Pie Slicer

The Case of:

John's Bicycle Attic, LLC

John loves bikes and wants to start a bike repair service. He tells his friend, Mike, and they decide to start a bike repair shop in their basement and call it John's Bicycle Attic and use a Grunt Fund to slice the pie. They appoint John as the president of the company because it was his idea and he has the most bike-repair experience. He sets up and manages the Grunt Fund.

John's first step is to figure out his and Mike's Grunt Hourly Resource Rate (GHRR). The only other job that either of them have had was when they were dish dogs at the local country club. John, who was a dish dog longer than Mike, earned $10.00 per hour and Mike only earned $9.00 per hour. John decides to take this rate and apply the 2x multiplier to calculate their Grunt Hourly Resource Rates (GHRR). This would give John a GHRR of $20.00 and Mike a GHRR of $18.00.

Mike and John, however, are smart guys. They realize that fixing bikes isn't the same as washing dishes and they agree they have complementary skills. So, they agree to take an equal GHRR of $20/hour or 20 slices/hour. You don't have to split hairs with a Grunt Fund. They keep it real. Annualized, this is a $20,000 per year salary, which is about right for two relatively inexperienced bike shop employees.

To get the business started, John provides a repair stand and a killer set of tools he has owned for several years. Because the equipment *enables* the business, it should be assigned a theoretical value, or slices. John didn't buy the tools specifically for the business so they looked up a comparable set of tools on eBay.com and found some for around $1,000. So, the theoretical value of the business enabling equipment is $1,000, which is equal to 1,000 slices.

Over the next month, John works 100 hours setting up the shop, and Mike works 100 hours, placing ads, posting flyers, talking to bike owners, and generating business. Mike spends $1,000 on flyers and ads for the company and he brings $100 in snacks for the shop from his home. He does not expect to be reimbursed.

Mike also contributed to the business with supplies consisting of flyers, for which he paid $1,000, and snacks, for which he paid $100. The snacks, which he brought from home, are business facilitating supplies and should not be assigned a value. They are nice to have, but not critical. The flyers, on the other hand, are a business expense for which Mike does not expect to be reimbursed. The theoretical value of that contribution is the amount of cash times four.

So, at the end of the first month, John would own 33% of the pie and Mike would own 67%.

	John	**Mike**	
Time	2,000	2,000	
Equipment	1,000	-	
Cash (x4)	-	4,000	Total
	$3,000	$6,000	$9,000
	33%	67%	

In the above example, the Grunt Model has properly divided the pie of the business among the two partners.

Over the next month, the partner's commitments change. Mike gets a new girlfriend, Anne, and starts spending a lot of time over at her apartment. Over the next month, he only spends 50 hours promoting the business and spends no money on advertising. John spends 50 hours in the shop and 25 hours generating business. He also spends $500 on advertising.

At the end of the second month, his total theoretical value has grown to $6,500. Mike has committed 150 hours and $1,000 on advertising. His total theoretical value has grown to $7,000. At the end of the second month, John's slice of the pie is 48% and Mike's is 52%.

	John	**Mike**	
Time	3,500	3,000	
Equipment	1,000	-	
Cash (x4)	2,000	4,000	Total
	$6,500	$7,000	$13,500
	48%	52%	

As you can see, John's pie slice grows to reflect his dedication to the business. In this model, the allocation is fair, based on the personal choices of the two participants.

Mike continues to spend time with his smokin' hot girlfriend instead of building the business so they decide to add a third partner, Sam. Sam ran a bike shop for many years before selling it. His experience will add a lot to the business.

Sam's last salary at a bike shop was $50,000 per year. Sam agrees to the Grunt Model and starts work. Over the next month, Mike spends 20 hours promoting the business, John spends 150 hours in the shop, and Sam spends 25 hours in the shop and 25 hours calling his old customers and generating a lot of business (50 hours total.)

Under the Grunt Model, Sam can slip right in and start earning pie. At $50,000 per year, his GHRR is $50.00. John and Mike think this is fair, given the fact that he has far more experience than either of them. At the end of the third month, the pie split is as follows:

	John	Mike	Sam	
Time	6,500	3,400	2,500	
Equipment	1,000			
Cash (x4)	2,000	4,000		Total
	9,500	$7,400	$2,500	$19,400
	49%	38%	13%	100%

The Grunt Fund has provided a method for adding another partner in a fair and consistent manner. The theoretical base value has grown and all parties have a fair share. If John and Mike had simply split the business 50/50 in the beginning, there would no doubt be hard feelings among the partners, especially after some rough renegotiation when they brought on Sam.

Removing a Partner

In the above example, it seems that Mike's commitment is waning and he may be on his way out. At such an early stage, it would be impractical for Mike to keep his pie, in spite of his contribution. Investors don't look favorably on absentee-owners.

Although Mike has added value to the business and it should not be overlooked, it is clear that the young company has a long way to go and unless Mike sticks with it, he may not be entitled to the gains. There are three scenarios in which Mike can depart the business. Each one creates special circumstances that need to be considered if he is to be treated fairly. The three scenarios are:

1. Mike can quit, also called resignation without cause
2. Mike can be "pushed out", also called resignation with good cause or termination without cause
3. Mike can be fired, also called termination with cause

Starting a new business is precarious and commitment of the partners is important. Half-hearted commitment can damage a business beyond repair. An understanding, in advance, of expectations can help pave the way to a successful transition without hard feelings.

Resignation without Cause

If Mike quits for personal reasons—resignation without cause—then he will have to accept a reduced slice of the pie and give the company the opportunity to buy it back. If the company cannot buy back the equity, the Grunt Fund after Mike's departure looks like this:

	John	Mike	Sam	
Time	6,500		2,500	
Equipment	1,000			
Cash (x4)	2,000	1,000		Total
	$ 9,500	$ 1,000	$ 2,500	$ 13,000
	73%	8%	19%	100%

The Grunt Model has fairly resized the slices. Mike now receives $0 per hour worked instead of $20 and his cash contribution does not get the 4x multiplier.

Notice that the total theoretical value of the pie has gone from $19,400 down to $13,000. This is not a problem. Remember, the company still has no actual value so this number is simply used to help define the relative size of the Grunts' slices. It really doesn't matter what the number is, as long as it helps us keep track of the inputs. If they have enough money in the bank to buy back Mike's slices, they can choose to do so. Mike, essentially, receives his money back. The pie would look like this:

	John	Mike	Sam	
Time	6,500		2,500	
Equipment	1,000			
Cash (x4)	2,000			Total
	$ 9,500	$ -	$ 2,500	$ 12,000
	79%	0%	21%	100%

Both John and Sam now have a larger share of the pie. That doesn't necessarily mean they are better off. They no longer have Mike and they may have to find someone new.

Mike shouldn't feel too bad. The company just wasn't for him. He still has some pie, but the company can buy it back. It is important to remember that we are not dealing with actual stock with actual value. When I say "buyback", I'm really talking about the company paying back Mike's cash. Remember, slices in the pie are nothing except a personal promise from the founder to provide an equity cut at some point in the future.

If the company can't pay back Mike, and John, as the founder, does not want to give any pie to Mike, he has several choices. The first is to blow off Mike and not keep his promise. This happens all the time, but it's not fair. The other thing John could do is give $1,000 of his own money to pay Mike back for the expenses he incurred and the time he spent. John would then own Mike's pie at the 4x rate.

Termination without Cause or Resignation with Good Cause

Let's pretend that Mike liked working for the business, but couldn't dedicate much time to the effort and his lack of dedication bothers John and Sam.

John and Sam could simply ask him to leave. He did his job, he helped build the business, but they need someone more reliable. No hard feelings.

In this case, it would be fair for the company to either do a buyout or allow Mike to keep his pie with a buyback option.

If the company chooses to do a buyout, Mike would be entitled to the theoretical value of his pie.

Notice that this option is expensive. They will have to come up with $4,000 to pay back the $1,000 Mike invested. This is perfectly fair. Mike didn't actually do anything wrong, the other Grunts just wanted to replace him. It's okay for them to want someone else, but they can't penalize Mike for no reason.

This kind of agreement creates a little job security for Grunts because herd members will need to think twice before they act on a whim and let someone go without cause.

Likewise, if John and Sam told Mike that he wasn't going to get paid as much (but they were keeping their rates), or if they told him that he was no longer in charge of marketing, Mike could resign for good reason with the same benefits as if he had been terminated without cause.

Termination with Cause

If Mike had been repeatedly asked to perform certain duties and he did not, John may have a cause to fire him. In this case, it would count as a termination with cause and Mike would not be entitled to some of the pie.

Mike would forfeit the pie earned through his hours worked as well as any unpaid commissions he would have received in pie.

The cash Mike put in would be recalculated to match the actual value of the cash without the multiplier. The company does not have to pay this back, but will have to issue equity when the time comes. If the equity is issued, then there should be a one-year protection as discussed before.

John's Bicycle Attic Survives

As you can see, because John's Bicycle Attic is using a Grunt Fund, the pie adjusts as the business changes and it is clear what happens under different scenarios.

In all of the above scenarios, Mike is treated fairly. He receives what he deserves. Because he is a friend and fellow Grunt, he should be treated fairly no matter what.