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How To Split Equity Among Co-founders To Achieve Satisfaction

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Splitting the equity of a startup is a major decision for cofounders. With the equity split, cofounders distribute power among one another, decide who receives more voting rights, or who has the last say in major decisions. In addition, the equity split determines the financial return of each cofounder once the startup is sold. Despite this decision being so important for the startup team, almost 40% of all teams take little time to think about the decision and simply split the equity equally.[1] Yet, a novel study reveals that such an equal equity split might not be the best decision for the team.

According to a study on 55 teams all in the process of founding high-tech high-growth startups, teams with an equal equity split can take longer to make decisions. Detrimental conflicts may also arise due to differing opinions among equal co-founders. However, the contrary of very unequal equity splits might also not be ideal. The more unequally teams split their equity, the less information co-founders tend to share with one another and the more unfair the equity split is likely perceived to be. Due to these issues in teamwork, both equal and very unequal equity splits are problematic. Cofounders are less satisfied with their team and are more likely to become less committed and excited about the startup. They are even more prone to exiting, which can disrupt the startup.

The optimal level of equity inequality

Preliminary results of the study, however, show that there is a sweet spot in between equal and very unequal equity splits that allows for the highest levels of satisfaction. Such a moderate level of equity inequality leads to cofounders being most satisfied with their teams. This effect is strongest during stressful times.

At moderate levels of equity inequality, teams can minimize the negative effects of both equal and very unequal equity splits. Cofounders share more relevant information with one another and perceive their equity shares to be fair. In addition, decision-making is sped up because it is clear who has the last say, and less detrimental conflicts arise. During stressful times, cofounders are likely to especially appreciate the resulting smooth teamwork, as it gives them more time to work on what is important instead of having to spend time and energy on teamwork issues.

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[1] Hellmann, T., & Wasserman, N. (2017). The first deal: The division of founder equity in new ventures. *Management Science, 63*(8), 2647-2666.

Achieving the optimal level of equity inequality

To achieve such moderate levels of equity inequality, cofounders can consider following a three-step process:

1. *Individual reflection*
   In the first step, all cofounders can individually reflect on how much equity they would give themselves as well as the others. Cofounders can consider who came up with the initial idea or invention, who substantially developed the business plan, how much time, money, and resources they each invested into the startup, how much expertise they bring to the team, or what responsibilities they each have. After this first reflection phase, each cofounder can write down his or her own personal insights.

2. *Team discussion*
   In a second step, all cofounders can come together to simultaneously reveal and present the results of their individual reflections. If the results of all cofounders are similar, the startup team can consider calculating the mean of the individual reflections. If the results differ substantially, cofounders can go on to establishing a list of weighted criteria based on each of their individual reflections. Subsequently, they can go through all criteria cofounder by cofounder. If major disagreements arise, having a coach to guide the discussion might be helpful. After this team discussion, the startup team should have agreed on a preliminary equity split.

3. *Finalize*
   In the last step and before formalizing the decision, each cofounder should have time to let the discussion sink in. Then, the startup team can meet again. If each cofounder is still content with the agreed-on equity split, it can be signed off.

Splitting equity is one of the most important decisions when founding a startup and has substantial impact on the startup team. Taking time to consider all potential influencing factors and discussing different solutions is therefore essential to achieve an optimal split. According to the preliminary results of a recent study, agreeing on moderate levels of equity inequality might lead to cofounders being most satisfied with their teams.

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