

ALLOCATING EQUITY AMONG TEAM MEMBERS

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Co-Founders of Xiaomi



By *equity* we mean an ownership or profit interest in the enterprise.

- Many new ventures involve several team members.
- (However, not-for-profit enterprises usually can not be owned by individuals or by for-profit entities.)
- Usually valuable for key team members to be owners.
 - Typically required by outside investors to align interests of team with investors to maximize the value of the enterprise.
 - Allows enterprise to compensate team with something other than cash, which is usually scarce.
 - Entrepreneurial individuals usually motivated in part by the possibility of large financial returns associated with venture formation and growth.

Example Capitalization Table (“Cap Table”)

Illustrative only

	Shares	% Ownership (fully diluted)
Founders	500,000	50 %
Key Team Members (e.g., Vice Presidents of Sales, Marketing, Engineering, etc.)	100,000	10 %
Option Pool for Employees and Advisors	100,000 (for tax reasons, usually issued as “options” not as outright share grants)	10 %
Outside Investors	300,000	30 %

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	Shares	% Ownership (fully diluted)
Founders	500,000	50 %
Key Team Members (e.g., Vice Presidents of Sales, Marketing, Engineering, etc.)	100,000	10 %
Option Pool for Employees and Advisors	100,000	10 %
Determined by cash invested and by “pre-money” valuation. For instance, this outcome could result from an investment of 300,000 USD at a pre-money valuation of 700,000 USD.		
Outside Investors	300,000	30 %



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Founders	500,000	50 %
Key Team Members (e.g., Vice Presidents of Sales, Marketing, Engineering, etc.)	100,000	10 %
	Allocation of future shares for incentive compensation for employees and advisors. (Usually a requirement for outside investment.)	
Option Pool for Employees and Advisors	100,000 (for tax reasons, usually issued as “options” not as outright share grants)	10 %
Outside Investors	300,000	30 %

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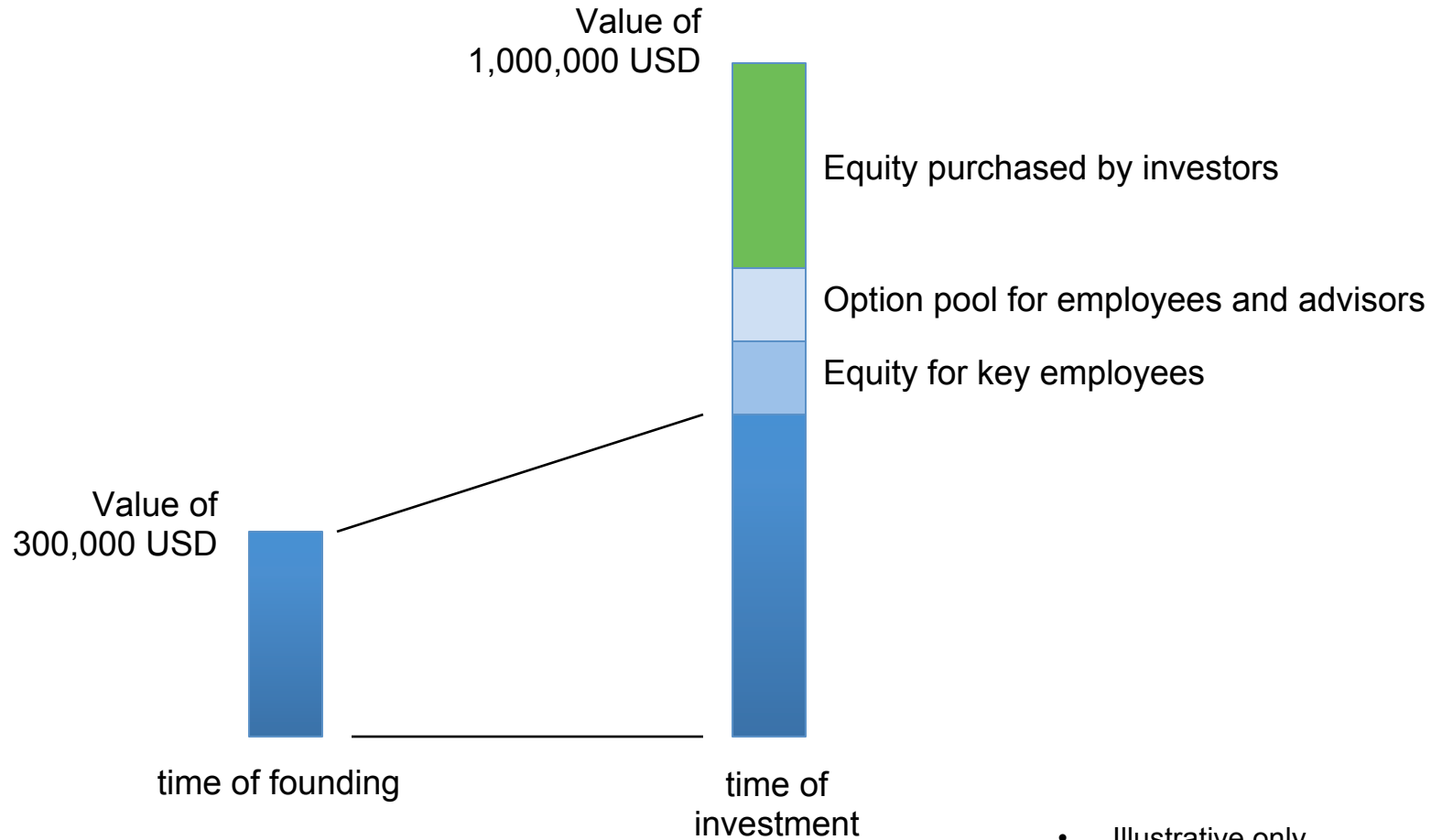


Usually driven by conditions in employment market, when team members are hired, and by the importance of the position.

Example Capitalization Table (“Cap Table”)

Illustrative only

	Shares	% Ownership (fully diluted)
Founders	<div>How do these get divided among founders?</div>  500,000	50 %
Key Team Members (e.g., Vice Presidents of Sales, Marketing, Engineering, etc.)	100,000	10 %
Option Pool for Employees and Advisors	100,000 (for tax reasons, usually issued as “options” not as outright share grants)	10 %
Outside Investors	300,000	30 %



- Illustrative only
- Ignores different classes of stock.

Allocating equity among founders

- Should be based on the relative value of the assets the founders contribute:
 - The original idea and related intellectual property.
 - “Sweat” committed to date, and until salaries will be paid.
 - Cash.
- Bargaining power and negotiation skills of course play a role in determining exact allocations.

Value of Sweat

- Market value of labor.
 - What is total compensation for people with similar capabilities, doing a similar job for cash salary?
- Adjustment relative to cash
(Is 100,000 USD cash worth 100,000 USD in foregone wages?)
 - Often done outside of a “day job,” not displacing actual earnings.
 - Cash investments are made with after-tax funds, but sweat value is estimated with pre-tax wage rates.
 - Cash is king; usually the scarce resource.




































Input	Who?	Market Value (USD)	After Discount (USD)	Ownership
Opportunity & Idea	Claire	100,000	100,000	33.3%
Sweat	Claire	120,000	60,000	20.0%
(e.g., for first year	Huijing	60,000	30,000	10.0%
prior to salaries)	Sanjay	60,000	30,000	10.0%
Cash	Claire	40,000	40,000	13.3%
	Huijing	25,000	25,000	8.3%
	Sanjay	15,000	15,000	5.0%
		total	300,000	

Value of Sweat Relative to Cash 50%

Notes:

- Illustrative only.
- Each value depends on specifics of the situation.
- This would be the ownership at the time of formation, prior to any outside investment, and not including any shares reserved for future employees.

Ownership Model

	Development				Operations					Cash	
	Idea	Proto	Design	Team	Activity	Mgmt	Sales	Mktg	Opns	Acctg	\$
Karl											
Alan											
Lunar											
Kevin											
Kim											
Trev											
Other	Review categories, sum totals and %. Need to see if this makes sense										



Issues

- What if a team member doesn't work out?
 - Usually don't “vest” equity until after a probationary period, and then over time.
- How to minimize cash tax liability for non-cash grants of stock?
 - Try to grant equity very early when it has very little value. (Consult lawyer and accountant!)
 - *Stock options* are typically used for later non-founder employees.

Advisors

- Value add from:
 - Actual services rendered (e.g., meetings, discussions, introductions, etc.)
 - Reputation enhancement and credibility.
- What is the economic value of the services being delivered?
- What is that value relative to the other inputs provided at the same time (e.g., cash, sweat of the founders)?
- *Sample calculation:*
 - 4 days over next 12 months @ 5000 USD per day is 20,000 USD of value.
 - Plus value of association in establishing credibility, perhaps 15,000 USD.
 - Total value 35,000 USD.
 - Advisor should receive equity worth approximately 35,000 USD, based on the value of the business at the time of the commitment to the advising role.
 - Usually ends up being 0.25 % – 2.5 % of equity per advisor depending on stage, level of engagement, and value of association.