Guidelines: Start-Up Remuneration – How to get the Team you want when you don't have any money

Investors seek to invest in a 2 to 3 person co-founder start-up, which means that even the solopreneur (i.e. the "loan wolf" entrepreneur) will eventually face the question of how to bring on the best team during the start-up stage when money is tight and the business has yet to prove itself.

Generally speaking, the solopreneur has exclusively been performing the role of managing director, chief executive officer, chief financial officer and technical or sales director since the inception of the idea. However, solopreneurs really are specialists in one area of industry and to build the company, other team members are needed to keep the start-up moving forward, build traction and help to accelerate growth.

Investors generally understand that a start-up does not have the money to pay for the Team, but they do need to see that the soloprenuer is capable of assembling a group of relevant people – so the first step is to enlist co-founders as your Founding Team.

The solopreneuer needs to bring on 1 or 2 co-founders who are like-minded, passionate individuals that represent other roles in the business. Co-founders demonstrate to investors that the solopreneur is able to trust and work with others and conversely, that others can trust and collaborate with the soloprenuer.

Crucial to co-founder selection is that these individuals are committed to joining the company once the company is able to compensate them and understand that for now, remuneration is not a weekly pay cheque but negotiated compensation and equity allocation.

Co-Founder Equity Allocation

When starting a company, the co-founders firstly should agree about how to split the equity. A conversation of this nature should take place early in the process, and the agreement should be formalised by a Founders or Shareholders Agreement.

There are various methods of determining Equity Allocation at the beginning stage – for example, Frank Demmler's 'The Founder's Pie Calculator' quantifies the elements of the decision making process:
http://www.andrew.cmu.edu/user/fd0n/35%20Founders%27%20Pie%20Calculator.htm

Let's look at a hypothetical example. Assume that we have a high technology start up spinning out of a university with four members of the founding team.

1. *The inventor who is recognized as the technology leader in his domain.*
2. *The "business guy" who is bringing business and industry knowledge to the company.*
3. *The technologist who has been the inventor's "right hand man."*

4. *The research team member who happened to be at the right place at the right time, but hasn't and won't contribute much to the technology or the company.*

If these were all first-time entrepreneurs, it's likely that they would each get 25% of the company's stock, because "it's fair."

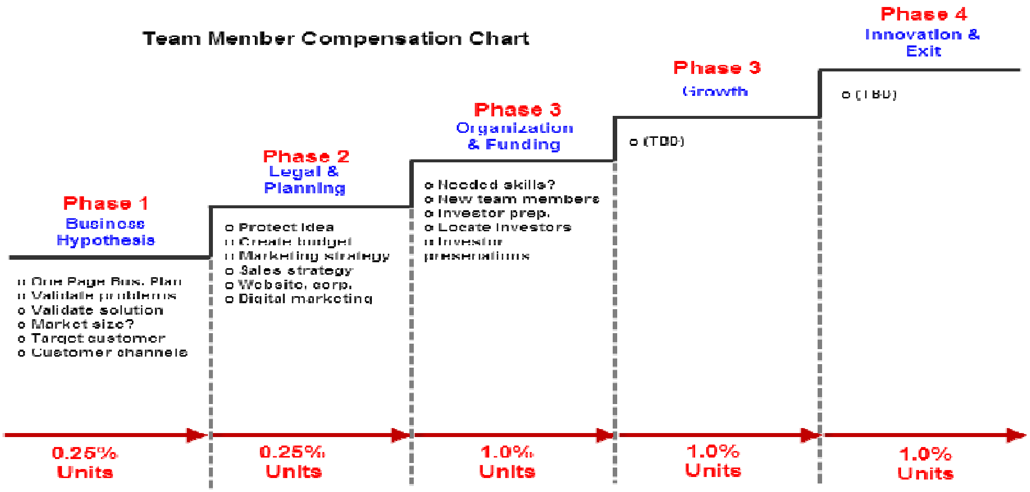
Let's take a look at what the Founders' Pie Calculator says. First we evaluate each of the factors on their relative importance and each of the founding team member's contribution to each on a scale of 0-to-10.

	Weight	Founder 1	Founder 2	Founder 3	Founder 4
Idea	7	10	3	3	0
Business Plan	2	3	8	1	0
Domain Expertise	5	6	4	6	4
Commitment & Risk	7	0	7	0	0
Responsibilities	6	0	6	0	0

Next, we multiply each of the founder's values by the factor's value to calculate weighted scores. Add up the numbers for each founder, sum those totals and determine the relative percentages. Do a sanity check to see if those numbers seem to make sense, and adjust them accordingly.

	Founder 1	Founder 2	Founder 3	Founder 4	
Idea	70	21	21	0	
Business Plan	6	16	2	0	
Domain Expertise	30	20	30	20	
Commitment & Risk	0	49	0	0	
Responsibilities	0	36	0	0	
Total Points	106	142	53	20	321
% of Total	33.0%	44.2%	16.5%	6.2%	100.0%

Whereas, James Naylor at Kenova Tech http://www.kenovatech.com/blog/how-startups-should-compensate-partners-team-members-without-cash-money/ links performance deliverables to equity allocation.



Ultimately, the methods employ the same concepts of considering the past, current, and future relative contributions of the founding team members to the ultimate success of the company, rather than giving away share capital for a rudimentary 50/50 or 25% split of the equity capital because "it's fair".

It is also important to consider reverse vesting, where each founder's equity percentage becomes available over time, or claw-back provisions where you can recover the shares issued to founders if performance fails to be achieved. If all the founders get all of their equity on day one, and six months later one founder leaves while other founders continue to work for several more years, the equity will not be fairly distributed. These 'try before you buy' mechanisms enable the solopreneur to get to know prospective team members and their working styles before fully committing to give away chunks of share capital.

Of course, it is not unreasonable that your co-founders may want to be paid for their services and commitment to you, so in that respect, you may need to negotiate each co-founder separately and consider a mix of equity and/or cash.

Directorships

Typically, the solopreneur and co-founders get nothing for their service on the Board. This is because they are founders or members of the management team and have already been compensated for their involvement with the company.

Most early stage companies compensate non-founding directors entirely with equity. This is ideal because cash is in short supply, and using equity maximises alignment between founders, directors and investors.

A good practice for a start-up company is to allocate a percentage of the total number of shares in trust for director appointments (e.g. 10%). Beyond expense reimbursement, directors should not expect to be paid any cash compensation at least until the company is actually generating cash in the business. There are exceptions to the rule of course, such as high-profile directors, however in most cases, directors will understand that fees are counterproductive to the start-up concept and sacrifice fees for potential future reward. Ultimately, they are on board for a reason and that is to build the business into a successful enterprise.

And consider an investor perspective where they invest in the company believing the funds to be applied for stated objectives to grow the company, only to find that numerous directors have been paid out of those funds raised!

Often, a debt instrument such as a convertible note may also provide a better option for remunerating directors, giving comfort to directors that their services have a dollar value, and that small stipend each month as a loan repayment maintains the essence of a start-up company (especially if that director has also invested cash in, or loaned cash to, the business).

Employees

It must be remembered that start-up employees are certainly taking a leap of faith and putting their trust in a business that could crash and burn at any time, rendering them without a job.

Whilst each employee is different, some creative ways to compensate employees during the start-up stage include:

- Hire part-time employees that are stay-at-home moms and dads. For less than half the cost of full-time staff, it is possible to attract experienced employees to your company.
- Defer compensation in an employment contract. Offer a deferred cash bonus when the business generates a certain amount of revenue; an increased salary when the employee hits performance milestones; or back-pay when the business becomes profitable.
- Use equity and options. Another alternative is to offer employees shares or options instead of cash. A good practice for a start-up company is to allocate a percentage of the total number of shares in trust for employees.
- Employ interns and volunteers. Universities are teeming with bright young workers willing to work part time or full time during vacations to gain experience.
- Focus on revenue. In reality, the best way to pay for employees is to generate more revenue and focus on selling your product. If you have a Team that fills the holes in human capital, then the financial response rate should be faster.