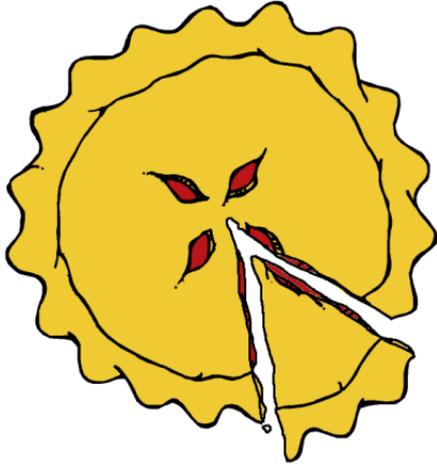


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# **Slicing Pie**

## **HANDBOOK**

*Perfect Equity Splits for Startups*

**Mike Moyer**

*Foreword by Noam Wasserman*



## **The Slicing Pie Principle**

% share of the *reward* = % share of what's *at risk*

### **My Promise**

If, after reading this book, you don't feel that it contains not just good advice, but the greatest advice on the subject that you have ever received, I will happily refund your money and apologize for wasting your time.

[Mike@SlicingPie.com](mailto:Mike@SlicingPie.com)

### **My Butt-Covering Disclaimer**

If anything in this book sounds like legal advice — it's not. If anything in this book sounds like financial advice — it's not. I'm not a lawyer and I'm not an accountant, and I'm not a certified financial advisor.

I'm just a guy who wants you, and your teammates, to get what you deserve from your startup. No more and no less!

## Foreword

“Don’t shake that hand!” That was my reaction in 2008 when I first saw the results of the equity-split analyses I was doing with Thomas Hellmann.<sup>1</sup> I had seen the problems personally time after time with founding teams, but now had systematic evidence across more than a thousand U.S. startups: The most common ways in which founders split the equity were also the most hazardous.

In particular, we found that 73% of teams split the equity within the first month of the startup, at the heights of the uncertainty about their startup’s strategy and business model, their roles in it, and their levels of commitment to it. Most of the teams barely spent any time discussing the split, avoiding having the difficult conversations necessary to really understand each other’s potential contributions and intentions. And the majority of them split it statically – i.e., didn’t allow for future adjustments as new

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<sup>1</sup> The final version of the paper with those analyses is Hellmann, T. & N. Wasserman (2016) The first deal: The division of founder equity in new ventures. *Management Science*.

information emerged about contributions and commitment.

I started referring to teams who had split equally without much discussion as “Quick Handshake” teams. Our analyses showed that Quick Handshake teams incurred a significant penalty when raising their first round of financing, either in reduced ability to raise the round or in lower average valuations if they did raise, *ceteris paribus*. And that was only the cost in terms of financing; within the founding teams themselves, the destructive tensions caused by a bad split are often even more devastating.

If you’re in the early days of a founding journey and your cofounder proposes a Quick Handshake – maybe “to get it out of the way” so you can focus on “what really counts” – don’t succumb to those pressures. Even a startup with a great idea can be stopped in its tracks by such a decision. Zipcar succeeded despite the fact that founder-CEO Robin Chase suffered “years of angst” due to her Quick Handshake. Likewise, for Facebook with Mark Zuckerberg’s ill-considered static split with Eduardo Saverin, which caused costly legal fisticuffs between the cofounders.

For every startup like these that survives a disastrous equity split, many more fail because of it. In fact, how founders split the equity among themselves is one of the biggest make-or-break issues

they face as a team.<sup>2</sup> Make sure that your equity-split decisions will heighten your chances of success rather than imperil them. Don't succumb to the rosy expectations that pervade the entrepreneurial mindset during the early days when Robin and Zuck split the equity, when they were least likely to anticipate, discuss, and plan for pitfalls on their journey.

How can founders avoid the angst, destructive tension, and legal problems that come with a bad equity split? Robin Chase's hard-learned advice was to adopt something more "organic" - something that takes seriously the remaining uncertainties and is able to adjust to their occurrence. The most common "organic" approach is to adopt vesting, in which the individual has to earn his or her equity stake instead of being granted it fully at the time of the split. In the U.S., this vesting is almost always time-based, but about 10% of teams adopt milestone-based vesting, which requires clearly-definable milestones, a concrete division of labor within the team, and other characteristics lacking in many founding teams. Vesting is a huge improvement over the static splits that pervade Founderdom. However, in many cases, time is a weak proxy for the creation of value in a startup, making it an imperfect basis on which to split.

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<sup>2</sup> As a whole, I call those make-or-break issues the "3Rs": The founders' prior Relationships, the ways they allocate the Roles and decision making within the team, and the allocation of Rewards.<sup>2</sup> Across the 3Rs, the most pervasive theme is that founders' most common decisions tend to be the ones that are the most fraught with peril. For more on the 3Rs, see Chapters 4-7 of Wasserman, N. 2012. *The Founder's Dilemmas: Anticipating and Avoiding the Pitfalls That Can Sink a Startup*. Princeton, NJ: Princeton University Press.

Over the last four years, I've been delighted to see the impact that Mike Moyer has had on the spread of dynamic approaches to splitting equity. After years of road-testing it, he has honed an approach to equity splits that educates founders about the perils identified in my research, gives them a framework for adopting dynamism, and provides them with the tools to execute his style of dynamic splits.

Please consider seriously the types of risks you face, have a serious conversation about them with your cofounders, and then see if Mike's approach to slicing the pie might help you prepare for one of the key pitfalls that can sink a startup.

**Dr. Noam Wasserman**

Founding Director, Founder Central initiative at the University of Southern California

*Author, The Founder's Dilemmas: Anticipating and Avoiding the Pitfalls That Can Sink a Startup*

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## Chapter One:

### **Meet Slicing Pie**

My mission in life is to make sure that every entrepreneur on the planet gets what they deserve from their company.

We live in a world where entrepreneurs and early-stage company participants get taken advantage of so frequently that we hardly notice. Bad equity deals are the rule, not the exception. Fairness is rare. The *intent* for fairness is there, but the *practice* of fairness is not. *Slicing Pie* (aka “Grunt Fund”) is an equity model that allows people to align their *intent* of being fair with their *ability* to actually pull it off.

I’m going to start off with a high-level overview of the *Slicing Pie* model before jumping in to the nitty-gritty of how it works. Once you get your head around the concept, it will make plenty of sense, but it’s not conventional wisdom. The conventional wisdom, as you shall see, has major flaws. But, you may already know this if you’re struggling with equity splits for your startup. By

the time you finish reading, you will know *exactly* how to split up the equity in your company.

*Slicing Pie* a straightforward process for implementing a “dynamic”, or “organic” equity split in an early-stage startup that ensures the fairest equity split possible. It is designed for bootstrapped startups and is used *prior* to cash flow breakeven or the first major funding event.

*It is a universal, one-size-fits-all, self-adjusting model that maintains fairness even as things change.* Startup companies change all the time. People come and go, strategies change, cash is consumed (when it’s available), and every day people contribute more to the company’s success. The only thing that *doesn’t* change about startups is the fact that they are always changing.

### Startup Equity

Equity in a startup entitles the owner to a portion of the company’s rewards, if and when they come. The rewards are a portion of the future profits or the proceeds of a sale.

*Slicing Pie* is based on a simple principle: **a person’s % share of the rewards should *always* be equal to that person’s % share of what’s put at risk to attain those rewards.**

When a person contributes to a startup company and does not get paid for their contribution, they are putting their contribution *at risk* with the *hopes* of getting a future reward. And, while the timing and the amount of the future

reward is unknowable, the amount of the contributions at-risk *is* knowable. *It is equal to the fair market value of the contributions.*

Because it's *impossible* to know when or even if the rewards will ever come, we can never know how much people must put at risk to get the rewards. Every contribution, therefore, is essentially a *bet* on the future of the company and nobody knows when the betting will end.

### *Blackjack*

Think of the startup as a game of Blackjack. You and a partner each bet \$1 on the *same* hand. You have no way of knowing if you're going to win or even how much you're going to win as different hands pay different amounts. The future, in other words, is *unknowable*. What *is* knowable is that you each contributed the same amount and that amount is at-risk because you could lose it all.

If you win, you should split the winnings 50/50, which is perfectly fair because you each bet the same.

But, what if the dealer deals two Aces? You didn't expect this, and you want to take advantage of the new opportunity, so you decide split the Aces and double-down. (If you don't know how to play Blackjack, "splitting the Aces" means you are turning one hand into two hands and placing another bet.) Unfortunately, your partner is out of money. You aren't, so you bet \$2 more. Again, you have no way of knowing if you're going to win or

how much you're going to win. What you *do* know is that you bet \$3 and your partner bet \$1.

Does 50/50 still seem like a fair deal? Probably not. In this scenario you deserve 75% of the winnings because you placed 75% of the bets. This is the essence of the *Slicing Pie* model.

If you simply keep track of what people bet, you can calculate *exactly* what portion of the rewards they deserve. It's quite simple!

### *A Dynamic Model*

*Slicing Pie* is *dynamic* model because it changes over time. This is because every day brings more bets of time, expenses, facilities, supplies and anything else the company needs to move forward. Keeping track of these things takes a little discipline, but it's not a huge deal and the benefits are enormous.

When you apply the *Slicing Pie* model, each person will get *exactly* what they deserve to get—including you. From the moment you start working with a *Slicing Pie* startup, you begin to accrue your share of the Pie. Your interests will be *perfectly* aligned with the other members of the team, so if you like the team and the business, you can rest assured that your money, time or other contributions will be handled with perfect fairness. If you don't like the team, you can leave and the termination rules (mentioned below) kick in and everyone is still happy.

## A New Mental Model for Equity Splits

*Slicing Pie* represents a new way of thinking about equity. It challenges the traditional thinking around equity splits because traditional models don't work. People try to make them work, but they never, ever produce a fair result. Here's why traditional models don't work:

### *The Fixed-Split Problem*

Traditionally, nearly every startup company uses a pre-negotiated "fixed" or "static" equity split. In a fixed split, equity is doled out to participants in chunks, based on their *potential* contribution. This is kind of like paying someone their annual salary on their first day of work because they told their manager they were going to work hard. If it sounds silly, it is, but it happens all the time because many entrepreneurs *believe they can predict the future*. In fact, if they *don't* believe they can predict the future they probably wouldn't have the confidence to start a company in the first place. Optimism and confidence are important, but they don't give anyone special powers like seeing the future.

So, with the best intentions, founders enter into fixed equity split agreements loosely based on their predictions of this equation:

$$\text{Your Share \%} = \frac{\text{The Value of Your Contribution}}{\text{The Total Value}}$$

This is easy if they know what the numbers are.

## 6 Slicing Pie Handbook

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For instance, if a you invested \$100,000 in a company that has a post-money valuation of \$1,000,000 you would have 10%:

$$10\% = \frac{\$100,000}{\$1,000,000}$$

This is perfectly fair. You get a percentage that is in proportion to what you contributed. In most cases, however, we *don't* know the values because they are likely to change, so people try to *predict/estimate/guess* the variables.

Founders have to predict the *future* value of each person's contribution (aka the economic benefit to the firm) and they have to predict the total *future* value of the firm (because the current value is most likely \$0). Both of the answers to these questions will no doubt be based on a complex set of assumptions with virtually no grounding in reality.

Try as they might, their numbers will be wild guesses at best. At worst, they will be overly optimistic fantasies of a meteoric rise to fame and fortune. It's *impossible* to create a fair fixed equity split. And even if they could, a split that was right one day will be wrong the next because startups always change. It's such a complicated, emotionally-charged discussion that many founders either avoid it altogether or do an even split like 50/50 or 25/25/25/25.

## *All Splits Are Dynamic*

Sooner or later, *all* splits will need be adjusted. In traditional equity models, the split often adjusts—incorrectly—after some kind of founder conflict. The adjustments simply set the team up for another fight later on—I call it the “Fix & Fight” model.

## *What Might Change*

You may wonder what could possibly change to cause such founder conflict. The answer is *everything*. Whatever you *think* you and your partners will commit in terms of time, money, ideas, relationships, facilities, supplies or anything else will likely be different as the company actually unfolds. When things change, you’ll be faced with one of two realities:

The first possible reality is that your share is *less* than you deserve.

$$\text{Your Share \%} < \frac{\text{The Value of Your Contribution}}{\text{The Total Value}}$$

This is probably *not* okay with you. If you have *less* than you deserve, it means there is someone out there who has *more* than they deserve and they got it at *your* personal expense. The greater the personal expense, the more upsetting this will be. You might even try to figure out who got *more* than their fair share and try to get some back with your posse of highly-paid attorneys (if

you can afford them). This happens all the time. (Have you seen the *Facebook* movie?)

Even if you *agreed* to this arrangement in advance it's still not fair. The only reason people agree to this kind of treatment is if they had no other choice or if they didn't know any better. This, too, happens all the time. Some people have a habit of taking advantage of other people when they sense desperation or ignorance.

If you've ever been caught on the short end of this equation (as many of us have) you are probably going to try to avoid this situation in the future by making sure you cover your own butt. The greater the pain you endured, the greater your interest will be in covering your own butt, even if it means someone else has to lose. This leads us to the second reality that is also *not* fair:

$$\text{Your Share \%} > \frac{\text{The Value of Your Contribution}}{\text{The Total Value}}$$

In this case you have *more* than you deserve. In many cases the more money, knowledge or power one person has over the other person, the greater their share will be at the expense of the other.

This may be okay with you if you are comfortable with the fact that someone else, who deserved more, had to take less so that you could have more than you deserved. I hope this is not you. If this *is* you then *Slicing Pie* isn't for you and you should *not* participate in a company that uses it. There are plenty of other opportunities out there for you to take advantage of people. I know this is

harsh, but I don't think it's okay to take advantage of others.

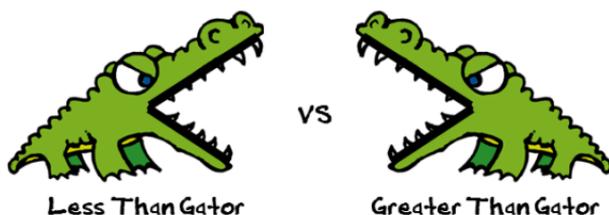
I am an advocate of fairness. I believe that every person deserves what they deserve. No more and no less. I don't want to work with people who want to take advantage of me or others, and I don't want to take advantage of others myself. I want to reward the people who help me get to where I'm going.

Given the current startup funding landscape, fairness is hard to achieve. We live in a world where it is so common for people to take advantage of one another that they may not even realize they are doing it!

Not everyone is comfortable with fairness and transparency. That's okay, but please don't try to force them to use a different model; fairness is too important. Just walk away.

## **Alligator Pits**

Because fixed equity splits stop being fair the moment something changes, nearly every startup has less-than alligators (<) representing people who have *less* than they deserve, and greater-than alligators (>) representing people who have *more* than they deserve. Eventually, the less-than people will get upset and want to renegotiate. Everyone becomes poised for a fight. I call these "Alligator Pit" negotiations.



In a fixed equity split, *every* negotiation is an alligator pit because sooner or later something will change and it will stop being fair.

When we approach the alligator pit, we do it with fear, mistrust and a keen instinct towards self-preservation. These are not the best building blocks for creating an awesome company.

Every time something changes, founders have to jump back in the alligator pit and renegotiate. Things *always* change, so it's always a big, bloody frenzy of gnashing teeth and swinging tails. This happens over and over again and each session in the alligator pit weakens working relationships. It's a nightmare.

In an effort to protect ourselves from the snarling alligators that gnash their teeth and swing their tails, we invent concepts like vesting, oppressive liquidation preferences and the dreaded full-ratchet anti-dilution. Our attempts to protect ourselves from the alligator pits are expensive, time consuming, and often exacerbate the very problems we are trying to solve.

## Get Them Gators!

If you want to create a working environment that is dominated by trust, fairness and cooperation where everyone has aligned incentives, you've got to *get them gators out of the equation*.

*Slicing Pie* is the solution—the *total* solution. *Slicing Pie* is a formula for implementing a dynamic equity split. There are two primary components of *Slicing Pie*:

1. The *Allocation* Framework that tells us how much each person should get; and,
2. The *Recovery* Framework, which tells us what to do when someone leaves the company.

As mentioned above, the model is dynamic, meaning that it changes over time to keep it fair. This part sometimes makes people nervous, but bear with me, as it will all make sense. Research has shown that companies that use dynamic models fare better than those that use fixed splits (as mentioned by Noam Wasserman in the Foreword). Some people think that fixed splits provide more certainty to participants. The only real certainty you will have is that you will eventually get thrown back into the gator pit!

## Calculating Bets

Think back to the Blackjack analogy. In order to apply the *Slicing Pie* model, you have to know how

to determine fair market value so you can calculate each person's bet. This is *much* easier to do than predicting the future!

For example, let's say you are an experienced programmer with many successful tech projects under your belt. Your time has a higher value than a young whipper-snapper right out of college with no concrete experience doing anything. Each of you could command a salary on the open market that is commensurate with your skills and experience.

Your respective fair market-rate salaries would account for expected contributions to a firm's productivity and would accommodate differences in skills, education and experience. All things being equal, your ability to add value to a company would be higher so you could command a higher salary. What an experienced programmer can do in a couple of hours might take the recent grad weeks or months.

If the company *pays* you your full market rate you are not putting anything at risk and, therefore, deserve no equity. If the company pays you *less* than your market rate, then you deserve equity *in proportion* to the amount that you're not getting paid. The same goes for the recent grad.

### *Adjustments*

There are two primary types of contributions a person can contribute to a startup: cash and non-cash. Cash contributions consume a person's cash,

while non-cash contributions do not. For example, time is a non-cash contribution and an unreimbursed expense is a cash contribution.

In most cases, it is much harder to *save* money than it is to *earn* money. A person who is earning \$100,000 a year would be hard-pressed to save that amount in a year. Even if they could save *all* their money, they would be saving after-tax dollars, so a \$100,000 annual salary would not mean \$100,000 in the bank. The employer would pay employment tax and the employee would pay income tax. Lastly, when people actually buy stuff they have to pay sales tax or VAT tax or other taxes, which further reduce the buying power of money. Therefore, the person who contributes cash to a company is putting *more* at risk than the person who contributes time or other non-cash contributions.

*Slicing Pie* accounts for this difference by applying cash and non-cash multipliers (aka normalizers). The multipliers are explained, in detail, later in this book. For now, just think of this as an “adjusted” fair market value.

## **Everything Has a Fair Market Value**

Later on this this book I’ll provide detailed descriptions of how to calculate a fair market value for all kinds of possible contributions to a startup company including time, money, ideas, relationships, equipment, supplies and other important resources. Each calculation takes into

account opportunity costs and the needs of the company.

Determining fair market value is usually pretty straightforward, but sometimes it's a little nuanced. For instance, the fair market value of a delivery truck has a lot to do with whether the truck was purchased for the company or if it has been sitting around in someone's backyard without being used for several years. In the former case, the fair market value is basically cash spent. In the latter case it has more to do with resale value.

### **The Slicing Pie Formula**

If we substitute the adjusted fair market value or FMV (which is easy to calculate) for future value (which is impossible to calculate) we have a perfect substitute for our calculation. This:

$$\text{Your Share \%} = \frac{\text{The Value of Your Contribution}}{\text{The Total Value}}$$

Becomes:

$$\text{Your Share \%} = \frac{\text{The Adjusted FMV of Your Contribution}}{\text{The Total Adjusted FMV}}$$

In this book, the *Slicing Pie Handbook*, and on *SlicingPie.com*, I use the term "slices". A slice is a *fictional* unit used to represent the adjusted fair market value of an at-risk contribution. A slice does not represent equity shares, nor does it have any actual value; it just helps us to calculate the right percentages. The *Slicing Pie* formula is:

$$\text{Your Share \%} = \frac{\text{Your Slices}}{\text{All Slices}}$$

### Slicing Pie in Action

Let's take a simple example of a fictional company where people contribute money, time, ideas, relationships and other resources. For purposes of simplicity, we will assume that each contribution has been converted to slices (S). There are two partners, Norvin and Anson. In the first quarter they each invest 100 S (which could be any mix of money, time, ideas, etc.).

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Total	Split
Anson	100 S				100 S	50%
Norvin	100 S				100 S	50%
					200 S	

It's logical that they would each own 50% of this business. And, because their contributions have been converted to slices, the contribution from Anson is "valued" the same as a contribution from Norvin, even though the company is probably worth nothing at this point. The next quarter Anson invests another 100 S and Norvin invests nothing. Maybe Norvin was busy with his day job that month. Here is what would happen if the split was fixed to 50/50:

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Total	Split
Anson	100 S	100 S			200 S	50%
Norvin	100 S	0 S			100 S	50%
					300 S	

In a *fixed* model Anson would have no incentive to invest the extra contribution because their split would stay 50/50. This isn't fair. Anson and Norvin would have to jump in the alligator pit and renegotiate their split. In a *dynamic* model the split would adjust based on the addition of extra contribution:

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Total	Split
Anson	100 S	100 S			200 S	67%
Norvin	100 S	0 S			100 S	33%
					300 S	

This is fair and both guys are happy knowing that they each have what they should. One might argue that earlier contribution is riskier, but measuring risk in a startup is as impossible as measuring future value.

What if, during the second quarter, the company's main client decides to cancel their contract? This would probably mean that the next round of contribution is actually *riskier* than earlier contributions. Considering this, Anson is more cautious, but Norvin is not:

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Total	Split
Anson	100 S	100 S	0 S		200 S	40%
Norvin	100 S	0 S	200 S		300 S	60%
					500 S	

In a dynamic model, each participant still has the right share. The ultimate value of the company is still unknown. All that is known is how much each person contributed *relative* to the other

person. Anson has a smaller share, but he is comfortable with it because without Norvin's contribution the company may have failed. The following quarter neither one contributes anything because the company sells for \$1,000,000.

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Total	Split
Anson	100 S	100 S	0 S	0 S	200 S	40%
Norvin	100 S	0 S	200 S	0 S	300 S	60%
					500 S	

Anson gets \$400,000 and Norvin gets \$600,000. This is *exactly* what they each should have had. Neither of them could have predicted that their company would sell for \$1,000,000 in less than a year, but they each invested what was needed to move the company forward. The model was always in balance.

In most cases, people attempt to negotiate, in advance, how much money, time, supplies, etc., they will need. Next, they try to determine what the ultimate proceeds will be. Then they determine a fixed split. It's a nightmare. Without the dynamic feature, they will be thrown into the alligator pit, forced to renegotiate with gnashing teeth and swinging tails. *Nobody* wants to jump into an alligator pit.

In the *Slicing Pie* model, whether they are investing cash, time or other resources they can rest assured that at any given time they will always have exactly what they deserve relative to every other person, who will also have exactly what they deserve.

## Saying Buh-Bye

One of the most disruptive events in an early-stage startup company is the departure of team members. These are often emotionally-charged times and the company winds up losing important talent that it might have to replace. It is at these times that equity splits become an issue and the alligators will rear their ugly heads.

The *Slicing Pie* model is designed to seamlessly handle these situations when it comes to what is fair for both the employee and the company.

There are four different situations under which a person can leave a company:

1. Termination for cause
2. Termination *without* cause
3. Resignation for good reason
4. Resignation for *no* good reason

In some cases, such as termination for cause, the company is left in the lurch and must scramble to replace the employee and make up for lost time. In cases like this, the employee bears the cost of departure, which provides a *disincentive* to slack off on the job. In other cases, such as resignation for good reason, the employee acted in good faith but the company made decisions that impacted their employment. In these cases, the company bears the cost of departure, which provides a *disincentive* to the management team for making decisions that adversely affect employees. Detailed descriptions

of these circumstances are outlined later in this book and in *Slicing Pie*.

When someone leaves the company, the model will easily readjust to accommodate the change so that you, the participant, and the others will always have the fair amount.

Let's say, in our example above, that instead of selling in the second quarter, Norvin decided to bail out because he found a high-paying job somewhere else. This is resignation for no good reason. It may be a good reason to Norvin, but it's not a good reason for the company. In the *Slicing Pie* model Norvin bears the brunt of the cost and he would *lose* the equity he earned for any intangible contributions like time. (Tangible contributions like money and equipment are treated a little differently to mitigate the potential for fraud.)

For simplicity's sake, we'll pretend that Norvin *only* contributed time to the business. When he leaves he will lose his equity. *Ouch!* This isn't great for Norvin, but leaving means the company must scramble to replace him and this causes a great deal of pain for the company. If he wants to keep his share he should see the project through to the end. After he leaves, Anson owns 100% of the company, but has no partner.

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Total	Split
Anson	100 S	100 S			200 S	100%
Norvin						
					200 S	

Luckily, Anson is able to find Merrily, who can replace some of the skills that Norvin had. The *Slicing Pie* model easily accommodates her effort. Her contributions are converted to slices and the project moves forward.

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Total	Split
Anson	100 S	100 S	0 S		200 S	67%
Norvin						0%
Merrily			100 S		100 S	33%
					300 S	

It might take a little while longer for that \$1,000,000 sale to happen, but they still have a chance. You might think it's weird to simply obliterate Norvin's time, but it's actually quite logical. The calculations are not reflections of actual value; they are simply ways of determining the right split and aligning incentives. The company's *actual* value is still virtually nothing.

Let's say that Anson decides that the company should move to be closer to their largest client, who is 500 miles away. Merrily doesn't want to uproot her family and move and decides to resign. This is resignation with *good* reason. Anson's decision to move the company puts Merrily in a bad situation through no fault of her own. In this case, the company must bear the cost of this departure. Merrily is allowed to keep her slices in the company.

When Anson gets to the new location, he hires Anne to do the job that Merrily was doing.

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Total	Split
Anson	100 S	100 S	0 S	100 S	300 S	60%
Norvin						0%
Merrily			100 S		100 S	20%
Anne				100 S	100 S	20%
					500 S	

Once again, the dynamic model adjusts to keep everything fair. Relative to the others, everyone has what they deserve. Merrily still has a piece of the company because it wouldn't have been fair to take it back. Anne understands that Anson treated Merrily with fairness and is confident in working with him because she knows that she will be treated fairly too. Everybody is happy. Even Norvin is happy in his new job knowing that it was his choice to leave the company and that he doesn't deserve a slice of its success because he left them hanging when they needed him.

## Conclusion

The point of this chapter was to pique your interest in *Slicing Pie* and dynamic equity splits in general by acclimating you to the basics of how they work and why they are important. I hope that you will see the value in the model and how it perfectly aligns incentives. Instead of wrestling alligators you can concentrate your attention on building a company with people who want to treat you fairly.

The rest of this book covers, in glorious detail, *exactly* how the model works. I'm going to

repeat and go into more depth on the topics above to fully immerse you in the fairest equity split model ever conceived and how to implement it in *any* bootstrapped startup company on the planet.

## Chapter Two:

### **Fix & Fight**

The *Slicing Pie* model, described above and as outlined in my original book on this topic, *Slicing Pie: Funding Your Company Without Funds*, is a structure for dividing up equity, or profit sharing, in a startup company among early participants, including founders, investors, employees, advisors, partners or anyone else that provides contributions for which the company cannot pay cash. If you apply the model as outlined in this book, you will enjoy a *perfectly fair* equity split no matter what.

#### **The Traditional Model (Fix & Fight)**

Most people, even super-smart people with great experience and good intentions, struggle to create a fair equity split because most of the conventional wisdom around equity splitting makes it *impossible* to achieve a fair split.

There are lots of reasons traditional models cause problems, but the main problem is that most people use *fixed* equity splits based largely on

*future* value creation. A fixed split means that chunks of equity are doled out to participants in pre-set amounts in *anticipation* of them creating value for the firm. Startup founders are nothing if not optimistic, but *accurately predicting the future* is a skill that eludes most mortals. Couple that with the *impossible* task of measuring value-add and you have a recipe for failure.

Of course, when things don't go *perfectly* according to plan, the team will have to go back to the drawing table, *renegotiate* the split and argue about value creation. The new split will rely on their *new* prediction of the future which, like the old one, will also be wrong.

This goes on and on throughout the early days of the company. Each round of painful renegotiations embitters the participants and pits them against one another as they fight about who is adding more value and what each person deserves.

Each round of battles often includes increased investment in legal agreements that include time-based vesting schedules and different classes of stock and option programs and hold-backs and all sorts of other things that simply apply a Band-Aid to the underlying problem, which is that fixed splits based on predictions about the future don't work. They only lead to fights.

Sometimes people will rely on "industry standards" about who should get what. Rules of thumb are everywhere, but the problem of the

fixed split remains: unless everything goes according to plan, the split won't be right and another fight will ensue.

Every day, all over the world, well-meaning entrepreneurs enter into equity deals that backfire in ways that could easily destroy their dreams. Consider these scenarios:

Frank, a marketing guy, starts a company. He hires Tom, a developer, and gives him 50% of the equity (Fix). Tom wants to hire some additional development help and wants to give the new guy 10%. Does the 10% come from Tom's share, Frank's, or both? (Fight.) *Slicing Pie* will allow them to sort this out.

Jill, a developer, has an idea for a sports app. Joe, a marketing guy, *loves* the idea and agrees to sell it to his great contacts when it's ready. They split the equity 60% for Jill and 40% for Joe (Fix). Jill quits her job and works full time for a year to get the app ready for sale. Joe has moved onto other things and won't sell the app, but still wants to keep his 40% because he invested \$5,000 (Fight). *Slicing Pie* won't allow Joe to do this, but will still treat him fairly.

Len hires Miles and gives him 25% of the equity with a one-year vesting schedule (Fix). Miles works hard, does his job and

meets his goals. Len fires Miles for no reason a week before his first vesting date (Fight). *Slicing Pie* will not allow Len to take advantage of Miles.

Cindy hires Ron to build an app for her in exchange for 35% of the equity (Fix). She works hard to develop the market while Ron works part time to build the app. She pays Ron \$40,000 over a six-month period—all her money. Ron finishes the app but decides he wants more money and more equity before turning it over to Cindy (Fight). *Slicing Pie* will not allow Ron to hold Cindy's software hostage.

John and Milton start a company and split the equity 50/50 (Fix). Within the first year, they have great success and become profitable. Milton gets killed in an accident and his wife, Molly, inherits his 50%. Now John has to do all the work himself. Does he have to give her 50% of all his profits? (Fight.) *Slicing Pie* will provide a moral solution that Molly will understand.

You and I go into business and split the equity 50/50 (Fix). You do all the work, but I own half the company... now what? (Fight.) *Slicing Pie* will give you recourse if I turn out to be a deadbeat!

Because all of these well-meaning founders used traditional Fix & Fight equity deals, they *all* face potentially insurmountable conflicts that could easily lead to the demise of the business.

*Slicing Pie* is the solution that all these founders need. It is the only equity model that will work. I believe *every founder on the planet* should use *Slicing Pie*. By the time you finish reading this book, I'm pretty sure you will agree!

*Friends don't let friends Fix & Fight!*



## Chapter Three:

### **The Slicing Pie Principle**

The *Slicing Pie* model is a **universal, one-size-fits-all solution for bootstrapped startups**. I realize this is a **bold** statement, especially in a world where “it depends” is so common. However, I make this statement because I believe the model can apply *anywhere*. When I designed the model, it was my intent to make it universal.

The reason I think the *Slicing Pie* model is universal is because the basic principle behind *Slicing Pie* is profoundly simple and unambiguous. The *Slicing Pie Principle* is:

$$\begin{array}{c} \text{Your \% share of the reward} \\ = \\ \text{Your \% share of what's at risk} \end{array}$$

The *reward* I'm talking about is financial and comes in the form of profits/dividends or the proceeds of a sale. What's *at risk* are contributions of time, money, ideas, relationships or anything else participants invest in a startup and don't get

paid. *Everyone deserves a slice of the rewards that properly reflects their slice of what's put at risk to achieve those rewards.*

Some people believe their share of the reward should be *greater* than their share of what's at risk. But most people don't want to work with someone who is willing to benefit at the expense of others.

Hardly anyone believes their share of the rewards should be *less* than their share of what's at risk. When someone realizes they are being taken advantage of, they become angry, resentful and unmotivated to perform.

Most people know that they deserve what they deserve, no more and no less. I hope you're one of these people.

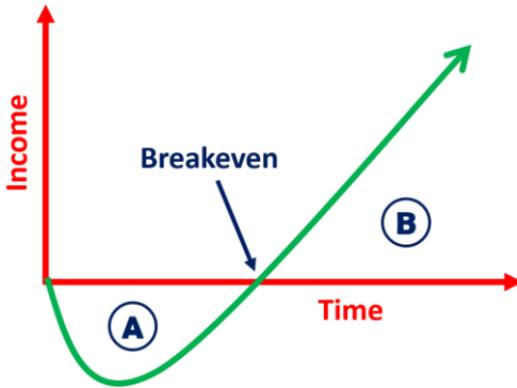
The ideal startup team consists of people who want to work together to generate rewards and take only what they deserve. *Slicing Pie is about doing right by those who help your company succeed.*

### **At-Risk Contributions Before Breakeven**

To dig down a little deeper, consider a typical breakeven graph like the one below.

The plotted line represents income which is revenue - expenses. In the beginning, income is negative. Participants are either spending their own money or otherwise *not* getting paid for their contribution. *After* the breakeven point, revenue *exceeds* expenses. At this point, participants are getting reimbursed for expenses

(or the company is paying the bills) and they are being compensated for their efforts. In other words, *after breakeven, an individual's new contributions are no longer at-risk*, because they are getting paid.



What's *really* important to note is that at the point of breakeven, area A, representing the at-risk contributions, is *quantifiable* and *knowable*. However, the future income generated by the company, area B, is *unknowable*.

*Slicing Pie* is used *before* breakeven. Equity is based on what people put at-risk. *After* breakeven everyone is getting paid, so equity is no longer about what's at-risk.

After breakeven or in established companies, equity is sometimes part of a bonus or retention strategy.

## The Slicing Pie Formula

If you buy into the basic *Slicing Pie* principle, then the formula that *Slicing Pie* uses to allocate equity should be easy to understand:

$$\text{Your Share (\%)} = \frac{\text{What You Put At Risk}}{\text{Everything That's At Risk}}$$

What's *at risk* in the *Slicing Pie* model, as I will explain in much detail below, is a function of the **fair market value** of a contribution (like time, money, ideas, etc.) and a **risk multiplier** that *normalizes* cash and non-cash contributions and imposes consequences on the at-fault party in the event of a person's separation from the company.

## It's Not Complicated

*Slicing Pie* is not complex. It is simple and obvious. To apply the model, however, you will have to keep track of what each person puts at risk.

The reason I've written *entire books* on this topic is not because the model is complicated, but because I want to help everyone figure out how to determine and track the fair market value of their contributions and what to do when someone leaves.

Keeping track of contributions requires a little structure and discipline. The good news is that if you are part of a team that values structure and discipline you're probably much more likely to succeed.

## Slicing Pie is for Bootstrappers

The *Slicing Pie* model is best suited for startup companies that are bootstrapped during the early stages of development.

Startups use the model until sufficient cash is available to *pay* participants for their contributions. This is usually when the company starts generating revenue or when the founders raise Series A investment.

When everybody is getting paid for their contributions (after breakeven), they will no longer be putting their contributions at risk. At this point the model will essentially “freeze,” and, subsequently, it will tell the managers how to divide up profits, if and when they are dispersed. Or, it will tell managers how to divide up the proceeds of a sale. The profits a company generates or the proceeds from a sale are the *rewards* of a startup. Remember, a person’s % share of the rewards should equal their % share of what’s put at risk.

## Slicing Pie is Better Than Traditional Fixed Splits

The *Slicing Pie* model mitigates the potential for fights that often arise from a traditional Fix & Fight model. In a fixed-split model, equity is allocated at the outset of the venture, often in equal amounts, among founders (e.g., “50/50” or “25/25/25/25” or “51/49”). It is not uncommon for such

agreements to be poorly documented “handshake” agreements between overly optimistic founders.

The basis for fixed split allocations are industry trends, *guesses* about future value, advice from well-meaning advisors or negotiation skills. Even *if* a fair allocation could be achieved using a fixed model, the allocation would cease to be fair the moment something changes or unanticipated events occur. All startups go through change.

Disagreements with fixed-split allocations often arise when members of the team are added or subtracted, or the work product of individual participants differs from what the team originally anticipated. At the core of these complaints is a general feeling of unfairness, mistrust, and greed as participants, lacking an objective measure of fairness, attempt to get the highest possible share for themselves, even if it’s at the expense of other participants. Such disputes can lead to unnecessary legal expenses, unpopular pay-offs or buyouts of various employees, and a deterioration of working relationships that may ultimately lead to the demise of the company. Most corporate and startup attorneys are all too familiar with such disputes. There is plenty of work for lawyers in the Fix & Fight model.

At first glance, fixed splits will *appear easier* to implement than the *Slicing Pie* model. The hard part about fixed splits isn’t implementing them; it’s *unwinding* them when you realize you’ve made a mistake. *Fixing* a fixed split model can be extremely complex legally, financially and

emotionally. You're much better implementing the *Slicing Pie* model and spending the rest of your efforts on building your business instead of fighting with team members.

*Slicing Pie* reflects reality, the Fix & Fight model is all make-believe.

## Allocation and Recovery

The *Slicing Pie* model provides a means to avoid such disagreements by laying out a universal framework for both the *allocation* of equity or profit sharing in the company and the *recovery* of outstanding slices in the event of an individual's separation from the company.

The **allocation framework** tells you how to give slices to individuals as they make contributions to the company. It is a dynamic model, meaning that it changes over time. This means that at any given time *all* participants will have *exactly* what they should have, regardless of changes in the strategy or the team. With fixed allocations, it is *impossible* to have a fair split—each person always has too much or too little.

The **recovery framework** tells you what to do when someone leaves the company. In some cases, the company will be able to recover outstanding slices for no or low cost; in other cases, the person leaving will be entitled to keep their share or sell it back at a fair premium. It depends on the nature of the separation. The recovery framework ensures that each participant

understands the consequences of their decisions as they relate to ongoing participation in the firm.

An absentee owner is someone who owns equity or profit sharing in your company but is no longer actively involved. It is best to avoid this situation if possible. The recovery framework provides a means for buying out ex-employees if and when appropriate.

### **A Moral Agreement**

Although the *Slicing Pie* model can be part of a legal contract (you will find contract templates at [SlicingPie.com](http://SlicingPie.com)), at the core of the model is a *moral* agreement. It's about doing right by the people who help you succeed. When implemented as outlined herein, it provides a structure for fair play, favors no one person over another, and ensures that everyone receives what they deserve.

In my experience, most people *want* to treat others fairly, but they may not know exactly how given the limitations of conventional wisdom and practice. The *Slicing Pie* model is the *how*. It will help the people who mean well to *do* well.

Of course, greed can be a powerful force that sometimes causes people to act in unscrupulous ways. Greed is when a person has a strong desire to have more than they deserve. A person may act within the law to capture value for themselves at the expense of others, but just because something is *legal* doesn't mean it's *fair*.

Some people are so overcome by greed that fairness doesn't seem to matter at all. Perhaps you will be able to avoid these people in your career as an entrepreneur. It's not always easy; but even if you find yourself in an uncomfortable situation, the *Slicing Pie* model can help. Applying the model will tell you the extent to which you are being taken advantage of so you can make better decisions about what to do next.

A person's willingness to apply the *Slicing Pie* model could be an indicator of their intent to be fair. If I find someone who *doesn't* want to use this model, I don't join their startup, nor do I ask them to join mine. Don't get me wrong; I'm not saying this model is an *absolute* measure of a person's character, and I realize that a person's unwillingness to collaborate using this model doesn't mean they are a greedy or immoral person. But why add the risk? Startups are already risky.

## **Startup Risk**

In finance, risk & return go hand-in-hand. When an individual, or a team of individuals, embarks upon a new venture, they are accepting risk and putting their contributions at risk. The risk they are accepting is the risk that they will never get paid for their contributions of time, money, ideas, relationships and anything else consumed by the company in the process of realizing its vision. Anyone who accepts this risk deserves a slice of the

pie that reflects this risk *relative* to other participants who also accepted risk.

If a person takes *no* risk, he doesn't deserve any return. If a person takes *100%* of the risk, he deserves 100% of the return. If two or more people *share* in the risk, they each deserve a portion of the return that properly reflects that risk relative to the other person. If one person puts \$100 at risk and another person puts \$1,000 at risk, the person who put in \$1,000 has taken more risk *relative* to the person who put in \$100. If the other person also put in \$1,000, then both people risked the same relative to one another.

If one person took 90% of the risk and the other took 10%, it wouldn't be fair to split the return 50/50. Splitting the return 90/10 is more appropriate. If the two people accepted the same level of risk, it would be appropriate to provide the same return.

### *Betting On a Startup*

Think back to the Blackjack analogy from the introduction. Like in Blackjack, when someone contributes to a startup company they are, in effect, placing a *bet* on the future outcome of the startup. The good news is that, unlike the future, the amount of risk each participant is accepting when they make a contribution is *very specific* and *measurable*. It is equal to the amount that they otherwise get paid by someone else for the same contribution. This amount, also known as "fair

market value," is easily observable in the marketplace.

In other words, when a person contributes to a startup they are *betting* the fair market value of that contribution on the future outcome of the startup.

The fair market value of a year of a person's time, for instance, is equal to their salary for a similar job at a company that had the means to pay. So, if you forego that salary to work for a startup (doing similar work), you are *betting* that amount of money. The opportunity cost of working for a startup is *equal* to the amount of money you would have earned elsewhere doing a *similar* job. Similarly, the fair market value of office space is *equal* to the amount of money the landlord can charge for that space. So, if the landlord allows you to use the office space at no cost, they are *betting* the amount of money they would have otherwise received from someone who had the money to pay.

People bet whatever they *contribute* to the startup effort. Every contribution is what it is. Nothing *magic* happens just because you make a contribution to a startup. The only difference is you're not getting paid the fair market rate. For instance, you may spend weeks working on a problem before you come up with a brilliant solution. The minute that you come up with the solution doesn't magically become more valuable than all the other minutes you spent on the job any more than the pencil you used to write down the idea doesn't become more valuable than any other

pencil. But, even if it did become more valuable, it is *impossible* to measure the value it created.

Because fair market value is so easy to observe, it can be used as an important component for the calculation of ownership or other interest in the income generated by a startup company. Using easily observable values means we don't have to guess. Most of this book and the *Slicing Pie* book is about how to determine fair market value and apply the formula.

### **Multipliers/Normalizing**

The only reason a rational person would be willing to join a startup and accept this risk is if they believe that their ultimate compensation will *far exceed* the amount they would otherwise get paid. Unfortunately, the chance of this happening is *very* low, and the risk of receiving nothing is *very* high. Indeed, startups are *extremely* risky.

Because startups are so risky, the other major component used in calculating ownership or other interest in a startup, besides fair market value, is a *multiplier* that will not only reward an individual for taking that risk, but also normalize cash and non-cash contributions. The multipliers also create consequences for the at-fault party in the event of a separation. *Multipliers are the secret ingredient that makes Slicing Pie work.*

## **A Slice of the Pie**

The way an individual reaps the benefits of a company's financial return is through their individual entitlement to a slice of the Pie. In many cases, this would imply equity ownership in the company (and I promote the model as such), but it does not have to. As long as an individual receives distributions of cash in proportion to their slice of the Pie, they should be happy, regardless of the underlying ownership structure.

For instance, if I own 100% of the equity in a company, but you, as my partner, contribute (risk) 19% of the contributions necessary to make the company worth something, you are entitled to 19% of the Pie. So, when the company distributes profits, you should receive 19% of the money. Or, if the company sells, you should receive 19% of the proceeds. Beyond that, the underlying ownership isn't important as long as you receive the payout you deserve. This is called "profit sharing" and may be an acceptable option for your company. A profit-sharing program can include ways to easily buy-out individuals at a fair price.

Equity can imply decision-making control over the company, so issuing actual equity in the company may complicate the individual roles people play. Founders wishing to maintain decision-making control of their companies have some options depending on the legal structure of the company. I'll cover more on this later.

Your team can decide whether to issue actual equity shares or profit sharing in the company. Both scenarios will have legal and tax implications that I will address later on. There are some *Slicing Pie* lawyers on SlicingPie.com, who can help you figure this out.

### Slices

A “slice” is a fictional unit of measure that reflects the adjusted at-risk contributions made by individual participants. Slices will allow you to calculate equity or profit sharing. This is not the same thing as a share, which is a legal unit of ownership.

NOTE: If you read *Slicing Pie* version 2.3 or earlier, you’ll notice that I don’t use the term “slice.” In that book, I use the term “theoretical value.” **Slices** and **Theoretical Values** are the same things.

### The Pie Slicer Application

You may have noticed by now that *Slicing Pie* requires you and your team to keep track of the contributions made by different people including time and money.

You and your team can keep track in whatever level of granularity that you are comfortable with, but I recommend logging hours on a daily or weekly basis and organizing time and expenses based on projects.

Like many things in business, keeping track of time and money can be tedious. The **Pie Slicer** application is an online tool that is designed to make this process as painless as possible. You can find it at [SlicingPie.com](http://SlicingPie.com)

Throughout this handbook, I will refer to the online Pie Slicer Application and how to use it to keep track of your equity split. More detail about getting started is in the Pie Slicer chapter. You do not *have* to use the online tools to be successful. As long as you keep track of what's going on in your company, you will be fine.



## **Pie Slicer**

Boxes like this one will provide information about how to get the most from the Pie Slicer application. If you're not using the Pie Slicer, you can skip these boxes!

### **Summary**

*Slicing Pie* is based on the basic principle that a person's % share of the reward should equal their % share of the at-risk contributions. This means that this simple dynamic formula will allow you to calculate a perfect split:

$$\text{Individual's Share (\%)} = \frac{\text{Individual's Slices}}{\text{Total Slices of all Participants}}$$

Today, the most common type of equity split is a "fixed" split. This means that chunks of equity are doled out to participants at the outset of

a venture in *anticipation* of their future contributions.

Fixed splits are based on unobservable information like future value or are based on industry “standards” and negotiation skills. *All* fixed splits become unfair the moment something changes, leading to disagreements among early participants that can escalate and possibly destroy a company.

The *Slicing Pie* model is a framework for the fair allocation and recovery of equity or profit sharing based on the fair market value. The fair market value of a contribution is the amount of money that the contributor would have been paid by someone else for the same contribution in a given market. This, combined with a risk multiplier/normalizer, gives us everything we need to calculate a perfectly fair split among all participants in a startup.

At the heart of the *Slicing Pie* model is a moral contract. It is about doing right by those who help you succeed.

### **END OF FREE SAMPLE**

I hope you enjoyed this free sample! There are plenty of other free resources on SlicingPie.com or you can **buy the complete book!**





## **About the Author**

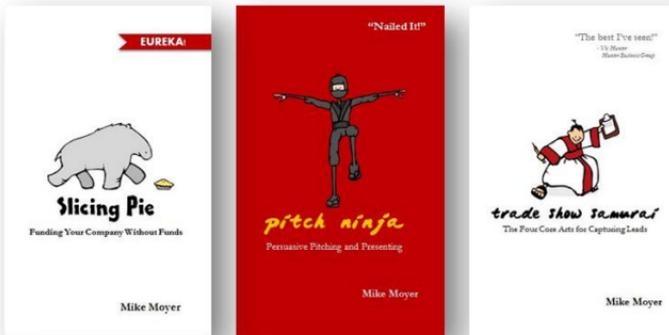
**Mike Moyer** is a professional entrepreneur who has started companies from scratch, joined start-up companies, helped others start companies, raised millions of dollars of start-up capital, and helped sell start-up companies.

He has worked in a variety of industries ranging from vacuum cleaners and motor home chassis to fine wine.

Mike has a MS in Integrated Marketing Communication from Northwestern University and an MBA from the University of Chicago. He teaches Entrepreneurship at both universities. Mike lives in Lake Forest, Illinois, with his wife and three kids, and the Lizard of Oz.

## Other Books by Mike Moyer:

- **Slicing Pie**- the original book on dynamic splits
- **Pitch Ninja**- about giving an awesome presentation
- **Trade Show Samurai**- how to capture lots and lots of leads at your next show



Mike is also the author of *Get Them Gators*, *How to Make Colleges Want You*, *Perfect Parent Hats*, and *Business Basics*

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