

## Capstone Project

*Technical note*

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# SERVICES FOR EQUITY

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## Executive summary

For a start-up that has little financial means, there is a solution other than the classic models of a fundraising and Business Angels: Services for Equity. This work will highlight the advantages and limitations of this method of financing, mainly through testimonials.

These practical experiences were gathered from the CEOs of start-ups that used Services for Equity, companies that offer their services for shares in start-up companies, a lawyer specializing in corporate law as well as experts in economics such as: Olivier de Wasseige, boss of the Walloon Union of Enterprises.

The purpose of this work will be to allow young entrepreneurs to get an idea and to form an opinion on the model. Unfortunately, it does not exist enough scientific work, mainly due to the fact that it is a fairly recent practice, even if similar methods (including the Media for Equity) have already existed for thirty years. This Capstone, mainly focused on the experience of Walloon and French stakeholders, should therefore allow start-ups looking for the next step to take to grow, to know better if a Services for Equity relationship would be conceivable for them or not. .

## Context

Services for Equity is a method of financing that offers companies with few financial resources, or who wish to find another way of working, to benefit from the services of certain people or companies, and on the other hand these people, service providers, to be remunerated by shares of the company using them.

As part of this work, several people familiar with this method of financing have agreed to explain their role in companies and to tell us more about the benefits and disadvantages of Services for Equity. The purpose of this work is to understand this method of financing and to highlight the critical elements that the parties must be attentive to.

We decided to divide this report into different points. At first, the theoretical aspect will be approached, just like the legal aspect. Then, the practical aspect in which we will expose the advantages and the brakes of the method, based on the different interviews and documents that the companies sent us, and finally, we will conclude with advices that it is for the people who offer their services only to those who use them.

For the writing of this work, we wanted to have a maximum of actual and current testimonials, but, above all, divergent points of view. Since there are very few scientific books on this subject, we wanted to collect the most heterogeneous opinions so that the reader can make his own opinion about Services for Equity. In order to better inform us, we contacted many companies and people, such as:

- Charles-Edouard Bouée, Roland Berger and Augesco Ventures's CEO;
- Prof. Dr. Christoph Schalast (Frankfurt School of Finance & Management);
- Prof. Dr. Jürgen Seitz (Hochschule der Medien Stuttgart);
- Andreas Kitzing, Sponsoo;
- Rocket Internet (Allemagne);
- Dan Martell ;
- Frederik Tibau (Content Director startups.be);
- Robin Wauters (Founding Editor tech.eu);
- Easyflyer;
- Like a bird;
- Fred de la compta;
- Skill Value;

- Bluefox;
- Sharalike;
- Citygoo ;
- Byzon esport ;
- Pick me cab ;
- Olivier Robijns ;
- Gauthier Cruysmans ;
- Lionel Halleux ;

Some of these companies took the time to respond to inform us that they did not have time for an interview, however, some of these people sent us videos, interviews or documents on the subject to inform us of their personal experience.

As for the very essence of our work, it will be based on the testimonies of a few key people who were:

- Bernard Tilkens, Next Steps's CEO;
- Éric Gouin, SkillValue & Pentalabbs's CEO ;
- Pierrick Filippi, Like a Bird & Like a Bot's CEO;
- Olivier D'Aout, Layer at Defenso ;
- Anonymous Start-up ;
- Olivier de Wasseige, UWE's Administrator ;
- Guy-Louis de le Vingne, Make It's CEO ;
- Nizar Dahmane, La Poste *Services for Equity's* General Manager.

All the research and interviews were carried out together by Sebastian Löfgen and Mélissa León Blanco. Each stakeholder provided a personal opinion on Services for Equity and commented on the advantages and limitations of this method for contractors or service providers. However, as mentioned earlier in the methodology, we will distinguish the parties from the companies using this method of financing, and from the other, the companies that offer their services, respectively studied by Mélissa and Sebastian, although all the research was conducted together. The same interview structure was followed for each of the stakeholders to find out their experience with the financing method, their opinion on it and the advice they would give to a start-up interested in it as well as to a company providing the service. These questions were based on those written in the methodology section.

## In Theory

The following information is a synthesis of the information provided by the limited scientific literature on the subject as well as the statements of the speakers. This method of financing is not widely used in the world and, according to some speakers, is probably too young. As stated in the contextualization, the Services for Equity funding method can be compared, to put it commonly, to a kind of barter. A young company needs a specific service and a specialized company offers this service in exchange for shares in the start-up. The company thus becomes a partner and service provider.

This equity method is more common in some areas such as IT or media. A company or start-up that needs a website or application will use a development studio that will offer its services in exchange for a share in the company. Another area where Services for Equity is relatively common is the field of architecture. An architect provides plans and coordination activities in return for shares in a real estate company.

Recently, IT for Equity has become more and more in demand in the entrepreneurial world, although it is still little known in Belgium. Some of the companies interviewed offer this method of financing such as Pentalabbs, Make It and Rocket Internet. According to Nizar Dahmane, these companies are trying to "build the most relevant solutions for a start-up", in addition "start-ups and large groups often have difficulty aligning their interests. "Services for Equity offers "a new way of collaboration".

In the case of Media for Equity, this method has been better known and used for more than thirty years. The German television channel group ProSiebenSat1 is a pioneer in Media for Equity<sup>1</sup>. *Media for Equity is therefore a sub-category of Services for Equity where media groups provide promising B2C start-ups with advertising space to boost their notoriety. In exchange, they obtain capital shares from the startup. This sub-category therefore allows start-ups to massively distribute their content and the media to have a foothold in the entrepreneurial world.*<sup>2</sup>

The lack of documentation on Services for Equity can be explained by the fact that it is a rather recent model: most of the interlocutors told us that while "Media for equity" (where you exchange a product rather than a service and it is not a lasting relationship) is a model that has been used

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<sup>1</sup> VILAGINE Yves, Diakse cède des parts contre des services à La Poste, Les Echos Executives, 24 avril 2019, [Shttps://business.lesechos.fr/entrepreneurs/financer-sa-creation/0601092598326-diakse-cede-des-parts-contre-des-services-a-la-poste-328795.php#Xtor=AD-6000](https://business.lesechos.fr/entrepreneurs/financer-sa-creation/0601092598326-diakse-cede-des-parts-contre-des-services-a-la-poste-328795.php#Xtor=AD-6000), dernier accès le 5 mai 2019

<sup>2</sup> BOOGAR Liam, Media for Equity fund 5M Ventures launches with investments in YouBoox & JobAroundMe, 3 juillet 2013, <https://www.rudebaguette.com/2013/07/5mventures/?lang=en>, dernier accès le 5 mai 2019

quite often for decades, "IT for equity" and more generally Services for Equity are methods that are only beginning to be taken into consideration by start-ups and service companies in recent years.

In one of the most famous stories, is the one of graffiti artist David Choe, who Facebook called upon to revitalize its offices in the early 2000s. At first, the artist charged \$60,000 to paint the entire office, but he was asking the company more and more for the work required. Subsequently, the president of the young start-up Facebook offered him shares in the company rather than being paid in cash. For Choe, this was a risky decision since Facebook had not yet proven its worth. Finally, he agreed to paint the premises in Equity. As a result of the races, his actions today are worth hundreds of millions of Euros<sup>3</sup>.

## Legal aspect

We interviewed Mr. D'Août to get a legal opinion on the subject. Mr. D'Août works at Defenso, the lawyers' association, SNC D'Aout-Deumer & van Durme avocats. He is a lawyer at the Bars of Liège and Charleroi, a lecturer at ULiège, co-director of the UCLouvain Special Licence in Tax Law, a member of the ULiège Tax Institute and an OBFG accredited specialist in tax law and company law.

Olivier D'août believes that the Services for Equity is above all a human adventure that it is a kind of marriage contract and that it is imperative to put everything on paper. In this type of financing method, different profiles exist. Mr. D'Août stated that each of the parties will have to be careful in terms of power relations, tools and statutes. All these points will have to be organized in the shareholders' agreement in which it will be necessary to consider the exits with a delay to avoid problems.

One of the current advantages is that the Belgian system was outdated and that the new code that was voted on 27 February 2019 will make it more flexible to participate in all these power relations, which will become more flexible for voting and profit distribution, which will make it easier for the Equity shareholder. The old code was more complicated in terms of relations between shareholders and will allow for clearer remuneration between them as well as the level of profit distribution. Conversely, the new code will, among other things, make it easier to weight the equivalent between certain shares and the voting rights associated with them - an investor

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<sup>3</sup> MARTIN Emilie, 7 septembre 2017, How this graffiti artist made \$200 million overnight, <https://www.cnbc.com/2017/09/07/how-facebook-graffiti-artist-david-choe-earned-200-million.html?fbclid=IwAR0U79bGIERLOxV28HE514KIIJDGP8BEuIPikeQ0SEgqc7Yk9XvuqaBguBI>

Services for Equity could therefore more easily be granted a significant number of shares (which will entitle him to dividends if the company ever makes a profit) and yet will limit his weight at the General Meeting, given the ephemeral nature of the relationship.

Bernard Tilkens, an expert in start-up financing, was kind enough to inform us about this new reform, which came into force on May 1<sup>st</sup>. This new reform aims to radically reform Belgian company law in order to make it more modern, adapted and efficient, and to convert Belgium into an attractive and competitive place for companies. The new reform will have an impact on the capital in the SRL since the contributions will have to be fully subscribed and the contributions fully paid up unless there is a clause to the contrary.

As far as contributions in kind are concerned, the current rule on the control of the contribution is maintained. Finally, for industrial contributions, an authorization in principle and a sub-category of in-kind contributions will be required.

We can therefore say that this new reform will tend to influence the Services for Equity financing method, since it will aim at a clearer and fairer distribution of profits and remuneration.

## Practical aspect

For this practical part, we used companies familiar with the Services for Equity. To do so, we contacted Pentalabbs, which is a platform of Pentalog, which offers Services for Equity; Like a Bird, which is a company that has used Pentalabbs; Make It, which has offered Services for Equity, La Poste, which has been offering this financing method since August 2018; and a Belgian start-up that has used it, but wishes to remain anonymous.

It seemed important to us to introduce each company in order to set the context in relation to the practical aspect of their personal experiences.

## Pentalabbs

Eric Gouin is the CEO of Pentalabbs, which is therefore a start-up accelerator. This platform offers contributions in digital marketing and technology based on a team of 800 people.

So far, they have offered Services for Equity to 24 companies, raised €40 million by their start-ups, and have €10 million available for investment. To do so, they are composed of a team specialized in mobile application technologies, algorithms, research and development, social media strategies, web marketing or direct marketing. Pentalabbs is present all over the world.

The company's headquarters are based in Orleans and they have offices in Paris, Romania (in four cities), Moldova, Vietnam, Germany, the United States, Mexico and Uruguay. The Group is composed of several layers of services for start-ups, software publishers and SME in digital transformation. These layers are technological and digital layers with manufacturing and marketing strategies.

Pentalabbs allows you to quickly build and get first results by coding an application, a website, creating connected objects and productions with cloud management for customers. The group is comprised of 1,000 people. The Services for Equity investment part was born in 1993 and they have been investing in start-ups for seven years now. They produce about 200 products per year.

The group is independent and does not have any investment funds. Part of the management is involved. Approximately 90% of the group's capital is held by members of the group. Since they started offering Services for Equity, they have observed that the product sold generates goodwill for start-ups, i.e. that the services generate more value than their initial price. They therefore have two roles: that of service provider and that of strategic partner.

Éric Gouin sees a lot of positive points for both the service provider and the recipient. He did not mention any negative points at all. It would have been beneficial for us to have an objective opinion on the companies with which the relationship went well and with which it did not go well. He essentially told us about his company and the services they provide.

## Make It

Guy-Louis de le Vingne is the CEO of Make It, a company that is a start-up studio that creates start-ups. Some time ago, they offered equity services. They did it in two different ways, but Guy-Louis de le Vingne told us that they will not do it again. So, they brought work rather than capital and cash. Creating the first object, the first application may seem attractive to a start-up with few financial resources. The company provides knowledge and technical development as well as hours at the strategic level. The positive point for Make It is to have shares in the company.

The main problem for both parties was that the outline was not properly defined and that Make It had to constantly justify the shares they had received to the other shareholders when they had not received them but had won them and worked for them. This problem is certainly since the shareholder agreement was not strong and explicit enough.

It is very complicated at the beginning of an entrepreneurial adventure to define concretely what the contours of the services will be. It is difficult to be precise since a start-up pivots and quickly

changes priorities. Service providers invest a lot of time and effort. Even after four or five years, some service provider companies must continue to justify their shares and work at a reduced price, which is not an attractive situation for these companies and start-ups. In addition, the start-up is attached to the service provider and has difficulties taking off since the company offers an unbeatable deal and the services provided would cost a startup more to have their own team to develop what the supplier offers. In the short term, this method is a good way to get started, but at some point, they have to become independent and create your own team. The problem is that start-ups tend to try to do this as late as possible, which leads to companies that are developing but do not have their own team.

Finally, Services for Equity generates many related perverse effects.

till concerning Make It, a client introduced himself in the company by offering to pay for his service in the form of Equity. For Make It, paying 100% Equity would have been impossible since they had to limit their risk. They therefore chose to have the customer pay 50% cash and 50% services to pay their costs, although this is limited. Unfortunately, this equity experience has, once again, been negative for the company since the services provided have never generated any income. They have had to adapt each time, however, when the problems add up it becomes a problem.

On the contractor's side, the contractor expects a high level of service knowing that the service provider is a partner and shareholder.

Another problem with service providers is that some investors in the start-up question the fact that Make It is in the shareholder base thinking that the services are worth less than a cash contribution. Nevertheless, Make It did the calculation with the number of hours worked for the services and compared it to a cash contribution. They concluded that the amounts and percentages are quite similar or higher when it comes to service contributions compared to cash contributions.

Make It compares the Services for Equity to a Business Angel who would have put money into it as the start-up develops and who generates income at the end of the year. They concluded that for them, when they monetize, it is almost the same thing, but Equity creates a lot of uncertainty and friction between the two parties.

M<sup>r</sup> de le Vingne therefore advised to value above all the shares based on the fundraising that has taken place or will take place since it is difficult to value a service in advance.

Make It had two bad experiences with the Services for Equity method, but also because they do not believe that this method is beneficial for their business. Nevertheless, the company has only experienced two equity situations.

### La Poste Française

We interviewed Nizar Dahmane, General Manager of La Poste Services for Equity. For him, Services for Equity is a new service. He says that there has been Media for Equity and IT for Equity for some years now, but that the Service for Equity was not really used before. La Poste offers as services advice by mobilizing the most relevant experts for start-ups, services through access to previously inaccessible offers, equity through the optimization of start-ups' time and cash flow, and partnership through the creation of new business opportunities.

They provide support to start-ups by advising them on, for example, how to generate customers or make their roadmap evolve. La Poste has decided to launch itself into equity thanks to the team of trained experts and their network. They saw great advantages in embarking on this type of financing.

Swiss Post's Services for Equity was launched in August 2018. However, Mr. Dahmane says that the return on investment is more attractive in Services for Equity than a conventional investment. To date, Swiss Post's Services for Equity has about ten ongoing transactions that have already generated revenue almost immediately after the provision of services. It ensures that it is a safer model for the investor since it runs less risk than investing cash.

Since La Poste's Services for Equity is still young, the team has not yet had a bad experience. The manager simply warns that it is necessary to correctly choose the partners to whom a start-up opens its capital.

### Like a Bird

Pierrick Filippi is the founder and manager of Like a Bird and Like a Bot, which are respectively companies that offer tools to manage marketing campaigns on social networks and a chatbot tool.

The company will celebrate its seventh anniversary and was started with its own funds. They obtained support from the City of Lyon such as support for business start-ups and support for innovative companies.

In a new round of financing, Pentalabbs intervened, not through a loan, but through a capital increase. Pentalabbs acquired a stake in the company by acquiring 20% of the shares. Following the capital increase, they were able to seek new assistance from the BPI, which helped them, but

this time through borrowing. Currently, they are in a new phase of fundraising oriented towards the industrial sector with the acquisition of a majority industrial stake.

As for the relationship between Pentalabbs and Like a Bird, they are always in contact with Eric Gouin with whom they exchange at least once every three months, where it is a two-hour exchange on the communication of the company's data. They no longer have any operational relations with Pentalabbs. Whereas at the beginning, they were clients of Pentalabbs' services through the Equity mechanism. At first, Pentalabbs played a role of advising, accompanying and providing opportunities to Like a Bird by opening doors to acquaintances and customers, currently Pentalabbs only plays an advisory role.

If they had to do it again, they would use this kind of method again since for them, Equity was a lever for acceleration. On a traditional fundraiser, they would have obtained the funds raised, and should have used those funds to recruit and they knew that recruiting is a time-consuming process, especially when it comes to technical profiles. Equity has saved them a lot of time.

Like a Bird found direct interest as the team was set up directly at Pentalabbs and was available after two weeks or a month after the fundraising, which removed a barrier to fundraising and recruitment.

### **Anonymous Start-up**

For this practical part, we wanted to gain a negative experience of the financing method. A founder of a start-up company gave us an interview. It is a Belgian start-up created two years ago. The two founders called on Services for Equity for IT needs to develop a first version of the application. They saw Equity as a quick way with a good deal in terms of cost and action for their project.

For them, the advantage was to benefit from a less expensive method in terms of money and an interesting way since the method had to involve the company in the project. Unfortunately, the company, which provided the project, pushed it to the side.

At the beginning of the relationship, everything was going well. Nevertheless, since their project was less remunerative than another project that could have directly brought back 100% of the price in cash, the quality of services decreased, the deadlines for the execution of the work were extended, the bugs were not solved, and the communication became bad.

In the life of the IT-based start-up, the important elements of the company have lost their agility. The delay in services has not allowed them to adapt to the needs and demands of their market and they have wasted time in this relationship.

If they had to do it again, they would not use the model again since the company took shares in the start-up for services that had to be completely redone. He would have preferred to raise more funds to pay for the services they needed.

## Pros and cons

### For companies using the method

As mentioned in the initial methodology, the aim of this work was to know the limits of this method as well as its advantages and disadvantages according to the experience of some start-ups, as well as the way in which this method of financing can help to build a company. This work will thus help new entrepreneurs to find a financing solution when they may not have the financial means to start their business.

Positive	Negative
<p>Faster growth</p> <p>Advice from an additional shareholder who is an expert in his field</p> <p>(Ideally) Committed partner</p> <p>Rapid increase in turnover</p>	<p>Investor without cash inflow</p> <p>Dependency on the company</p>

As we have seen in the various testimonies, one of the significant advantages of the method is the speed of action for a start-up. When raising funds, a start-up will tend to take much longer to recruit technical profiles to form its team. Whereas, when a start-up uses *Services for Equity*, upon agreement with the company providing the service, teams are quickly trained and deadlines are, in principle, shorter. This method of operation will allow the start-up to grow more quickly and will enable it to achieve, in principle, its objectives.

Since the service provider also becomes a partner, it is in his interest, in theory, to provide a service that makes it possible to generate revenue more quickly. The start-up therefore should be taking less risk than using a company that it would pay in cash.

Nevertheless, as seen in practice, a company providing the service may tend to put other projects ahead of the one in which it owns shares.

In addition, *Services for Equity* will tend to create a certain dependence of the start-up on the team providing the services. Since services are provided at lower costs for the start-up, it will tend to delay the formation of its own team.

One of the major problems of this relationship is that it is difficult to assess the value that the services will have on the life of the start-up. It is complicated to know whether the delivery will be effective or efficient (effectiveness and price).

**For companies providing the service**

The objective of this part of the work will be to answer the following question: "Is *Services for Equity* a 'payment' method that can be beneficial in the long term for a company that agrees to be paid by shares rather than money? ».

Positive	Negative
<p>Faster return</p> <p>Less risk than a cash contribution</p>	<p>Lack of security</p> <p>Mistrust of other shareholders</p> <p>Difficulty of assessing the profitability of the operation</p> <p>Need for sufficient financial resources to finance the services</p>

A significant advantage for companies providing the service is that these services will allow start-ups to grow much faster than if they were granted money by a Business Angel (this money will have to be invested first, recruitment takes time, etc.). In most cases, a *Services for Equity* investment makes it possible to make a start-up more quickly profitable than a traditional Venture investment. As a result, a company that holds shares will be granted a financial return more quickly from a start-up that has become profitable thanks to its services rather than the contribution of a traditional Business Angel.

However, compared to a traditional service sale, the company will not receive cash directly.

On the one hand, this investment in kind carries less risk than an investment in cash, although the supplier is likely to lose the service contribution he has made and the financing of his teams and his cost structure to produce the service. However, like any investment, there is no real security for the success of the start-up.

*Make It* had made a quick calculation to determine whether the contribution in kind was more beneficial than a cash contribution and concluded that the contribution in kind was bigger than the cash contribution for an equal return.

The value of services therefore has every interest in being properly valued over the long term in relation to the value of the company using them.

Another disadvantage is the relationship that the supplier will have with other shareholders. An investor injecting cash will end up with one or more shareholders who have not taken out any cash and have, nevertheless, a certain number of percent. The shareholder service provider will often have to justify his shares.

## Recommendations of the experts

- *The Services for Equity* relationship has often been compared to a marriage. It is therefore necessary to choose your partner wisely since the investor is also a supplier. It is necessary to get along well and lay the groundwork from the beginning of the relationship. The person using the *Services for Equity* is advised to handle his supplier well and to be attentive to the quality of the work delivered.
- Most of stakeholders advise not to have blind trust and to compare costs in shares and money.
- On both sides, it is beneficial to *benchmark* the market in order to understand whether the relationship is beneficial - and, if so, when.
- Olivier De Wasseige even advises to have the quality and value of the services validated by a third party; this third party could even arbitrate the relationship.
- Like any relationship, it is important to lock it in a framework so that, if it does not go well, both sides can exit it without too many problems. A specification is obviously necessary to ensure that the services offered are properly monitored, although this should not be too strict if the company is a young start-up. It has been proven that start-ups tend to pivot. If the specifications prove to be too strict, the product or services delivered may not correspond to market demand.
- Companies that already have experience in *equity* advise setting a minimum and maximum number of hours of service.
- The shareholders' agreement must foresee a way out of the relationship if it deteriorates.

- In addition, it would certainly be wise to inform other shareholders who have made a cash contribution about the nature of the relationships and the contribution of the shareholders who provide a service.
- Some of the interviewed companies prefer semi-equity. They claimed that this solution entails less risk for the company providing the service and, at the same time, provides several services to the company using it. Offering money will tend to boost benefits.
- As a start-up, when looking for partners for a *Services for Equity* model, prefer companies with experience with this model.

## Conclusion

In conclusion, the *Services for Equity* financing method will tend to attract young companies and entrepreneurs with little initial funding. It is an opportunity to accelerate the start of a start-up's life. This method of financing also allows the company providing the service to incur less risk than if it were to invest cash in the start-up; although time, team funding and the cost structure for creating the service are not to be disregarded. In the case that everything goes well, the company providing the service will tend to generate returns more quickly than if it had invested money.

It is also important to value the services at the beginning of the relationship since they can be compared to a contribution from a Business Angel who would have put money as the start-up develops and generates income at the end of the year.

In any case, both parties should be vigilant from the beginning of the *Services for Equity* relationship. The foundations will have to be laid to ensure the proper functioning and understanding of both parties so that this relationship is beneficial to both businesses. Due to the interventions, the conclusion that *Equity* creates a lot of uncertainty and friction between the two parties is obvious.

As Guy-Louis de le Vingne pointed out, a contribution in service can be compared to a Business Angel, the only difference being that the counterpart, which allows the start-up to grow, is not money, but services. This is often where conflicts arise: a relationship that is, by definition, ephemeral and especially important at the beginning, through the very principle of the model intended to last until the shares are resold or the company is liquidated. Hence the importance, according to Olivier de Wasseige, of a clear roadmap with clearly identifiable deliverables that will define when the role of the service company ends. These specifications will make it possible to predict where possible conflicts could arise.

*The Services for Equity* method therefore remains an interesting model but requires a lot of pondering and a powerful legal convention to avoid future conflicts. For start-ups that have, on the other hand, enough financial resources not to let partners enter their shareholding, who will remain ephemeral by their role, should rather move towards more traditional, stable and long-term forms of partnership.

## Find out more

### Media for Equity

BOOGAR Liam, *Media for Equity fund 5M Ventures launches with investments in YouBoox & JobAroundMe*, 3<sup>rd</sup> July 2013, <https://www.rudebague.com/2013/07/5mventures/?lang=en>, last accessed on 5<sup>th</sup> May 2019.

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