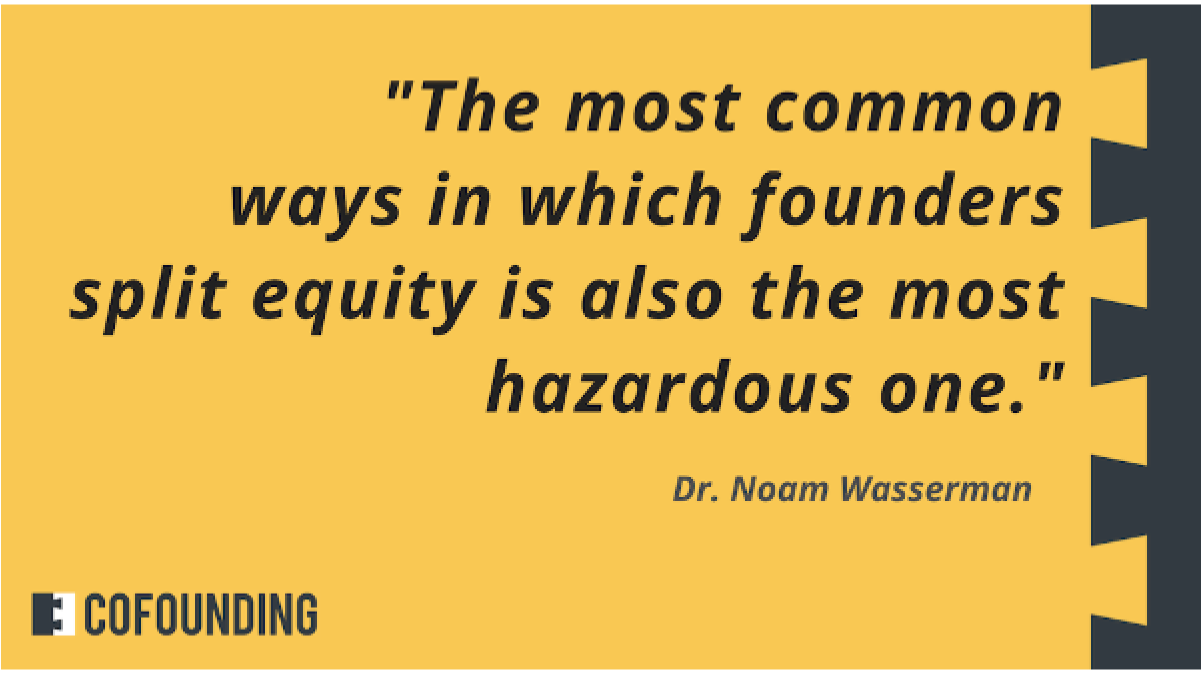
Which options do I have?

Lets start at the start - what are the options that you as a founder have when allocating your equity?

Fixed equity split

The traditional way to do it is fixed equity split. At the moment of incorporation of your company, you decide which shareholder owns how many shares. Back to your biggest challenge, at the relatively early stage you need to assume how much each of the future shareholders will contribute towards building a profitable business. Meagre mitigation of the future risks are vesting schedules - either time or milestones based. For the time based vesting schedules - the biggest shortcoming is that time spent with the business is not sufficient proxy for value created. Just because I am hanging around as a cofounder, does not guarantee that I deliver any / expected contributions. For the milestones based schedule - the challenge is to be able to set clear, not-interdependent milestones in the early stage of the venture.

Most unbalanced and unfair equity splits I have come across were not caused by evil founders trying to take advantage of other founders. By far the vast majority of unfair equity splits that lead to cofounder divorces were caused by the very own nature of the beast - the fact that founders needed to decide very early, based their equity split on certain assumptions about future contributions - and then the circumstances changed. And they did not have an option to adjust the equity allocation to fit the circumstances.



Dynamic equity split

The good news is - there are alternatives - dynamic, merit based, equity split methods.

To help founders address the future uncertainty challenge. To help founders to be as fair as most of them actually want to be - certainly the ones who understand the consequences of unfair equity splits.

The basic principle is very simple - for the period when the founders' are investing contributions at risk - that is when they are not being paid by the business what would be their fair market salary (adjusted for startup environment) - the cofounders contributions are being recorded and measured and their share will be proportionate to the value they created for the business. One of the most used and popular dynamic equity split methods is the *slicing pie* developed by Mike Moyer, a US serial entrepreneur and professor of entrepreneurship. The method simply assigns - based on clear and transparent rules - a monetary value to the founders contributions. It distinguishes between cash and non-cash contributions (factoring in the price and availability of cash for early ventures) and comes also with defined rules for all major contribution categories (time, intellectual property, assets etc). It also provides a framework for what happens if a cofounder leaves.

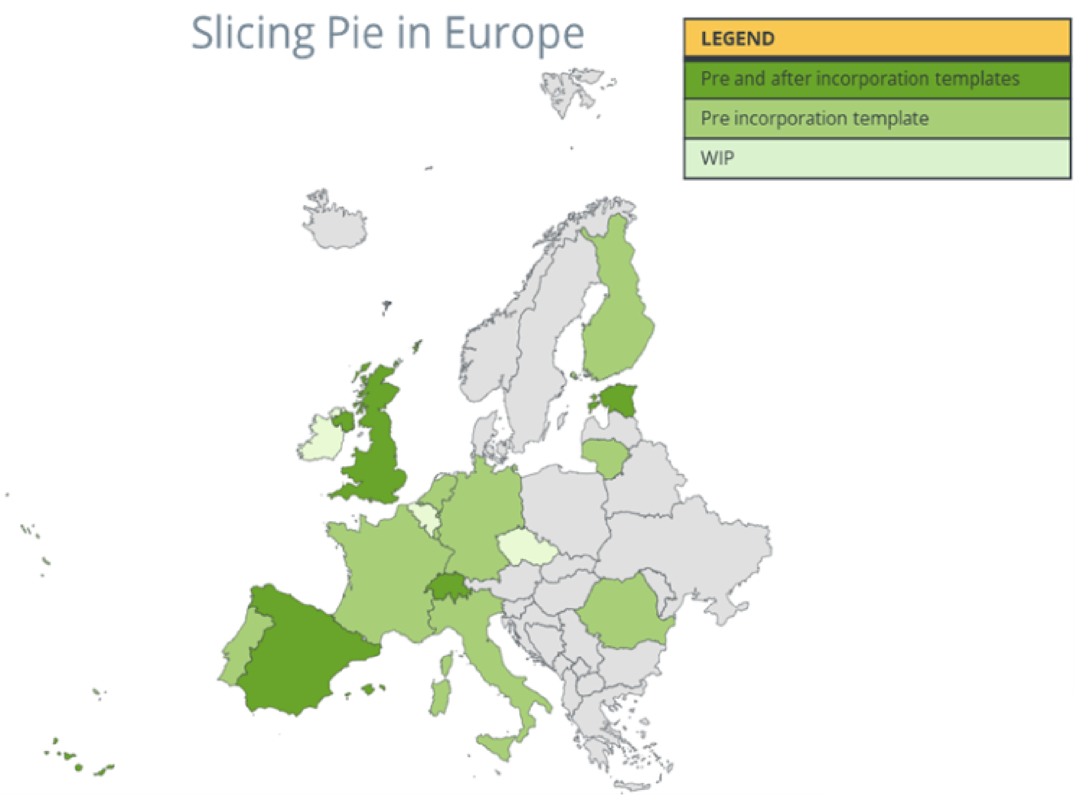
The benefits of this method are:

- You don't need to be able to foresee the future! To achieve an equity split which would be proportionate to founders' contributions - founders' simple agree on how you measure the contributions and then the equity allocation is done based on the actual, rather than expected contributions - allowing the team and the company the flexibility that early businesses often need (including the need to change the cofounding team, pivot, etc)
- Team alignment: by agreeing the input parameters for slicing pie, the cofounding team has to talk about important topics such as how much they value each others contributions (what is the founders fair salary), do they assign actual value to the initial idea and how much and what are the other cofounders' contributions worth. Very often - if they cannot agree - it is generally not a great idea for this team to go ahead and found a company together.
- Project management and governance: by having visibility of founders' contributions, the team gets great insights into the teams' bottlenecks, early warning flags (competences, performance) and

allocation of resources.

Nice, but can I actually do it?

From the beginning this method became very popular in the US - with thousands of companies using it for their early bootstrapping stage. In Europe, because of the regulatory - legal and tax - environment, the founders were not able to use this method as easily. That is, until recently. In the last 5 years joint efforts of visionary and innovative founders and lawyers, led by *Cofounding*, enabled European founders from 15 countries to legally implement the method for their ventures.



Next to being able to implement it legally, the technical implementation just got a whole lot easier too - thanks to a Dutch startup We.Vestr - who next to other functionalities for cap table management offers the slicing pie module. One of the We.Vestr founders - after his own cap table struggles in his previous company - and having had the recommendation for slicing pie from one of his investors - decided to include the dynamic equity split option in *We.Vestr* - to make the implementation of slicing pie as easy as possible.

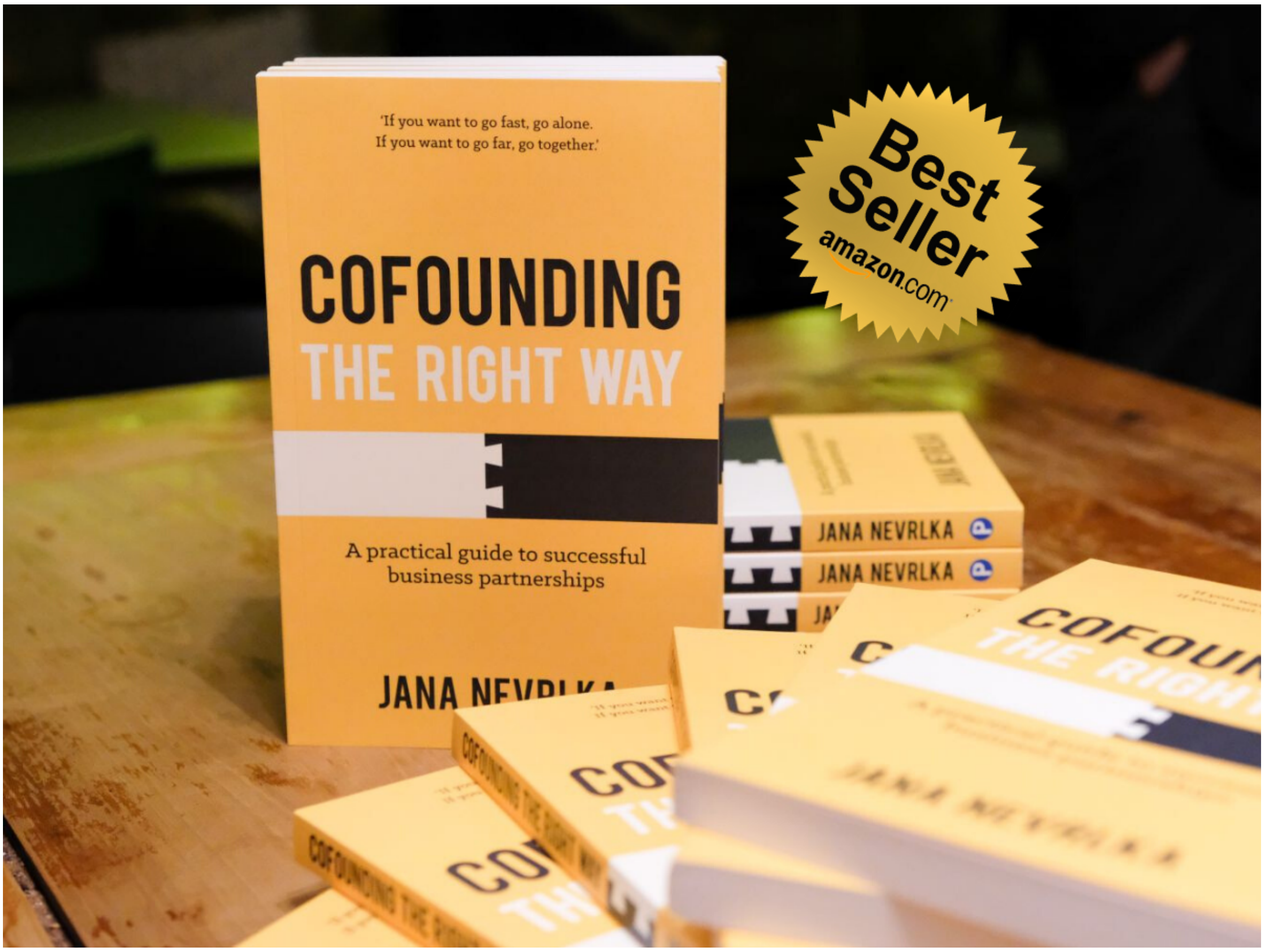
Closing remarks

It is great development that European founders can now use the dynamic equity split based on slicing pie and benefit from this flexible and fair equity split option.

It is especially useful for the early stage bootstrapping startups, but also being increasingly used for employee stock options or even by venture capital funds.

As a founder, you have enough hard work to build your business. And you need the right team to do it. Remember that there is no one size fits all answer to equity split, but it starts with you, the founder, understanding the challenges and options you have.

Jana Nevrlka is the founder of *Cofounding* and the author of *Cofounding the Right Way*.



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