6 Tips for Successfully Splitting Equity in Your Startup

www.entrepreneur.com/article/245037

Something interesting happens between the time an idea is developed and it becomes extremely profitable. Typically, everyone who had a role in the process -- no matter how small or large -- begins to jockey for position and to fight for a piece of the company. In other words, everyone wants some equity, regardless of the amount of work they've put in. As a member of the founding team, you should take responsibility for splitting equity in a way that's fair to all contributing parties, while simultaneously positioning your startup for long-term success.

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The problem with splitting equity, however, is that there's never a "clean cut." Any time you have more than a couple of people involved, disagreements will erupt over what value people bring to the table, which parties were there from the beginning, etc., etc. But by keeping several guidelines in mind, you can ensure the process is grounded in fairness. Here are six tips:

1. Take advantage of tools and resources.

While there's something to be said for taking a very hands-on approach to splitting equity, don't confuse your desire to play a role in the decisions with a need to manually control the entire process. In other words, take advantage of automated cap-table management tools like eShares, which can save time and streamline the process. There are so many sophisticated tools and resources available that you'd be foolish to use only an Excel spreadsheet.

2. Place an emphasis on sweat equity.

While capital contributions are great (and they can be rewarded by the company issuing convertible debt or preferred stock), what you really want to reward is sweat equity. Equity should almost always be allocated based on who has put in the most work and will continue to do so in the future. If you're unsure of the latter part of the equation, look at the career intentions of the founding partners.

If one person intends to quit his or her current job to work full-time with the new business, that change will entail much more risk than that of the founding partner who is only willing to work part-time until things take off. As successful entrepreneur Ryan Himmel has pointed out, equity splits should reward a combination of the highest-valued contribution and the largest undertaking of risk.

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3. Don't move too quickly.

While you certainly don't want to go on too long without determining a concrete equity split, that task is nothing to rush into. Patience is key, and you and your founding team should spend time listening to concerns, asking questions and reviewing all aspects of the split. For companies that end up being very successful, the difference in a percentage point can mean hundreds of thousands of dollars. Don't gloss over the details in an effort to avoid making difficult decisions.

4. Avoid getting caught up in the original idea.

While some weight should be given to the co-founder who came up with the idea, that shouldn't be the primary decision factor in who gets what percentage. Actual contributions and sweat equity deserve far more weight than the concept. In many cases, the person with the idea has also put in the most work, but this isn't always true. Just keep

that in mind.

5. Don’t let emotions control decisions.

Co-founders are often personally connected -- either by friendship, family or previous work experience. This usually means you enjoy being around those people or interact with them on a frequent basis (outside of work). This fact can prove particularly cumbersome when it comes to splitting equity, as you don’t want to hurt feelings or burn bridges. So you may have to put in extra effort to avoid letting emotions dictate equity splitting decisions.

6. Vest all shares.

Finally, it’s important to remember that -- regardless of how the equity is divided -- all shares should be subjected to vesting restrictions. While you may not see this as an issue now, you never know what a co-founder will do in six months or a year. By vesting founder equity, you can ensure that a founder doesn’t leave while he or she still retains a large portion of the company. How you vest is up to you, but typical schedules vest over a period of four to five years, with a large percentage vesting at the conclusion of the first year.

In the end, splitting equity may be the toughest thing you have to do as a member of a founding team. You’re going to hurt feelings, make difficult decisions and live with the consequences. However, by keeping these tips in mind, you can rest easy at night knowing you did everything you could to oversee the process as fairly as possible.

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