Chapter 5 – Cutting In Half

As we worked our way past our first year of existence, it became apparent that three of us had a real passion for SQLServerCentral and three didn’t. More and more often we’d find that work assigned to one of our three partners would be delayed or even fall into a black hole. The scale of contributions tipped towards Andy, Brian, and myself who seemed to have a daily presence on the site, and in the back office.

It was apparent to the three of us that the amount of work we were doing was starting to overwhelm that of our partners. I’ve learned since that this is often a problem as companies grow. The various founders all have different situations in their personal lives, different goals in life and for the company, and a different level of passion for the enterprise. It caused friction as we started to resent the equity split. It might never amount to anything in terms of real money, but that doesn’t prevent hard feelings about the amount of work you put into some project.

We eventually decided to have a three way conference call one day to discuss our situation. It was set for late in the day for me, just after work for Andy and Brian. At the time I worked in a shared office with one other person, and I asked my office-mate to give me an hour of privacy. I think she actually decided this was a good day to go home early, which was fine with me.

I tend to pace when I talk, and I can still picture the small office, two glass desks smashed together in the middle with me walking back and forth from my side to the other, making a U shaped track that I traced back and forth on the carpet.

The three of us had similar feelings: we were doing most of the work and we should somehow reflect this in the structure of the company. With 3 or 4 advertisers paying us regularly and the launch of a second newsletter, we were starting to actually turn a profit. None had been paid to the owners, but that was getting close to changing.

The big question was how to handle this. We essentially had two choices: adjust the equity allocation or buy out our partners. The first choice is what often happens in larger startups where additional shares are allocated to the people who do more work, essentially diluting the shares and power of people not doing work. I think we each had 10,000 shares at the time in the company, and we talked about allocating more to the three of us, perhaps up to 100,000 more for us. We would each then have 110,000 shares of 360,000 shares, or 30% of the company, while our other three partners would each have 10,000/360,000 or about 3%.

I don’t know if those are the actual numbers, but our discussion was along those lines. The problem with share allocation is that ultimately we were 3 against 3 and if our partners didn’t feel like their contributions were unfair, they could essentially vote to not allocate us more shares. Likely we would have had to compromise in some way on the numbers, and that might have fractured the company.

I believe it was Andy that had a strong opinion at this point that we should just buy them out. Either we should spell out their contributions and tie it to share allocation to get them to participate, or we should by their shares and let them leave the company. He preferred the later, as did I, but I was worried about funding. I still wasn’t at the point where I could contribute more money personally, and we didn’t have that much in assets. I felt that we would disagree over the buyout amount, and might end up destroying the company because we paid too much, or everyone would get fed up with the situation and stop working on the site.

We came to the conclusion that we should offer a buyout as our preferred method of dealing with the workload and compensation and see what happened. Maybe we could reduce our number of partners to 4 or 5 and get more work out of a few of them.

How do you decide what someone’s contribution is worth to a company? There are all sorts of business metrics that people have used to determine how efficient a company is per employee. There are ways ot look at salesman’s contributions, maybe even measure how many widgets a person produces and assign a cost to their effort. When people contribute in different ways, it becomes a much more difficult task.

As an example, one of our partners had written a saved search routine. When someone searched for content on our site, we would return results, and optionally, allow them to save this search with their account. We would re-run this search daily and if any results were returned, we’d send them an email with the list of results. This is essentially what Google Alerts does today, though on a much smaller scale. It was a popular feature, and involved some SQL Server full-text code, stored procedures, jobs, as well as some ASP code to handle the front end for the users. Not a trivial task.

Another author had written a couple longer articles. One of them still gets regular reads on the site and across 7 or 8 years now has accumulated well over 100,000 reads.

But how does that compare with me answering 100 questions a month or writing articles? Perhaps you could compare the time spent, but a few months after tasks are completed, will you have a good estimate of time? Studies and experience have shown most of us in technology that we cannot estimate with any level of accuracy.

Over the next week or so, we proposed numbers among the three of us for our partners, debating and arguing what we thought was fair. We tried to put down actual tasks accomplished by each person, getting actual metrics on articles, posts, code features, and more for each of them and then trying to weight the value of those contributions.

We also had to simultaneously make some guess about the value of the company. Ultimately it doesn’t matter if your time is worth $100/hour and you spend 100 hours on a task. If the company is only worth $500, you can’t claim that you contributed $10,000 worth of value. It just isn’t there.

Eventually we came up with a proposal and sent it around to each person. As expected, it wasn’t well received, and to be fair, we probably should have tried to handle some of this in a more gradual manner. We should have had regular meetings with the partners, and complained or expressed expectations of what each of them should be doing over the next month or two at each meeting. They felt somewhat blindsided, though I think they also recognized that they weren’t contributing at the level of Andy, Brian, or myself.

At the time, Andy actually worked with 2 of the partners at the same company. I think this was both good and bad for all of us. Andy had to listen to complaints and arguments from them offline, in a way that Brian and I were both shielded from. On the other hand, his relationship with them allowed him to talk to them in a more friendly, honest way, allowing each side to understand the other’s view. I’m sure it was a rough few weeks for Andy as we tried to negotiate a solution.

We fairly quickly determined that each of the three partners was open to a buyout. They realized their contributions were limited, and they had no desire to increase them in the near future. That was a relief as it meant we would not continue to have partners that did not help grow the company. Eventually we would have a company that was built by, maintained, and grown by active partners. The sticking point was the structure of the deal.

As expected, our partners wanted more and we wanted to pay less. It’s a classic dilemma and one that is only solved through negotiation. We went back and forth, debating over values and contributions. We had the argument about a person’s hourly rate and the hours spent on the site. We had the argument about the value of a certain feature to the community. We had the argument about the value of the company, which was a very contentious issue in and of itself.

All of us had written for Swynk before it was sold. We knew that the sale was a six-figure sale, and we were already approaching the size of that site when it was sold. The Internet bubble had burst (this was 2002), but things were turning around. Who knew what our company was worth?

We had another conference call around this time, where we examined our revenues, our expenses, and made projections. By this time we had moved to our own hardware, hosted by a friend of mine in Colorado, but we knew that our infrastructure needed investment. Our revenues were relatively fixed in our two newsletters, and while we could raise rates, we couldn’t do so indiscriminately and take the chance of losing our clients.

I remember talking about the proposals we had, the amounts, and worrying about cash flow. If we continued earning a$1,000 or two a month, was it worth all this effort. At some point I asked the question if we ever thought that we could earn $10,000 a month. It seemed like a huge number that our revenues were nowhere close to, but one that would make this an interesting business. We laughed about it, but I think either Andy or Brian felt we could get there in a few years. It felt like a huge dream, and an unlikely possibility, like having the winning lottery ticket. However over time we would get there, and all of this effort on structuring the buyout would be worth it.

The three of us, Andy, Brian, and myself, didn’t think that our company was worth much, and weren’t sure that a sale at that time would even net us $50,000. However we could get there, and given the rapid growth in users, it might not be more than a few years. Our partners were concerned that we might get an offer at any time and they would be left out. I wouldn’t doubt if they even suspected we had an offer and were trying to buy them out so that we could sell and make more money ourselves. I’d like to think that wasn’t the case, but negotiating the sale of a business, or a piece of it, is hard.

Each agreement ended up being both similar and different. Each partner was offered a cash settlement for their shares, and retained some stake in the company that would decrease over time. That’s a fairly standard type of agreement and it’s almost the reverse of the option grants that many employees get from large corporations. All stock reverted to the company, essentially making Andy, Brian, and myself equal and sole shareholders of our company. That was what we wanted to achieve, and we managed to get there.

Each of our partners received a different amount of cash, and in the case of two of them, it was a payment over time. We sent them a regular check across the next year since we didn’t have the cash, or cash flow, to do it all at once. It was a little painful, and it definitely caused some worry as we couldn’t have afforded our advertisers to miss payments. We didn’t have a lot of profit built into our current revenue and expense numbers at this time, and the buyout consumed most of it in the coming months. I think we ended up paying a little over a thousand dollars a month to the two partners, which left under a hundred dollars to spare each month for anything unexpected. The only good thing was that it forced the three of us to continue to work hard to build the company and ensure that more profits would come in. The partner that had contributed the least accepted a smaller payment that we just sent as a lump sum. That reduced most of our cash reserves, but getting that payment out of the way was worth it to us.

The other part of each partner’s buyout agreement was a sale agreement. We had to agree to pay each partner a percentage of the sales price if we sold the company. This was a declining amount over time, probably over the next year or 18 months. Across many years, different computers and failed hard drives we lost the agreements, but since they had expired, it wasn’t something we worried about. We were also happy to add this to the agreement because we had no intention of selling the company. We didn’t want them to go on forever since we never knew if we would sell, but we had no plans in the next year or two, so in my mind, these were non-issues in my mind.

If you’ve never written one of these agreements, I’ll outline how one works with an example. These numbers are completely made up, and I’ll use a fictional business with my kids. Let’s say that I start a lemonade stand with my three kids, Kyle, Delaney, and Kendall. We have some success, we are earning $100 a week, but the boys aren’t contributing enough. So we decide to buy them out. Both Kyle and Delaney each get $50 in cash, and an agreement to pay them if we sell the company. Kendall and I are now sole owners, each with 50% of the equity.

We also agree that if we sell the company in the next year, both boys will get a share of the sale. If we sell within 4 months, that both Kyle and Delaney get an equal share of the sales price, 25% each. That means if we were to sell the company for $100, each of the four of us would receive $100. However if we sell between 4 and 8 months, the percentage of the sale the boys gets goes down to 15%. So if we sell for $400, then Kendall and I get $140 and each boy gets $60. Note that any money that is made in that time is only split between Kendall and me. If we earn $100/week, 4 weeks/month, say 5 months, a total of $2,000, I get $1,000 and Kendall gets $1,000. The boys only have their initial $50.

If we sell between 8 months and 1 year, then the boys only get 10% each of the sale, and if we sell after a year, the boys get nothing more than their initial $50. You can see that these agreements are ripe with abuse potential. Would Kendall and I sell at 11 months or delay for 32 more days if we had the chance to make more money. Is 20% of the sales price significant? I’d like to think that we would do the moral thing and pay our partners if we made the decision to sell at 11 months and not stick to the letter of the law. However if you are selling your company for $2 million instead of $2,000, you might view that 20% in a different light.

Ultimately it didn’t matter to the three of us since we did not plan to sell the company anytime soon. However the debate about selling the company would come up again, at a few different times, and it was a contentious issue each time.