

What's Your Deal

J. Mark Waxman

781-330-5801

Sullivan Center Expert In Residence

Allocation of Founders' Equity

Starting a business is usually a team effort.

Recognition of contributors to that effort through “first owners” ownership stakes -- Founders vs. Owners

The initial decision point – who is entitled to initial equity ownership?

Not later than when you are ready to “launch” – taking in investors, dealing with third parties (landlord, contractors, employees), receiving grants, etc.

At that point you need a structure (e.g. LLC or Inc.) and a written, complete, executed agreement(s).

Sooner is better than later. Do you need a lawyer? What if you don't use one? How can you minimize the cost?

What if you all cannot agree?

Some Insights To Keep In Mind

There is no perfect formula or template, e.g. equity calculators.

Have the right attitude: transparency, fairness, honesty, goal oriented.

Hard conversations might benefit by having a mediator/neutral involved.

Consider the price of not reaching agreement.

Valuation Approaches

Contributions up to an agreed start date (e.g. incorporation or initial charter filing) – who had the idea, did the critical thinking, market tested viability, obtained the necessary license, patent or copyright, devoted the most time (or money) to the effort, who do you need to go forward?

Contributions after the start date – Governance, management and getting the key work done, without fmV compensation: The “C” Suite

A Few Models

Equal split

Value based split

Time based vesting and hybrids with milestones

An Example of a Hybrid

Pre-start contributions: 33% - A - 15%; B - 12%; C - 6%.
[VESTED]

Post start contribution for governance and management efforts: 33% [TIME VESTED]
A - 11%; B - 11%; C - 11%

Achievement of milestones according to Plan (aka a performance-based equity grant): 34% [MILESTONE BASED VESTING]
A - 8.5%; B - 8.5%; C - 17%.

Mistakes To Avoid

1. Informal commitments and agreements.
2. Ignoring issues and allowing them to fester.
3. Being greedy or naïve.
4. Ignoring future contingencies.
5. Failing to consider what happens if there are deadlocks (50/50 situations invite this).
6. Misaligning incentives (50/50 also invites this).
7. Lack of transparency and honesty in the process.