



VIII. Ownership

UNIT PURPOSE

Ownership – who owns how much – is a complicated, charged and challenging issue for many people going into business together, as well as for many partners facing transitions. Many people, including some seasoned business people, are a bit naive about how complex this issue actually is and believe all they need to do is pick numbers (50-50, 51-49, 25-25-25-25, etc.) and their job is finished.

This unit, along with Units 5, 6 and 7, are designed to help you sift through the challenges by leading you through discussions that many partners wish they had, discussions that respect the complexity of the topic, even if the final choice looks as simple as 50-50.

Although you may have already decided your respective percentages, we suggest that you not bypass this unit. Figuring out your interests upon formation is only one part of the challenge.

BACKGROUND

In its most elementary form, there are two ownership challenges that beg to be addressed when people enter into co-ownership arrangements: (1) how the business will be divided among the owners when they establish it, and (2) how those percentages will change with time and circumstances.

It should be obvious, but it must be said, that the initial distribution of ownership percentages needs to make sense to all of the partners and be willingly agreed to by everyone. The percentages do not have to make sense to others, but the partners should understand them and willingly agree to them. If the reasoning behind the numbers is not well understood, or one of the partners feels he has no real choice but to accept his percentage, then the chance of problems arising later is greater. To make sense, the percentages should be a reflection of how the partners interpret the reality of their partnership and the reality of their business.

Assessing the contributions of the partners carefully and thoughtfully is the best way we know to ground ownership percentages in reality. The way to do this is by completing the Value-Contributed Ownership Matrix found below. The starting point for the matrix is the contribution list from Unit 6. Beginning with actual contributions helps people avoid the tendency to pick a number and then rationalizing backwards to justify the number.

It is important to note that people are not bound to use the percentages that flow from the matrix; the matrix simply provides data points that are grounded in the contributions that people intend to make to the venture. These data points can inject some objectivity into what can be a highly subjective discussion. There are subjective elements to the matrix, but the matrix helps people see which factors are subjective and which are objective, and makes it possible to approach the discussion of percentages more rationally.

Even though it may seem sufficient to establish your percentages of ownership at startup, our mediations with partners has convinced us that it is wise to plan now for how ownership will change in the future. The ownership structure will change if the partners change or if the percentages held by any partner change. The partners will change if someone new is added or an existing partner leaves. The percentages will change if one or more of the partners acquire a greater interest, thereby diminishing the relative interest of other partners.

Anticipating and discussing how the changes could occur can shed light on what those discussions would be like in the future and pave the way for smoother transitions in the future. Interestingly, it sometimes makes it easier to reach agreements on current ownership when partners agree upon how ownership interests will change in the future.

UNIT INSTRUCTIONS

1. Review Chapter 4 of *The Partnership Charter*. Be sure as you re-read the chapter to note issues that you want to include in your Charter.
2. Individual Preparation. The preparation for the partner meeting includes focusing first on the current ownership and then on changes in the future.
 - (A) **Current Ownership**. Complete the [Value-Contributed Ownership Matrix](#) to provide greater clarity about current ownership. (There are different forms depending on the number of partners. Contact the authors for forms for 5 or more partners.) This matrix can help you think clearly and explicitly about the distribution of ownership interests. Each partner completes the matrix on her own and the completed forms will capture the thinking of each of you about how you value the partners' respective contributions and give you real data for a discussion of ownership interests.

Needless to say, you must avoid the urge to complete the matrix backwards, i.e., picking a percentage that you think each partner should have and then

working backwards to fill in the weightings and the relative contributions for each partner. If the percentages come out different than you like, that is something you will discuss when you meet with your partners.

- (B) **Future Ownership.** Once you have completed the Value-Contributed Ownership Matrix, answer the questions below regarding [Future Changes In Ownership Exercise](#).

3. Meeting together.

- (A) **Sharing your thoughts and feelings.** The first step when you meet as a group (and your BMC Advisor if you are working with one) is to share your work on the matrix, your thinking regarding future changes in ownership and your thinking on other miscellaneous ownership-related issues. The purpose is to communicate your thoughts and feelings and understand the thoughts and feelings of your partners.

It should be clear that you do not begin by talking percentages! You want to end by talking percentages. We suggest the following sequence for your discussions together:

- (1) *Ownership Weightings.* Referring to your Value-Contributed Ownership Matrix, discuss the weightings – the relative importance – that each of you gave to each type of contribution being made by partners to the venture. To make the discussion easier, put the list of contributions on the left side of flipchart paper and leave room to the right for the weightings of importance by each of the partners.

Anticipate that partners will have differences of opinion about the importance each type of contribution. (Not surprisingly, we each tend to value what we can bring to the party!) Approach this like a learning experience – an opportunity to learn more about how your partners reason, debate, compromise, respect one another's ideas and work through differences.

Obviously, it's best not to rush these discussions. Ideally, people have the courage to express their thoughts, no one tries to intimidate or manipulate anyone, and no one capitulates to anyone. It is often here that partners need the assistance of professional mediators to ensure the discussions are constructive and productive.

- (2) *Relative Contributions.* Refer again to your Value-Contributed Ownership Matrix to discuss how much each partner brings to the partnership in the various areas of contribution. This will be straightforward for some contributions (perhaps capital) and highly subjective for others. Again, write these numbers on flipchart paper so everyone can see them in the same place. Remember, the focus at this time should be on developing a thorough understanding of the thinking of each partner regarding how he or she views the relative contributions of everyone.

- (3) *Relative Ownership*. Compare the division of ownership suggested by the analysis each of you did in your Value-Contributed Ownership Matrix.
- (4) *Future Ownership*. Discuss how each of you sees the various ways ownership may change in the months and years ahead.
- (B) **Creating agreements**. Only when all of the partners feel that the others understand their reasoning, should you begin working on building consensus regarding the respective ownership percentages. Negotiating agreements should not begin until you each have a comprehensive view of the others' perspectives.
5. Drafting the Money and Ownership Units of your Partnership Charter. One of the partners should now prepare a draft of the Ownership Unit of your Partnership Charter. This is intended to memorialize what you've learned in this Unit and what commitments you have made. You may want to use the [Framework for a Partnership Charter – Ownership](#) found below as a starting point. The other partners should review the draft and have any additional discussions needed to finalize it.

Value-Contributed Ownership Matrix (Form for 2 Partners)

Instructions and Example: Because this matrix is unfamiliar, we have included an example matrix of a hypothetical partner, Sharon, to illustrate how the matrix is used to prepare for the partners' meeting to discuss ownership. You can see Sharon's matrix on the following page. (Her partner is named Amy.)

- (1) Contributions. In the column on the left of the matrix, enter all of the various contributions you and your partners listed for yourselves in Unit 6. One partner may be contributing on one thing of value to the partnership (e.g., the idea for the company, a patent, capital), while another may be contributing a dozen different things. The list of contributions should include all of them from all of the partners. (If you need more lines for entering all of the contributions, copy the appropriate form and continue the list on a second page.)

If you were thorough in developing your list of contributions to the partnership, then the matrix should capture each of the pieces that make up the total ownership puzzle. If you realize that one partner is contributing something that should affect his or her ownership that is not on the list, add it to the list now. This exercise forces you to identify all of the contributions by all of the partners because no one will end up with ownership that does not come from a contribution they have made, or one they intend to make. If you decide that there is a contribution that needs to be added, inform your partners as soon as possible so they can also consider it as they complete their matrixes.

You can see that Sharon and Amy had 14 different contributions that one or both of them thought they were bringing to their new venture. Sharon put them into the Contribution column on this form.

Value-Contributed Ownership Matrix

(Example of Sharon and Amy)

Your name: 1. Sharon Your Partner's Name: 2. Amy

Contributions ¹	Weighting ²	Relative Contributions ³		Relative Ownership ⁴	
		<u>Sharon</u>	<u>Amy</u>	<u>Sharon</u>	<u>Amy</u>
Capital	10	20	80	2	8
Compensated Work	0	25	75	0	0
Customer/client relationships	20	50	50	10	10
Energy & enthusiasm	0	50	50	0	0
Existing reputation and network	0	75	25	0	0
Financial resources	0	25	75	0	0
Intellectual property (patent)	25	100	0	25	0
Inventory and order backlog	0	0	0	0	0
Office space	0	100	0	0	0
People skills	0	70	30	0	0
Personal property (equipment)	10	0	100	0	10
Professional credentials	0	0	0	0	0
Uncompensated work	35	100	0	35	0
Website – existing	0	0	100	0	0
Total	100	N.A.	N.A.	72	28

(2) Ownership Weighting. Estimate the relative value of each contribution to the success of the venture by distributing 100 percentage points among them. This will tell you and your partners the importance you place on each type of contribution to your venture.

¹ Contributions. From the list of contributions in Unit 6.

² Weighting. Column totals equal 100.

³ Relative Contributions. The row totals for the 2 partners totals 100.

⁴ Relative Ownership. The cell numbers are the product of the Weightings times the partner's Relative Contribution. The totals at the bottom of the table are the sum of the Relative Ownership cells for each partner.

It may be that you have contributions on your list that have been acknowledged by you and your partners but are not significant to warrant factoring into your partners' or your ownership interests. You would give such contributions a weighting of 0. The sum of the numbers in this column needs to be 100.

In the example of Sharon and Amy, Sharon estimated that the cash contributed by all of the partners was 10% of the total value of all the various contributions. Sharon thought that the value of the patent she was giving the company was 25%. She placed a value of 35% on the work that she had performed for the company before any one received any compensation. Sharon plans on providing office space in her house for the new venture but she will be compensated for it so she doesn't think it should be included in the ownership considerations.

- (3) Relative Contributions. For any given contribution, the sum of all of the partners' contributions must equal 100 (i.e., looking across the row under Relative Contributions for all partners).

In the example, Sharon is contributing a patent to the company and it's the only intellectual property going into the company, so she credits herself with 100% and Amy with 0%. Sharon and Amy are both putting money into the company. Sharon is putting in \$100K and Amy's putting in \$400K; their respective percentages are therefore 20-80. Sharon thinks that they are bringing the same number of client relationships to the new company so she's entered 50-50 to depict equal contributions.

- (4) Relative Ownership. These columns put specific values on the various contributions the partners are making to the business. They show the "credit" each person would award to all of the partners for all of the contributions being brought to the table.

The numbers are simply the product of a contribution's weighting and the partner's relative contribution. So for example, Sharon has given the weighting for cash contributed to the venture a 10 and her relative contribution is 20%, therefore her relative ownership for this contribution is 2% ($10 \times .20 = 2$).

After you've done the weightings and the relative contributions, multiply them out to get the relative ownership for each contribution and then tally the columns to see the total percentages for all of the partners. If you computed the rows and columns correctly, the sum of the relative ownership columns for the partners will equal 100%.

The way Sharon weighted the contributions and divided them between Amy and herself produced an approximate $\frac{3}{4}$ - $\frac{1}{4}$ split in ownership.

Future Changes In Ownership Exercise

[Note: The legal document that frequently is used to define rights regarding changes in ownership is the Buy-Sell Agreement. The decisions you reach regarding many of the questions below will provide a solid basis for such an agreement.]

- 1) What principles will govern changes in the division of equity in the future? What will be the basis, or legitimate arguments, for changing ownership percentages?
- 2) Will existing partners be allowed to continue as owners if they are incapacitated? How will incapacitation, or disability, be defined?
- 3) If a partner dies, what will happen to her interest in the company?
- 4) If a partner is forced by personal or family circumstances to sell her interest, will she be treated any differently than if she voluntarily chose to leave?
- 5) If a partner employed in the business cuts back her hours significantly, can she continue to be an owner, either at her current ownership level or a reduced level?
- 6) If the business needs additional capital to survive or grow and not all of the partners can contribute according to their current ownership percentages, will the ownership percentages change? How would they change?
- 7) Can you envision adding one or more new partners at some time? If so, how will this be decided? Will they need to meet certain standards? If so, what are they?
- 8) Will family members (spouses, children or other family) be eligible to be owners?

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- 9) If a partner voluntarily wishes to sell her interest in the business, will the remaining partners be forced to buy her interest? How would they purchase her interest?

- 10) Will a partner who wishes to sell her interest have the option to sell or transfer her interest to a third party? Should there be restrictions on partners' ability to do so? If so, what are those restrictions?

- 11) Will any partner have the option (i.e., right) of buying out other partners? If so, under what circumstances? At what value? On what terms?

- 12) Are there circumstances that would justify forcing a partner out? (It helps to think of a generic, or hypothetical, partner, not your actual partner. A hypothetical partner could embezzle money, mistreat employees, etc.)

- 13) If a partner holds a majority interest, can she buy out her partners if she pleases? If not, can she do so under specific circumstances?

- 14) If a partner is selling less than a majority interest, will she receive a value equal to her percentage ownership or will her interest be discounted because it is less than a controlling interest?

Framework for a Partnership Charter: Ownership

Note on using this Framework: Every partnership is unique and every Charter must be as well. This framework offers a starting point for addressing a few of the key issues that may be relevant in the Ownership section of the Charter. It does not attempt to cover all of the issues that were discussed in this unit or that may be important for you to include in this part of your Charter. You will need to add sections that are specific to your situation and omit any that are not relevant.

Ownership Interests

[ALTERNATIVE 1: We have carefully considered our respective contributions to the business and agree that each of us will be an equal owner in our venture at this time. We've reached this conclusion because...]

[ALTERNATIVE 2: We have carefully considered our respective contributions to the business and as a result, we have decided to distribute ownership on the following basis:]

Partner 1: [%, contributions expected and rationale]

Partner 2: [%, contributions expected and rationale]...

...

We have reached this decision because...

If any of us comes to feel that this is an unfair arrangement, we will review our decision in the following manner...

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For your consideration: As noted in the Introduction to the Business Issues Section, ownership is closely related to issues of money, governance and roles. Take the time to compare your decisions here with those you make in the other Business Issues units. It's important to recognize and address any inconsistencies. It's equally important that the decisions combine into a relationship that makes sense and seems fair.

Changes in Ownership

We agree that if one of us wishes to leave the partnership, we will handle that in the following manner:

Right to sell to others:

Partners' right to first offer or first refusal:

Valuation:

If one of us dies or becomes disabled and is unable to make his expected contributions...

We will purchase sufficient life and disability insurance to insure that in the event of the death or disability of a partner...

If any partner is convicted of a crime of moral turpitude, usurps the partnerships business opportunities or grossly fails to meet his responsibilities as a partner, the other partners may...

We will admit new partners to our venture under the following conditions:

For your consideration: The decisions made in this section are essential to the Buy-Sell Agreement that should form part of your legal partnership arrangements. Be sure to review these ownership issues with your attorney – to solicit his or her advice and to make the preparation of your legal agreements more efficient.

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