Comprehensive and Practical Equity / ESOP / ESS Guide For Founders

Alexey Mitko has structured ESOPs for Australian, US, and Philippines markets for several startups.

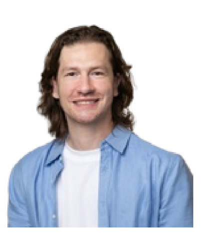
Many learnings came into sharper focus during the building of Eucalyptus, and this guide shares those lessons.

Note: this guide was written in 2022, please check for updated tax rules, as these can and do change.

The principles, however, remain consistent, and after reading this guide founders should be in a position to ask the right questions of their lawyers and accountants.

Core Guide — Contents

A special effort was made to keep each section to 1 page where possible.
For further discussion or suggestions, Alexey can be reached on LinkedIn - linkedin.com/in/alexeymitko/



How to Think About the Purpose of an Equity Plan

Why does a company need an equity plan?

There is an endless list of subjective reasons, often stated as assumed truths, e.g., "To retain talent". But it is not always clear how exactly an ESOP achieves that. This guide adopts a different approach: tracing purported outcomes to specific mechanics of the plan. An equity plan only supplements other business initiatives. There are four distinct purposes a plan can help with:

Cash Saving

Employees may accept a lower salary because their pay is supplemented by an equity component.

Practically, not all employees needed can be acquired this way, nor will they remain happy to be underpaid for a prolonged period of time.

Effective Recruitment

An equity grant can supplement recruitment operations, sometimes because major competitors provide equity, in other cases to illustrate potential financial upside, or to provide a fairly certain cash payout at a predetermined point in time.

Unity Building

Aims to bring the idea of "we are all owners and in this together" into a practical context.

Equity is not the only mechanism that brings this idea to life, but it can play a major role.

Employee Retention

Equity programs can create points at which economic incentives to remain at the employer are significant, most vividly in a company that has undergone significant appreciation or has planned for a specific exit event like an IPO.

What goal is the company trying to achieve?

Equity plans are flexible. While there is a conventional way to implement an equity plan, the rules of a specific plan can be modified to focus on what matters most. The purposes above are not necessarily in conflict, but they can be.

For example, plans that aim to lock employees economically into their seats generally mean that leavers lose out - which may affect recruitment and unity building.

The most important point: ESOPs are tools that allow companies to enhance financial, recruitment, team building, and retention initiatives. ESOPs do not work in isolation. Companies should consider what is truly needed now and what is likely to be needed in the future.

Key Ways Equity Plans Can Be Structured

This guide aims to be readable for all levels, starting with the basics. Equity is usually granted by issuing one of three instruments:

1. **Shares —** A piece of the company.
2. **Options —** An agreement to buy a piece of the company in the future at a price determined now, also known as a strike price.
3. **Restricted Stock Units (RSU) —** Not equity per se, but a derivative agreement for cash compensation that varies depending on the share price.

That's it, everything else is a remix of these core structures for tax, legal, or plan-purpose reasons. Once the structure is decided, the common additional ingredients are:

Grant Mechanics

Companies could simply give employees shares, options or RSUs, but in many cases local tax or corporate securities laws create complications without careful structuring. This set of provisions tailors the plan to eliminate those issues or take advantage of available tax concessions.

A generalised example is loan-funded share schemes, where the company grants employees loans to purchase shares. Meaning employees own the shares earlier and can take advantage of local tax rules.

Vesting

The idea that an employee comes into possession of their equity after completing a particular hurdle. Vesting hurdles can be anything imaginable, with time-based vesting being most common.

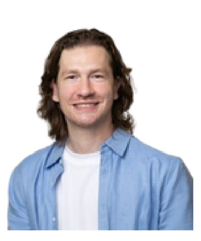
The standard schedule is 4 years with a 1-year cliff (25% vests at the first employment anniversary; the remainder vests monthly over the next 3 years). Backloaded schedules (e.g., 50% in the last year) are also possible.

Limitations

What employees cannot do with their grant. Most plans prevent employees from selling equity unless as part of an exit event or defined sales process. Some plans distinguish between "good leaver" and "bad leaver" (e.g., moving to a direct competitor).

Other plans also remove employee voting rights, assigning them to founders, useful for simplifying administration or for founder control purposes.

These and many other provisions allow the plan to be tailored to whatever purpose is most important.



Characteristics of Well-Structured Equity Plans

Good equity plans are the ones that carry no surprises.

Any surprises mean costs for the company, disgruntled employees, and headaches for founders. Key things to look out for:

1. No upfront payments required from employees

Good plans do not require employees to expend cash at the point of grant to acquire the grant or cover tax obligations. Unless, of course, equity is traded and liquid.

The structure of the plan selected dictates the exact mechanism, but this is a foundational requirement.

2. The plan considers applicable tax legislation(s)

Among the nastiest tax implications is the upfront requirement to pay tax while still employed, this destroys whatever purpose the equity plan was designed to serve. Just as painful is when tax must be paid without a corresponding ability to sell the equity.

Finally, many countries offer concessional treatment of capital gains (for assets held longer than a predetermined period), so a plan structured poorly can cause inefficient taxation.

3. Clarity around the mechanics of employee departure

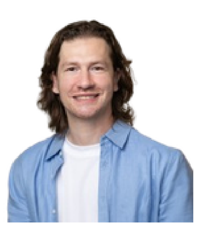
In some scenarios, employees keep whatever is vested; in others, good/bad leaver provisions apply; in yet others, the employee must take proactive action such as exercising options.

The range of outcomes depends on the plan's written terms, but operating provisions around departure are often buried in layers of legalese. The view held here is that these need to be clearly surfaced, though plans are sometimes structured deliberately to obscure them.

4. Simple to administer

In practice, simplicity is largely dictated by the tax and legal environment of the country where the plan is rolled out. Within each jurisdiction, the most common structure tends to be the simplest possible.

Once a company establishes international presence, the same plan structure cannot work across multiple jurisdictions. Either tailoring to each country or establishing a parallel equity plan is needed, with the simpler approach depending on the countries involved.



How Much Equity Should a Company Give and When?

This question is perhaps the most subtle, and the answer is very subjective.
There are five ways to think about it:

1. Give it to nobody

A valid option. Cash compensation is sufficient to attract needed employees; any equity dilution saved can be leveraged more effectively in subsequent fundraising rounds.

Arguments about attracting a different character of person, or that price does not equal performance, or that retention will suffer are mostly subjective. Each company must decide for itself.

2. Give it to senior managers only

More common in Australia even outside startups. Equity is used only to secure key senior positions, with junior employees acquired via cash compensation alone.

Can equity create a two-tier society? Not by itself, it can be a contributing factor, but only if already present in the culture.

3. Wealthfront equity plan model - Link

Does not specify how much to give individual employees, but creates a systematic approach to the timing of grants within an employee's lifecycle and vesting schedule. Well worth 15 minutes of research.

4. Give to everyone via Founder Link

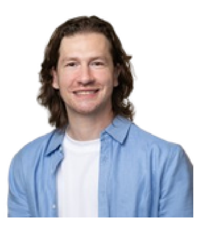
Designed and implemented at Eucalyptus. The startup goes through fundraising rounds with a typical equity pool of 10–15% of total equity. Setting expectations around dilution and number of employees (executive, senior, mid, junior) across the fundraising journey gives a clear picture of how the pool will be used over time.

A worked example is provided at the end of this guide.

5. Sprinkle to everyone

Similar to Founder Link in aiming to give equity to everyone, but less focused on individual economic outcomes and more on common ownership. Founder Link eventually transitions to mostly cash compensation once the business matures; this approach maintains equity issuance to all employees.

Useful for crafting a message, but can become less meaningful as equity allocations become minor and the pool stretches thin.



Ways Not to Present Equity Offers

Presentation to employees is important. It sets expectations for the ongoing relationship. The following approaches are commonly used but are not ideal:

"You will be getting X% of the company"

The easiest way to revert to, especially after founder discussions that used percentage splits. It does not translate to the employee context for several reasons:

1. It puts no economic context on the discussion. 10% of a small business is less than 0.1% of a multibillion-dollar business. Comparing startups on a % basis is meaningless (but that won't prevent employees from trying).

2. People have mental pegs on what is large or small without understanding how startups operate: "0.5% is a tiny number, I'm worth at least 20%!"

3. In many cases, especially where a strike price on options exists, potential % ownership is not correlated to economic output.

"$ worth of options" or "$ worth of shares"

In effect: multiplying the number of options by the strike price, or taking the last investment round price per preference share and multiplying by the number of shares granted. The problem:

It's a mental fallacy. Options multiplied by the strike price gives the amount employees have to pay to acquire the options, not what they receive. In the share example, the price is for a preference share; employees think they are receiving that value, but in fact they are receiving a window into future company appreciation.

This approach has more merit for public, liquid, slowly-growing equity, but not at early stages.

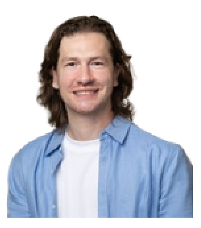
"X% of your salary converted into equity"

A percentage of salary is converted into equity, using calculations similar to the above. Problems arise when salary is adjusted upward: as starting offers rise as the startup progresses, the amount of equity given increases over time. Counterintuitive to what would be expected.

Across all of these examples, there is a desire to link the equity offer to a dollar outcome. This is natural since it helps recruitment, but the link is often made poorly.

These approaches miss the point that future exit scenarios dictate the ultimate value received. Even when a dollar value is stated, it tends to be subjective, notional, anticipated, and illiquid.

Depending on how the offer is phrased and how expectations are set, these approaches can also enter the realm of financial advice, falling under ASIC-enforced regulation.



Best Way to Present Equity Offers

The best way to present equity offers is by way of a table of economic outcomes (see below), closely linked to the Founder Link equity grant structure.
See the worked example at the end of this guide for a complete picture of how these two work together.

What makes this presentation approach appealing?

1 The highest salary option is closely matched to market rate; the lowest is set at a significant discount.
Not all employees will be able to choose the equity-heavy option (some have school fees to pay), but a proportion will. Reducing salary costs and cash burn at earlier stages.

2 Exit scenarios are calculated across a range of outcomes, including $0 and a billion-dollar exit. Employees pick their own level of equity exposure. The company is not stating what outcome will happen or what equity is worth, simply providing a tool to understand the simplified mechanics of their grant.

3 The fact that employees must make a choice is important.
If they did not choose the higher-equity option, the framing shifts from "not enough equity was given" to "how can I perform better to get more equity?"

4 Presenting a market-aligned table resets the negotiation field. The usual tactic of asking for more than whatever is offered does not work well here.
Requesting more comes with a clear salary vs. equity trade-off attached.

5 Introducing the concept of dilution (which does affect equity payout economics) is important, allowing employees unfamiliar with it to understand it at this stage.

6 The fully diluted share count is public via ASIC, so providing it upfront simplifies the discussion.

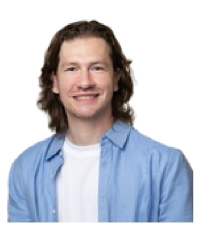
Employees can figure out their % ownership, but from a point of understanding economic outcomes, not just comparing percentages in isolation.

Sample Economic Outcomes Table

Salary (ex super)	Number of Options	Possible Exit: $0	$30M Exit	$90M Exit	$1B Exit
$80,000	100	$0	$30,000	$90,000	$1,000,000
$100,000	50	$0	$15,000	$45,000	$500,000
$120,000	20	$0	$6,000	$18,000	$200,000
Additional Information					
Total Equity Pool: 100,000 | % to Employees: 15%			Strike Price: $0.01 | Last Round: 10M pre Expected Dilution: 10–20% per round		

Now if they are comparing two offers they won't compare it solely based on a percentage basis and will need all the information above from other company to make a choice.

Since you are much better prepared for this discussion you will come across as a more open and put together startup.



Best Way to Present Equity Offers — Sample Job Offer Email

The following illustrates how all of these elements link together in practice. From an equity-first job offer framing:

Sample Job Offer Email

Subject: Offer of Employment — Junior Developer

Hi Robert,

I’m very excited to offer you the position of a Junior Developer!

<Tech Lead> mentioned that you aced your pairing programming session and we are all excited about the experiences you bring to the team!

The way offers are structured at Global Corp is a bit different, kind of a “choose your own adventure” approach to equity exposure. The options are summarised in the table below:

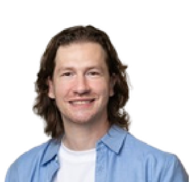
[Economic Outcomes Table — as per page 7]

The level of experience with equity instruments varies greatly, so the Finance Lead (cc'd) is available to answer any questions you have or, iff needed, book a longer session to explain how options work.

Steps from here:

1) Let us know your preference from the table above
2) HR prepares your employment contract for signature
3) We send your equity choice is sent to the board for approval (each grant needs to be approved individually, but we batch them into a monthly process)
4) Your Equity documents (offer letter + plan rules) will be ready on your first day!

I’ll give you a call tomorrow around X to have a chat about the offer, please let me know if this works?



Current Australian Tax Rules Around Equity Plans

As of January 2020, the Australian Tax Office (ATO) has extensive information here dedicated to the Employee Share Scheme (ESS) regime.
The key subdivision of interest is the ESS Startup Concessions, which came into effect in 2015 - here

ESS Startup Concessions — Conditions

If structured correctly, these concessions allow the taxation point to coincide with the eventual sale of equity, providing the capital needed for employees to pay their taxes.

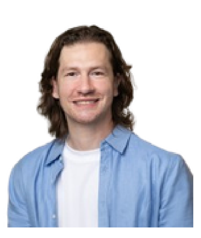
Conditions (verbatim from the ATO):

- The ESS interests you provide are in a start-up company
- Your company (which may not be the company issuing the ESS interests) must be an Australian resident taxpayer
- For an ESS interest that is a share - the discount must be no more than 15% of its market value when you provide it
- For an ESS interest that is a right - the amount that must be paid to exercise the right must be greater than or equal to the market value of an ordinary share in the company when you provide the ESS interest
- The scheme is operated so that employees must hold the ESS interests (or any share acquired as a result of exercising the interest) for a minimum of either three years or your employee ceases employment

What is a "Start-up Company"?

- The company that grants the ESS interests (Options in this case) must have had an aggregated turnover of less than $50 million in the income year prior to the year the interests are granted.
- The company (and its corporate group) must not have any interests listed on an approved stock exchange in the income year prior to the ESS interest being offered.
- The company (and its connected entities) must have been incorporated for less than 10 years.
- The employing company (which can be a subsidiary of the company granting the ESS interests are being offered) must be an Australian resident taxpayer.

Note: The Safe Harbour valuation methodology (covered on the next page) defines how market value is set for unlisted securities.



Current AU Tax Rules — Safe Harbour Valuation

Safe Harbour Valuation Methodology - Link

Taxation depends on the "market value" set as part of equity offers. Set too low: upfront tax on a grant becomes a risk. Set too high: employees miss out on potential value.

For unlisted securities, the ATO provides frameworks for determining an acceptable "market value." One allowed method is the net asset test. In summary, this allows companies to take net assets, less rights of preference shares, and divide by the number of common shares outstanding.

In practice, if a startup has raised capital but not yet turned a profit, the value per common share will be negative, or effectively $0.01.

This is very beneficial for early-stage startups, but companies must watch when they are too large to use the framework. At that point a professional valuation is required to continue issuing grants.

Compliance Layers to Track

Just to illustrate the layering of different tests, all four of the following must be tracked simultaneously:

1. ESS Startup Concession eligibility criteria (provided above)
2. Definition of a startup company (provided above)
3. Safe Harbour valuation methodology eligibility criteria - Link
4. If using the net asset test: definition of a small business entity - Link

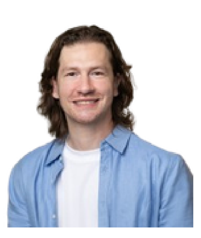
The key triggers to watch: turnover size, years since incorporation, and capital raised. All can make a company ineligible for parts of the regime.

What does all of this mean in practice?

Early-stage startups typically follow a very standard structure when issuing equity to employees. The ATO provides a standard set of equity plan documents for use - here

These are acceptable as-is, but are often tailored to allow for good/bad leaver provisions and other requirements.

Also note: under Corporations Act Section 113, proprietary companies in Australia are limited to 50 shareholders. Option plans are therefore most common at early stages, as they allow equity to be issued without triggering listing requirements based on the shareholder limit.



ATO & State Reporting Requirements for Equity Plans

ATO Reporting Requirements

Overview

What to report and the format of reporting is covered in the Annual ESS Reporting Guide (link to ATO Guide).

The purpose: companies tell the ATO when equity is granted to employees, so that when employees eventually sell, the ATO has a record of all the people to whom equity was granted and who are now liable to pay tax. A copy of the report lodged must also be provided to each employee; the guide specifies lodgement deadlines.

Practical Steps — Ways to lodge with ATO:

Via ATO Business Portal — the company or its accountant should have access.
Via specialised reporting software — for more than 50 employees. Most larger accounting firms can provide this service, often through ADP (a payroll outsourcing company).

Ways to provide ESS information to employees:

Download the form on the ATO portal — add entries manually, or transfer to Word and use Mail Merge for larger volumes.
If lodging for 10 employees manually, the process takes approximately 1–2 hours due to the manual nature of the ATO portal form. For larger numbers, it is worthwhile asking an accountant to assist.

State Reporting Requirements

In Australia, some states require the value of equity grants to be included in the payroll tax calculation.

How "value" is calculated varies across states and is outside the scope of this guide. The key point: companies must check both federal and state reporting obligations.

ASIC Reporting Requirements

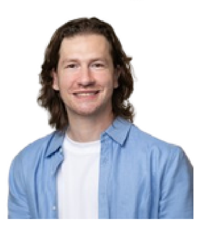
Any fundraising (and equity issuance to employees is viewed as such) in Australia requires a disclosure document unless an exemption applies. List of exemptions is here
The typical sequence of exemptions applied is:

Sophisticated Investor (Link): Amount invested >$500,000, or a qualified accountant provides a sophisticated investor certificate based on assets or income.

Senior Employee Rule (Link) : Senior employee defined as someone with the capacity to significantly affect the organisation's financial standing.

20/12/2 Rule (Link): Rolling 12-month exemption counting number of grants and amount raised as key thresholds. Note: this is combined with non-sophisticated angel offers in the fundraising journey (19 angel investors leaves little room for grants).

Also of note is the fact that offers to overseas people don't count into the amounts, but you may have foreign regulations to abide by (we'll cover this concept in another section later)



ASIC Reporting Requirements — Offer Information Statement (OIS)

Once exemptions are exhausted, companies must prepare an Offer Information Statement (OIS). Offers to overseas persons do not count toward domestic thresholds, but foreign regulations may still apply.

What is an Offer Information Statement (OIS)?

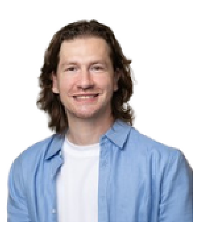
The OIS is a short-form prospectus with a scripted set of information requirements. Unlike a full prospectus that must cover virtually everything. A full description is in ASIC's Regulatory Guide 254.

Key requirements:
• Audited financial statements with 6-month balance date freshness at the time of lodgement with ASIC
• For a 30 June year-end company, this means lodging by 31 December. Missing this window prevents issuing grants for at least 7 months
• The OIS is valid for 13 months, but in practice is refreshed annually due to the peculiar lodgement timing
• Fundraising limit of $10 million. Fundraising outside of ESOP can affect thresholds
• Cost to prepare: approximately $10,000–$15,000 via a corporate securities lawyer (Prices may have changed)

October 2022 Changes

From 1st Oct 2022, changes to Corporations Act 2001 take effect relaxing requirements on disclosures for $0 strike price grants. More details on this can be found here.

Numerous legal articles discussing these changes are also available online.



Key Principles of Granting Equity in Other Countries

Australia has two governing bodies that regulate how equity is issued: the ATO (tax) and ASIC (corporate securities law). This structure is replicated in other countries — IRS and SEC in the US, FCA and HMRC in the UK, etc.

P1

Understand the relevant authorities

Identify the tax authority and corporate securities authority in each country where equity will be issued, and understand their specific requirements in relation to equity grants.

P2

Corporate securities laws also apply

In practice, it means you are looking for plan lodgement requirements, disclosure document requirements or information that needs to be provided to public or employees about the equity on offer.

As for tax, we have seen previously in AU the two primary concerns ATO has are when employees are taxed and that you let it know about the fact that you have provided grants to employees. This is pretty much the things you are looking for in other jurisdiction, while being mindful of state/federal distinction.

P3

Understand the taxation approach and notification requirements

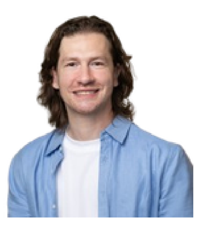
A useful way to think about how taxation works is by way of possible tax points for each instrument as per the table at the end of this section.

What approach is taken by each individual tax authority is anyone's guess, but hopefully, this can serve as a useful map as you go about interrogating local accountants.

P4

Budget for local lawyers and accountants

Implementing equity plans in an international context is not simple or common. Very few accounting or law firms have exposure to multinational equity plan contexts, so local advice is needed alongside combining or rolling out a parallel equity plan.

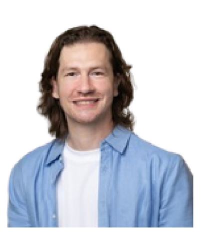


Equity Instrument Comparison

A useful way to understand how taxation works is via the possible tax points for each instrument across jurisdictions:

	Restricted Stock	**Stock Options**	**Restricted Stock Units (RSU)**
Value at grant	Yes	No* (if strike price is set correctly)	No (in the eyes of most tax authorities)
Value at vesting	Sometimes	No	Yes**
Transfer of shares timing	At the start	Upon exercise	At settlement
Tax point	At grant or at vesting, and at subsequent sale	Can be at grant, but usually at exercise***	At vesting
Capital gain available?	Generally yes	Yes, but ****	No
Costs to employee	Minor if structured right; fixable exposure at vesting	None if structured right; strike price could be an issue	None if structured right; fixable exposure at vesting
Company sale considerations	Treatment of unvested shares	Treatment of outstanding options	Outstanding RSUs and unsecured creditor status
Other			May need to pay payroll taxes. RSUs are usually treated as a form of compensation

* Options do have "time" value even if strike price equals market price, but this is generally ignored by most tax authorities.
** Vesting conditions do not have to be contingent on time passing, this could be set as a liquidity event.
*** Some tax authorities allow tax to be paid on the sale of shares, not at the exercise point.
**** Most tax authorities take the approach that tax should be paid on the sale of an asset. If options are exercised, the asset (the option) is gone and shares are received; waiting periods for capital gains discount may be reset. Some countries carry this over in their tax laws, but not all.



Ways Equity Is Granted Based on Company Stage

The following is excerpted from an article by Alexey Mitko titled "Startup Equity: Restricted Stock, Stock Options, RSU? What's best?" (written c. 2017). The article is not written for Australian context, but illustrates the rolling nature of equity structures well.

Meet Bob!

Stage 1: Founding

As a budding entrepreneur, Bob, decides to finally pursue his dream of building the next Uber for That-super-cool-industry. He develops a flashy pitch deck and was able to secure interest from some angel investors.

Angel investors tell Bob that he needs to set up a company before they invest the money into his idea. Bob gets his lawyer/accountant friend to set the company up, Bob sets the company up without considering the future IP that will be generated by the business or caring much about classes of stock. A lost opportunity or a mistake? Time will tell.

Bob has a company now and he gets some investment into it. Bob also realises that while his flashy pitch desk is very slick, he has to build a prototype and needs some technical talent on his team - a Technical Co-Founder!

Stage 2: Co-Founder Equity

Bob can't really pay a market salary for the required skills, so he decides to offer some equity to his co-founder. Bob does not really want to give away equity without some conditions attached to it, like vesting. So which plan should Bob use?

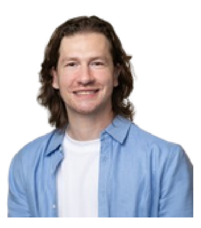
RSU can be paid in cash or stock, but are taxed at a point of vesting or, if Bob has the foresight, at a liquidity event. But who knows when that be? Also since we are talking about Uber for That-super-cool-industry, the shares, although not worth much now, will be worth a fortune in the future so tax at vesting sounds like a not so great idea.

Maybe options then? These sound reasonable in that mechanism of operation is fairly simple, but complexity with ISO and NSO, strike prices and associated tax rules is a bit off-putting.

How about the Restricted Stock then? Well, that sounds pretty good - shares are valued at cents to the dollar, recent investment by the angels pushed the price of shares up but by a small amount.

Bob can get the vesting conditions he wants, let's say four years with one year cliff (!), and the tax component seems fairly simple, provided the Tech co-founder lodges his/her 83(b) election.

Yep, restricted stock sounds like a suitable solution and upon a quick check with his lawyer to see if there are any regulations surrounding the issuance of securities, Bob gets the plan in place.



Ways Equity Is Granted — Unicorn Stage & Final Thoughts

Stage 3: Growth Round

A few months pass, the initial prototype was a success and did not take long to build due to the Lean Startup methodology Bob heard about, version 2.0 is in the pipeline and an additional round of investment is closed.

409a valuation just came back and the shares jumped in value from a few cents to a few dollars. Cause to celebrate? Perhaps, but there is much work still to be done and the restricted stock awards now cause some upfront tax pain for the new employees.

83b election causes employees to get a tax liability at the time of grant, and with a few dollars to a share, this is now a significant inconvenience. If the success keeps up the pace these restricted stock awards will become problematic.

Would RSU work? Liquidity is still a way off, and taxation upon vesting is still not great.

How about options? Well if Bob structures it right, employees don't have to pay tax or contribute at the point of grant. They still get access to capital gains in some circumstances and the complex tax treatment is still there, but Bob now can spend the cash to get proper specialist advice, there is also some flexibility for employees to decide when to crystallize their gain and while options that Bob will grant will have their strike price equal 409a value, there is still plenty of growth left in the company to make these valuable in the future (or so Bob hopes).

Cool! Options plan it is, Bob just needs to check with the lawyer on the process for issuing these grants to so many employees!

Stage 4: Unicorn — Pre-IPO

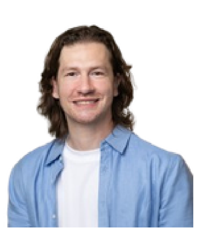
Fast forward a few years and Bob's (although not really his but his along with a few VC firms) company is now a Unicorn! Success! Champagne! And during one of the celebration canapes, investors broach the subject of listing and liquidity. What a great idea!

Another badge of success and Bob wants it, but he has a problem key employees have vested into their options and stock awards and Bob needs the key staff to prepare the company for listing. Also new staff do not see that much value in options since the company is arguably passed its super growth stage.

Bob does not agree with this nonsense as there are plenty of new blue waters to explore, but new employees simply don't get that.

Regardless, if employees don't want options perhaps RSU will work? A liquidity event is just in sight, RSU can be structured so that taxation point occurs alongside the IPO and some of those proceeds can be used to settle some of the RSU.

There are some drawbacks, such as lack of capital gains treatment for employees, but they also get certain value (as opposed to now possible value in an option). These employees have to stick around for a few years until the IPO, but that's exactly what this company needs!



Ways Equity Is Granted — Final Thoughts

The Point Behind Bob's Story

The method of issuing equity depends on company-specific circumstances. As circumstances, tax, and corporate securities legislation change, so should equity plans. Additionally, equity plans can be tailored, opening a range of possibilities for influencing employee behaviour.

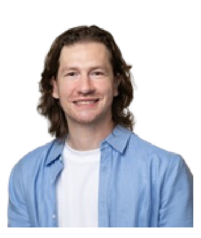
Final Thoughts

I sincerely hope that you have enjoyed reading this guide. I sometimes forget how dry all the tax and corporate legislation is, but I also remember how exciting it is to build startups! And equity plans are an integral part of that journey, so I try to move some of that excitement into my mind when I'm reading all the legislation.

As with all guides, I have neglected some areas and summarised the others. I hope I have not missed too much, but if you think there is an area that you would like to explore further, please let me know! We most certainly will have a delightful chat about it and I'll add it in or create another guide depending on overall demand for the topic.

Happy building!

Alexey Mitko, CoVentures



Worked Example — Founder Link

Before exploring Founder Link, consider how shares reserved for the equity plan work across fundraising rounds. The following example assumes two founders, each holding 10,000 shares.

Table 1 — Cap table at founding:

Shareholder	Shares Held	Percentage
Founder 1	10,000	50%
Founder 2	10,000	50%

Table 2 — After first investment round (4.5M pre-money, 500K invested, 10% ownership) Which does not include the dilution of the equity pool yet to be implemented:

Shareholder	Shares Held	Percentage
Founder 1	10,000	45%
Founder 2	10,000	45%
Investor 1	2,222	10%

Table 3 — After equity pool introduction (15%):

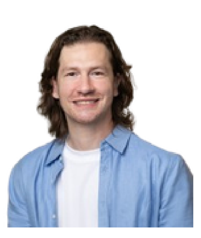
Shareholder	Shares Held	Percentage
Founder 1	10,000	38.25%
Founder 2	10,000	38.25%
Investor 1	2,222	8.5%
Reserved for Employees	3,920	15%

Note: As you can see you have 3920 shares that are available for recruitment. Each fundraising round the plan gets additional shares added to is as for it to remain at 15%.

For example, we have another investment round with 9m pre-money valuation and 1m invested. Investor 2 would want for the ESOP plan dilution to hit before the investment is being made so that they own 10% of the final Cap Table like so

Table 4 — After second investment round (9M pre-money, 1M invested):

Shareholder	Shares Held	Percentage
Founder 1	10,000	33.75%
Founder 2	10,000	33.75%
Investor 1	2,222	7.5%
Investor 2	2,973	10%
Reserved for Employees	3,920 + 520	15%



Worked Example — Founder Link: The Model

The pool has expanded with 520 additional shares reserved. Now three important concepts are layered together:

Employee Seniority

Four levels used in this example:

- Junior
- Mid
- Senior
- Executive

Employee Choice

Three options for each level:

- Equity Heavy
- Balanced
- Salary Heavy

Risk Stage

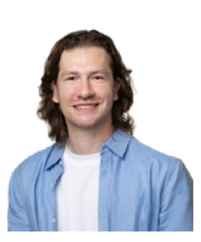
At Eucalyptus, risk was tied to funding rounds (Seed, Series A, Series B)

But it can be tied to technical proof points. At each stage, risk decreases. Hence the amount of equity given reduces.

Founder Link — Outcomes Table

"Founder Link" determines how many more times better off a founder is compared to an employee at a given level, choice, and risk stage:

Employee Level / Stage	Choice	Founder Link	Founder Equity	Employee Shares
Junior — Seed (risk factor 1)	Equity Heavy	10x	10,000	1,000
Junior — Seed (risk factor 1)	Balanced	20x	10,000	500
Junior — Seed (risk factor 1)	Salary Heavy	50x	10,000	200
Junior — Series A (risk factor 2)	Equity Heavy	20x	10,000	500
Junior — Series A (risk factor 2)	Balanced	40x	10,000	250
Junior — Series A (risk factor 2)	Salary Heavy	100x	10,000	100
Junior — Series B	Equity Heavy / Balanced / Salary Heavy			



Worked Example — Founder Link: Constraints & Planning

Once the Founder Link table is constructed, the exercise forces planning through the next 3–4 years of equity allocations within the constraints in place.

By balancing long-term and short-term considerations, a consistent view emerges of what constitutes a reasonable grant. Based on team, choice, employee level, and startup stage.

This is then reviewed and calibrated according to recruitment progress and employee choice patterns.

Constraints to Keep in Mind

Total pool size at each stage

The total shares reserved for employees must remain within the pool agreed at each fundraising round (typically 15%). Each new round adds shares to maintain this percentage.

Hire plan: levels, timing, and volume

The number of employees to hire, at what level (Junior/Mid/Senior/Executive), and at what funding stage must be estimated.
For example, at Series B, headcount could range from 60 to 120 employees, with senior-to-junior ratios of roughly 1:4.

Reserve for exceptional performance and top-up grants

Some shares should be left unallocated to reward exceptional performance and provide top-up grants. Failing to plan for this depletes the pool faster than expected.

Hard-to-recruit teams get a premium

Some teams (e.g., Developers) are harder to recruit. Their allocation can be set at, for example, double what a general pool employee would receive — explicitly built into the model.

The Founder Link model turns equity allocation from an ad hoc decision into a structured, plan-driven process. Aligned to company stage, employee level and individual risk appetite.