

## Determining the initial or founder shareholdings of a new venture

This is a notoriously difficult area for the individuals involved in the establishment of a new venture and one where there is relatively little formal advice. There are no set guidelines that can be referred to and this is a highly sensitive area.

By the time the decision has been taken to form a company it can be assumed that certain decisions have been taken, the concept will be agreed, the business model in the process of being developed. There will be some early stages, pre-formation, that an individual or individuals will have gone through in terms of idea creation, selection, refining with time and effort being committed to these areas and to early consideration of commercial possibilities.

If the new company is being formed by an individual matters are simple. If, however, there are more than one, then decisions need to be taken on these initial shareholdings.

The issue centres on attempting to place a value on the new venture at these early stages, before any of the conventional methods of valuation can be utilised. An indication of value, which then may be used to establish the respective shareholdings, could be based on the following:

1. Financial contribution
  - a. Assets (physical) brought to the business, including IP
  - b. Actual cash input
2. Time spent (for no reward)
  - a. Product development
  - b. Market assessment and early evaluation of commercialisation
3. Entrepreneurial contribution – 'Human Capital'
  - a. Contacts
  - b. Individual reputation
  - c. Skill set
  - d. Drive and ambition

i.e. cash, sweat and star qualities....

Item 1 above is relatively easy to determine. Item 2 will depend on the view of value of time. Item 3, the 'Human Capital' element, is the most difficult to quantify.

There is also the issue of precise timing of contribution. Typically, there will be one or perhaps two people who initiate the idea and then others who may participate later. This has to be factored into the equity equation.

Rh/2006