



Employee share ownership plans in start-up companies: Motivations,
challenges and implementation issues

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ABSTRACT

Title: Employee share ownership plans in start-up companies: Motivations, challenges and implementation issues

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In the ever-evolving landscape of modern business and entrepreneurship, start-ups have emerged as dynamic and innovative enterprises that challenge traditional norms. Despite their potential for disruptive innovation and agile adaptation, start-ups face many challenges, particularly in attracting and retaining talent. To meet this challenge and compete with established companies for highly skilled employees, start-ups are increasingly turning to Employee Stock Ownership Programmes (ESOPs). These ESOPs are a compensation option for companies that allow employees to become shareholders in the company, often issued as part of their overall compensation package.

Building on the existing literature, this study confirms established motivations for the adoption of ESOPs, such as employee motivation, the use of ESOPs by start-ups to supplement resource constraints, and the desire to align corporate interests.

The study provides new theoretical insights and perspectives, with regard to the challenges faced by founders in adopting ESOPs. In particular, knowledge asymmetry among employees and the complexity of achieving transparent practices play an important role. By providing insights into the standard of vesting periods and the size of the ESOP pool in the start-up landscape, the study also allows for managerial input. Based on nine semi-structured interviews with founders actively involved in the design of ESOPs, the study offers nuanced insights into strategic choices, challenges and potential impacts on start-up culture.

Keywords: Start-ups, Compensation, Founder, Employee Participation, Incentivizing, ESOP, Talent Attraction

SUMÁRIO

Título: Planos de participação dos trabalhadores no capital de empresas em fase de arranque: Motivações, desafios e questões de implementação

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No panorama em constante evolução das empresas modernas e do espírito empresarial, as empresas em fase de arranque surgiram como empresas dinâmicas e inovadoras que desafiam as normas tradicionais. Apesar do seu potencial de inovação disruptiva e de adaptação ágil, as empresas em fase de arranque enfrentam muitos desafios, nomeadamente na atração e retenção de talentos. Para responder a este desafio e competir com as empresas estabelecidas por trabalhadores altamente qualificados, as empresas em fase de arranque estão a recorrer cada vez mais a programas de participação dos trabalhadores no capital (ESOP). Estes ESOP são uma opção de compensação para as empresas que permite aos trabalhadores tornarem-se accionistas da empresa.

Com base na literatura existente, este estudo confirma as motivações estabelecidas para a adoção de ESOPs e fornece novas perspectivas teóricas.

O estudo fornece novos conhecimentos e perspectivas teóricas, nomeadamente no que se refere aos desafios enfrentados pelos fundadores na adoção de ESOP. Em particular, a assimetria de conhecimentos entre os trabalhadores e a complexidade de alcançar práticas transparentes desempenham um papel importante. Ao fornecer informações sobre o padrão dos períodos de aquisição de direitos e a dimensão do conjunto de ESOP no panorama das empresas em fase de arranque, o estudo também permite a contribuição dos gestores. Com base em nove entrevistas semi-estruturadas com fundadores ativamente envolvidos na conceção de ESOP, o estudo fornece uma visão matizada das escolhas estratégicas, dos desafios e dos potenciais impactos na cultura das empresas em fase de arranque.

Palavras-chave: Start-ups, Remuneração, Fundador, Participação dos Trabalhadores, Incentivo, ESOP, Atração de Talentos

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List of Abbreviations

Abbreviation	Definition
ESOP	Employee Share Ownership Plan
SME	Small and medium-sized enterprises
VC	Venture Capital
VSOP	Virtual Stock Option Plan

1. Introduction

The modern business and entrepreneurial landscape is one of constant evolution, characterised by the rapid emergence and growth of start-ups. These dynamic and innovative ventures have not only redefined traditional business models but also challenged established norms, promising disruptive innovation, agile adaptation, and the potential to revolutionize entire industries. Despite their enormous potential, start-ups face many challenges, particularly in the early stages of their business, including the critical task of attracting and retaining top talent. (El Hanchi, 2020)

As Hahn (2023) points out, "Human capital is critical to the long-term economic success of a company, whether it is a start-up or a traditional firm". This underlines the importance of recognizing and investing in the value that employees bring. To address the talent acquisition challenge, start-ups often turn to innovative strategies to incentivise employees. One such strategy that is gaining popularity is the implementation of Employee Share Ownership Plans (ESOPs). These programmes play a crucial role in attracting and retaining skilled professionals by offering them a stake in the company. According to a survey conducted by Speedinvest, a venture capital firm with a multi-billion-dollar investment portfolio, 57 per cent of respondents in 2023 said they currently offer employee share ownership. A further 15 per cent said they were in the process of introducing employee share ownership, while 18 per cent were considering it. Only 10 per cent said they did not currently offer employee share ownership. (Lesche et al., 2023)

This thesis explores the unique dynamics of ESOP implementation in the start-up ecosystem. These plans, which provide for equity ownership, have proven to be an effective tool for aligning employee interests with organizational goals, increasing employee motivation, and fostering a sense of ownership and commitment.

Much of the literature examines theories of employee ownership as applied in established firms and pays less attention to the specific challenges faced by start-ups. The specific characteristics of start-ups, and therefore the implementation of employee ownership under their conditions, is a central motivation for this thesis. This study aims to investigate this by looking at how ESOPs are implemented in start-ups, the motivations behind the implementation and the challenges faced by the founders. The primary research methodology used in this study involves semi-structured interviews with founders who have been actively involved in start-ups where ESOPs have been implemented. These interviews are designed to provide insights into the strategic decision-making processes, challenges, and ultimate impact of ESOPs on start-up

culture. By delving into the experiences and perspectives of these key stakeholders, the aim is to develop a comprehensive understanding of the nuances of ESOP adoption in start-ups.

This thesis is structured as follows: Chapter 2 provides a comprehensive literature review on ESOPs and based on this, attempts to identify research gaps that serve as the basis for formulating the following research questions. Chapter 3 details the research methodology, highlighting the approach to data collection, the methodology for data analysis and the criteria for selecting participants, as well as presenting the interview guide. Chapter 4 unfolds the research findings obtained through the application of the Gioia method, which is explained in detail in this section. Chapter 5 then discusses in detail the implications of these findings in relation to the findings from the literature review. Finally, a concluding chapter summarizes the key findings and provides recommendations for further investigation and research in this area.

2. Literature Review

This chapter provides a comprehensive review of the relevant theories relating to the implementation of ESOPs in order to inform future research. In particular, concise definitions and explanations of key theories and frameworks are provided to promote a solid understanding of the literature in the relevant research area. In addition, a comprehensive definition of the concept of “start-ups” is explained to allow for a precise delineation.

2.1 Employee Share Ownership Plans

Employee Share Ownership Plans have gained popularity as a compensation tool on a global scale and are crucial in the competitive job market to attract top talent to start-ups (Lesche et al., 2023). Their continued relevance and widespread adoption across different industries around the world underscores their importance and impact. (Mahmood, 2020) ESOPs are a form of equity compensation granted by companies to their employees and managers. Unlike traditional methods of distributing shares in a company, ESOPs provide eligible employees with the exclusive right to purchase shares at a predetermined price during a specified period of time. (Oyer et al., 2005) The company can finance the plan through cash contributions, debt that the company repays or share contributions. (Westendorf, 2007)

These plans are usually offered to employees as part of their overall compensation package, with specific terms and conditions set out in an agreement. Vesting schedules are often included in these agreements, requiring employees to meet certain criteria, such as remaining with the company for a certain period of time, before they can exercise their options. (Pendleton et al., 2021). The primary financial benefit of ESOPs is realized when the market price of the

company's shares exceeds the exercise price. At this point, employees have the opportunity to purchase company shares at a discount to the current market price, resulting in a potential financial gain for the employee (Hall, 2000). Unlike publicly traded options, this kind of options cannot be transferred or traded, and recipients only acquire ownership of the company by exercising their right to purchase shares (Brandes et al., 2003).

In the context of start-ups, virtual stock option plans (VSOPs) are usually granted to employees as preferred form of employee participation method. This is a legal arrangement that facilitates employee share ownership without the need for actual shares. A "phantom share agreement" places the beneficiaries in a financial position equivalent to owning a certain number of shares. This type of plan achieves the same economic results as traditional share option schemes without the complexity of actual share ownership. For example, it avoids the need to amend the articles of association and therefore the beneficiaries do not have the corresponding co-determination rights as actual shareholders. As with ESOPs, the structure of a VSOP depends on the individual agreement between the parties. (Hahn, 2023)

2.2 Benefits of Employee Share Ownership Plans

2.2.1. Work engagement

Much of the literature reviewed on employee share ownership plans focuses on their positive impact on individual and organizational productivity and profitability (e.g., Kruse et al., 2004; Freeman, 2007; Mahmood, 2020). ESOPs are widely recognized as motivational tools that foster a sense of ownership among employees and motivate them to actively contribute to the success of the organization (Pendleton et al., 2021). They are strongly advocated as a positive human resource strategy as ESOPs can have the potential to improve employee relations and increase participation in decision making (Mahmood, 2020).

In addition, ESOPs are recognized for their role in promoting employee commitment to the organization, fostering cooperation and trust between employees, and ultimately influencing organizational and individual performance (Pugh et al., 2000).

ESOPs offer employees the opportunity to participate directly in the success of the company through share ownership. This sense of pride in ownership can motivate employees to be fully productive because they have a stake in the company as they also provide a tangible representation of how much their contributions are worth to the employer. (Henning et al., 2023). These plans not only increase employees' job satisfaction but can also improve their financial well-being by providing lucrative financial incentives (Bryson et al., 2018).

Employee motivation through ESOPs also plays a crucial role in the context of start-ups. Particularly in the early stages, when young companies often have limited financial resources, the motivation of key personnel is crucial. The disadvantage of a potentially lower salary and less job security compared to established companies must be compensated by the prospect of a share in the current or future success, e.g. an exit. To ensure that this motivation is not limited to the founders but that the members of the operating team are also involved and recognize their essential role in the growth and success of the company, ESOPs are a typical compensation model in young companies. (Hahn, 2023)

Hartmann et al. (2021) also share this opinion, as funds for basic salaries are limited, start-ups can increase their attractiveness in the competition for highly qualified specialists through participation models. Recruiting the right specialists is often a major challenge for start-ups: 62 per cent of companies report difficulties in recruiting staff. Employee share ownership serves therefore both as an incentive and as a means of involving employees as co-owners in the company's development, which offers advantages in terms of talent recruitment and motivation.

2.2.2. Incentives and Alignment of Interests – Principal Agent Theory

ESOPs as a tool to solve the principal-agent problem have also received increasing attention in the literature. Principal-agent theory, formulated by Jensen and Meckling in 1976, refers to the inherent conflicts of interest and information asymmetries between principals (firm owners or shareholders) and agents (employees or managers). These conflicts arise from different starting points and personal goals, with each party seeking to maximize its individual utility, often focusing on income, possibly at the expense of efforts to achieve the company's goals.

ESOPs can serve to align individual interests with corporate goals and foster a sense of ownership and shared commitment among employees (Mahmood, 2020). By giving employees the opportunity to become co-owners of the company through stock options, ESOPs provide a financial incentive for employees to contribute positively to the company's performance, which can mitigate some of the principal-agent conflicts and encourage greater effort and commitment to the company's success (Henning et al., 2023).

2.2.3. Employee Turnover

Reducing employee turnover is a major concern for companies because the direct costs of turnover, such as hiring and training new employees, are significant (Mahmood, 2020). In addition, the indirect costs are also considerable, as turnover leads to a loss of knowledge and

skills within the organization (Balsam et al., 2007). The granting of ESOPs is intended to provide employees with an incentive to stay with their company until these options become exercisable. It is expected that this strategic approach will lead to a reduction in turnover in these companies. ESOPs are considered a natural solution to this problem as they typically vest over a four-year period and departing employees forfeit the value of their unexercised options. Moreover, as share prices rise, employees' options to work outside the company become less attractive, making ESOPs even more effective in discouraging employees from leaving. (Aldatmaz et. al., 2018) As Pugh, Oswald and Jahera (2000) show, in addition to their retention benefits, ESOPs are increasingly being used to ward off takeovers. ESOPs strategically place company shares in the hands of employees. In this context, their main purpose is to thwart hostile takeovers by aligning workers' interests with those of the company, thus reducing the likelihood of supporting ownership changes that could, for example, lead to redundancies (Mahmood, 2020). The research findings of Pugh et al. (2000) are also consistent with Oyer's theory (2005), which says that stock option plans are particularly effective in reducing turnover because they match employees' propensity to quit in response to external opportunities. According to Oyer ESOPs on average lead to greater reductions in turnover following positive market outcomes, which is particularly significant during periods when hiring is more difficult due to tight labor markets, indicating higher direct turnover costs under favorable economic conditions.

In terms of the external factors that ESOPs examine in relation to turnover, the study of Balsam et al. (2007) shows that ESOPs have a stronger impact on reducing turnover under robust economic conditions, especially when companies have high growth opportunities and retention of key employees is particularly important. Other external factors that may influence turnover besides the adoption of ESOPs could be that a company's share price is predictable for the manager implementing the ESOP and that several unaccounted variables could explain the results. Alternatively, the study focuses on market returns after the option grant. If the firm's option values increase when market returns are high, this suggests a stronger incentive to stay with the firm.

Aldatmaz et al. (2018) show the practical implications of such incentives are not entirely clear. A common problem is that competitors often incentivise employees with vested options with sign-on bonuses, essentially negating the impact of ESOPs on employee retention. The study of Caramelli et al. (2014) also shows that turnover actually decreases after ESOPs are granted, and

this relationship appears to be causal. However, the study finds that this decline in turnover is usually temporary, as employees can simply postpone moving to competing firms until their options vest. Once the options vest, turnover increases by an amount comparable to the previous decline, suggesting that ESOPs delay rather than prevent turnover. This increase in turnover after the vesting period suggests that the mechanism by which these options reduce turnover is related to employees' expectation of deferred compensation rather than a permanent reinforcement of loyalty to the firm (Bryson et al., 2018).

2.4 Potential risk of share ownership for employees

In addition to the potential benefits, the literature also discusses the potential risks of stock option plans for both companies and employees. Pendleton and Robinson (2022) describe the risk associated with ESOPs as asymmetric for employees and companies. While active, there is no downside risk for the employee; if the share price falls below the grant price (“out of the money”), the holder experiences no real loss of wealth if they choose not to exercise the options at that time. Employees who participate in ESOPs typically expect to exercise their rights at a pre-determined “strike price” and to reap financial benefits if the actual share price exceeds that level. By choosing to exercise the options and sell them immediately, they ensure immediate and guaranteed capital appreciation as a result of the increase in the share price between grant and exercise.

However, this financial benefit may not occur until the share price significantly exceeds the strike price, which may be a considerable time in the future. This situation has a disproportionate impact on early entrants, who often have lower strike prices but may not realize significant gains until share prices are well above the strike price.

The paper by Anderson (2009) discusses also the risks associated with ESOPs for the employee. In particular, it highlights the lack of diversification in ESOPs, which can lead to permanent losses for participants. The article also points to conflicts of interest between company insiders and employees who receive shares. Hartman et al. (2011) also argue that due to the inherent uncertainty in the development of start-ups, employee ownership also represents a bet on the future, which can be unattractive to risk-averse applicants and employees.

New research highlights these heightened risks employee face, particularly in the current start-up landscape where securing funding is a major challenge. Investors increasingly emphasize safeguards to secure their investments, which can inadvertently impact founders and employees, who often have limited influence over negotiations and limited access to confidential terms. (Holzki et al., 2023)

2.5 Company culture and transparency

Particularly in the early stages of ESOP implementation, companies face challenges that affect the culture of the organization. Vanderslice et al. (2000) emphasize the importance of a trustful company culture within the organization is conducive to successful ESOP implementation. The role of open communication, clear expectations and consistent behavior in fostering trust appears to be essential for this. The authors also discuss strategies for building trust, such as workshops, open dialogue, and financial transparency. Furthermore, asymmetries in employees' knowledge of such compensation schemes need to be considered during implementation. (Kruse et al., 2004). The introduction of ESOPs is often met with mistrust and skepticism among employees for a variety of reasons. Many employees, especially those lower down the corporate hierarchy, are often less familiar with this form of compensation and ownership. The lack of immediate liquidity and the limited access to the cash value of the shares for five to ten years after leaving the company also contribute to skepticism. In addition, employees may feel they have no control over the value of the shares due to limited voting rights and a lack of tangible change in their day-to-day work. (Vanderslice et al., 2000)

2.2 The context of start-ups

A start-up is an early-stage company, usually founded by entrepreneurs who want to respond to a perceived need by developing a unique product or service. Start-ups are rooted in innovation and aim to address shortcomings in existing products or create entirely new categories of goods and services by disrupting entrenched mindsets and business practices of entire industries (El Hanchi, 2020). For this reason, many start-ups are known as disruptors in their respective industries. (Skawińska et al., 2020) There are numerous definitions of what a start-up is in the literature (Table 1).

Source	Summary of key elements of the concept
Passaro et al., 2016	A start-up is a temporary organization, typically in innovation-oriented sectors, created with the primary goal of finding a repeatable and scalable business model, characterised by innovativeness, scalability, and rapid growth. Facing challenges such as competition, resource constraints and the need to collaborate within the business ecosystem to survive and thrive.
Steigerthal et al., 2018	The term start-up has no official definition, but commonly draws on three criteria, namely: Age: younger than ten years/ five years depending on the sector, Innovation in product, service or business model and aim to scale intention to grow number of employees and/or markets operated in.

Bormans et al., 2020	Start-ups are less than ten years old, have an innovative product, service or business model and are looking to scale up, i.e. increase the number of employees, turnover and/or expand into new markets.
Sevilla – Bernado et al., 2022	A start-up is characterised by a high degree of innovation in technology, internal processes or business models, its global market penetration, and its access to unique sources of funding that enable rapid growth.
Baldrige, 2023	Start-ups are dynamic, innovative companies founded with the vision of transforming industries by addressing existing shortcomings or introducing entirely new products and services that have a transformative impact on society.

Table 1– Examples of start-up definitions in the literature

Based on the presented definitions, start-ups can be defined as new, innovation-driven entrepreneurial ventures with a scalable business model that have been in existence for less than ten years, are founded as independent companies by individuals, and are not subsidiaries of established companies Skawińska et al., 2020. In their early stages, start-ups resemble small enterprises in terms of size and limited resources and are characterized by simple organizational structures, limited capital, few employees, and few alliances (El Hanchi, 2020). Unlike small and medium sized enterprises (SMEs), start-ups start their activities without an established customer base and without a preconceived business model. Their survival is a top priority, and their success depends on proving their credibility and usefulness and meeting growth expectations. Start-ups face particular challenges due to their size, as they operate with incomplete organizational structures, minimal processes, and high time pressure. In an environment characterised by contextual dependencies, start-ups are highly dependent on external influences that determine their emergence, survival, and success. (Ojaghi et al., 2019) In today's dynamic landscape, start-ups have taken on an unprecedented importance as the increasing openness of technology and innovation has lowered the barriers to entry for entrepreneurs. The emergence of an innovation ecosystem in which start-ups play a central role has been facilitated by continuous digital integration and advanced information infrastructures (Skawińska et al., 2020). The balance between short-term survival and long-term innovation is a fundamental tension for start-ups, requiring a strategic focus on operational efficiency, exploration, and innovation. The development of start-ups depends on their ability to create scalable business models in this dynamic and interdependent ecosystem. (Ojaghi et al., 2019)

The literature on ESOPs is extensive and provides insights into their use and impact in established organizations. However, the theories are less applied in the context of start-ups, so less attention is paid to the obstacles but also the motivations that start-ups face when

implementing ESOPs. Start-ups operate under unique circumstances: They are characterised by limited resources, rapid growth, and increased uncertainty, so the introduction of ESOPs can present unique challenges that require academic attention.

3. Methodology

The previous literature review led to the following research question: ‘What specific challenges, motivations and implementation factors do start-ups face in adopting and implementing Employee Stock Ownership Plans (ESOPs)?’ This research question is investigated by applying a qualitative methodology and semi-structured interviews. Qualitative research is a research methodology that focuses on exploring and understanding human experiences and phenomena through in-depth analysis of non-numerical data. Strauss and Corbin (1990, p.10) explain it as following.

“By the term ‘qualitative research’, we mean any type of research that produces findings not arrived at by statistical procedures or other means of quantification. It can refer to research about persons’ lives, lived experiences, behaviours, emotions, and feelings as well as about organisational functioning, social movements, cultural phenomena, and interactions between nations.”

It is interpretive and holistic in nature and often uses methods such as interviews, focus groups, observation, and content analysis. Qualitative research allows for an in-depth exploration of the topic, capturing nuanced details and a comprehensive understanding of the phenomena under study. This type of analysis is characterised by its ability to capture the context in which behaviors and experiences occur. The interview format allows researchers to take a holistic view of the issue and consider different perspectives and dimensions. (Strauss et al., 1990) The qualitative approach, which includes interviews in this thesis, fulfils the need for a contextual understanding of the subject matter and enables a detailed understanding of the motivations, hurdles and outcomes associated with ESOP implementation.

In addition, qualitative research allows for subjectivity, which is particularly important in this thesis when investigating ESOPs, as perceptions and motivations play an important role. The format makes it possible to gain a basic understanding of the topic and then go deeper by asking more detailed, specific questions.

However, it is also important to highlight the drawbacks of this methodology, which will be reflected on later again when the limitations of the work are highlighted. Firstly, qualitative research involves interpretation, and the results can be influenced by the subjectivity of the researcher, which can ultimately lead to biases in the analysis. There is the problem of limited

generalizability, as qualitative findings are often context specific, and it can be difficult to apply them to the field as a whole (Rahman, 2016). The emphasis is on depth rather than breadth, especially in the choice of interview format. The resource-intensive nature of this method was particularly evident in reaching and selecting interviewees. Qualitative research can be resource-intensive and requires a considerable amount of time and effort, especially when in-depth interviews and detailed analysis are involved. Because of the resource intensity, qualitative studies often involve smaller samples than quantitative research and may limit the generalizability of findings (Brüsemeister, 2000).

3.1. Sampling Strategy

In this study, data was collected through in-depth interviews with founders who are actively involved in employee stock ownership programmes in start-ups. This corresponds to a ‘purposive sampling’ approach, as participants were specifically selected on the basis of their relevant experience.

Robinson (2014, p.7) describes the choice of persons for the sample as follows.

“The rationale for employing a purposive strategy is that the researcher assumes, based on their a-priori theoretical understanding of the topic being studied, that certain categories of individuals may have a unique, different or important perspective on the phenomenon in question and their presence in the sample should be ensured.”

The use of the professional networking platform LinkedIn functioned as the main source for identifying participants. This involved searching for individuals with the desired characteristics to ensure the relevance of the sample to the study. In some cases, contact with additional interviewees was facilitated through existing connections, with some introductions occurring during the course of the interviews. In addition, potential interview partners were contacted via founder platforms and direct emailing.

With regard to the size and development phase of the start-ups and their founders, it was decided to exclude start-ups in the pre-seed phase from the sample, as initial contacts indicated that the introduction of ESOPs in companies played a subordinate role in this phase. By focusing on companies that have utilized at least seed funding (see Appendix 1), the aim was to ensure that the participants had a solid background in the context of ESOPs, thereby increasing the depth and relevance of the interviews. This form of exclusion criteria reflects a strategy of targeted selection.

Convenience and non-representative sampling strategies were not used to select interviewees, as the nuanced and specialized nature of the insights sought in this study required a purposive

approach, ensuring a deliberate selection based on the specific characteristics and experiences of participants in relation to ESOPs in start-ups.

3.2. Data collection

As previously mentioned, potential candidates for the interviews were sourced via the professional network LinkedIn, and the resulting interviews were conducted online due to logistical constraints. To that end, platforms such as Zoom, Google Meet, and MS Teams were utilized. The interviews lasted between 25 and 40 minutes and were subsequently transcribed using Cockatoo software.

The study design provided for semi-structured interviews, which ensures a high degree of flexibility and adaptability throughout the interview process as it allows the interviewer to be more responsive to the interviewee's answers and to ask more detailed questions, rather than having to follow a rigid procedure. (Adhabi et al., 2017)

The interview protocol followed three distinct steps:

Introduction: a first phase included a brief introduction and overview of baseline data of the start-up, followed by questions about the participant's experience with employee share ownership plans.

Main Part:

- ESOPs in start-ups: Participants were asked to explain the design of ESOPs in their start-up, as well as their level of involvement in the implementation and to identify the main factors that motivated them for or against the introduction of ESOPs.
- Influence of investors and long-term strategy: Participants were asked about the influence of investors on their decision-making process and whether their ESOP design was in line with agreed long-term strategic objectives.
- The founders were asked how they would assess the demand and knowledge of the employees in the start-up. Based on this, opportunities for knowledge transfer and employee training were discussed.

Outlook: Participants were asked to reflect on their experience and whether there were any lessons for other founders. They were also asked to consider the potential of ESOPs as a long-term reward opportunity.

A detailed description of the interview guide can be found in Appendix 2.

ID	Job Position	Number of Employees	Investment phase
I1	Co-Founder and CCO	7	Seed Stage
I2	Co-Founder and CEO	6	Seed Stage
I3	Co-Founder and CEO	15	Seed Stage
I4	Founder and Consultant	4	Seed Stage
I5	Co-Founder	4	Seed Stage
I6	CEO	45	Publicly traded/IPO
I7	Co-Founder and CEO	40	Seed Stage
I8	Co-Founder and CEO	4	Seed Stage
I9	Co-Founder and CEO	10	Seed Stage

*Table 2 – Overview of interview partners
Source: Own Illustration, Data given by interview partners*

3.3 Data analysis

For this study, the Gioia (2012) approach was chosen to analyze the data collected from the interviews. This approach emphasizes the importance of qualitative rigor, which is crucial to the credibility and trustworthiness of the findings. This method was chosen because it is considered particularly useful when a study involves the exploration and development of new concepts in the field of research (Gioia, 2012). The advantages of Gioia's method are its disciplined approach to data collection and coding, aligned with quantitative research standards (Magnani, 2023). The Gioia method also provides rich insights into data collection and empirical evidence: the systematic presentation of both 'first-order' analysis (reflecting informants' perspectives) and 'second order' analysis (incorporating researcher-centered concepts) provides a solid basis for demonstrating the empirical evidence for the thesis. (Gioia, 2012)

The choice of the Gioia method for this thesis has the advantage that the method's disciplined qualitative analysis ensures an exploration of the complex dynamics of ESOPs, thus providing a holistic understanding of implementation, motivation and understanding. In particular, the work required an adaptable theory through the semi-structured interview format provided by the Gioia method. This allowed the interview protocols to be adapted as the work progressed, as new insights were gained, and to return to earlier informants to ask questions that arose from later interviews. The research and development of new concepts in this area seemed important for the work, as the research question focuses on the special challenges that start-ups face with the implementation of ESOPs. Another advantage of the Gioia approach for this study is the

ability to be transparent about the research process, from data collection to analysis and theory development. This transparency contributes to provide evidence of scientific progress, as this approach makes it possible to show how new concepts or theories have been systematically developed based on the data. This is particularly important for the present study as it aims to fill gaps in the existing literature. To summarise, the Gioia method proved to be a suitable method for this thesis to investigate the previously defined research question, as it focuses on understanding the social construction of reality and the experiences of the research participants and is therefore well suited to the chosen data collection.

4. Findings

The thematic analysis of all nine interviews revealed key findings and themes from the data collected. Consequently, first order categories were selected based on the key findings and their alignment with the research question. These findings can be grouped into three main categories relevant to the research question: “Implementation”, “Motivation” and “Challenges” related to the use of ESOPs.

Within the “Implementation” category, the findings include the perception of ESOPs as a common practice in the start-up environment, the complexity of implementation and the negotiation processes with employees. The second category, “Motivation”, includes findings from the interviews on the emotional commitment of employees and financial incentives as driving factors for the adoption of ESOPs. Finally, the third category of findings deals with the challenges that founders face in introducing ESOPs, focusing on issues arising from employees' lack of knowledge about ESOPs and the need to establish an appropriate level of transparency. The various aspects and considerations relevant to the discussion on the use of ESOPs as a compensation model in start-ups are effectively illustrated and structured by these dimensions.

1 st order analysis Direct Quotations	2 nd order analysis	Aggregate Dimension	
<p>“It's part of the standard contract, that an ESOP pool will be included.” (I1)</p> <p>“But I would go so far out on a limb as to say that it's standard in start-ups to have a 10% ESOP pool from the outset.” (I1)</p> <p>“In Germany it's 10 %, you can increase that later. (...) but in Germany it's usually 10 per cent. And it stays that way in any case.” (I4)</p> <p>“The standard [ESOP pool] is 10%.” (I2)</p>	<p>Most start-ups set up a 10 per cent ESOP pool as standard.</p>	<p>ESOPs are considered standard practice in the start-up ecosystem, and investors also recognize their importance in creating positive incentives.</p>	
<p>“And vesting was fixed over a period of 4 years. So, it is the normal number in a program” (I5)</p> <p>“We are at 8.5% [ESOP pool] and exactly vesting is normally five years.” (I7)</p>	<p>The standard vesting period for ESOPs in start-up companies is between 4 and 5 years.</p>		
<p>“Exactly, they [VCs] take it [ESOPs] for granted. But it also makes total sense, because they are also interested in managing the cost structure layers.” (I5)</p>	<p>In a start-up traditionally funded by venture capitalists, investors view ESOPs as standard.</p>		
<p>“So we introduced it right from the start. also has the background that we are classically financed. (...) and nowadays it's actually standard practice demanded by investors to build up a classic VSOP pool.” (I7)</p>			
<p>“The investor says, (...) the people at the beginning, these are the most important people you have, you have to get the smartest people and preferably senior people and if you could bring the cash down a bit at the beginning. (...) so they're more positively incentivized.” (I2)</p>			
<p>“It [the implementation of the ESOP] just failed because of the realisation (...) it was just constantly postponed. Yes, (...) because it's super intensive and complicated.” (I1)</p> <p>“Yes, I would say that it [the implementation of the ESOP] didn't fall on our feet, not at all, but it would have had good potential for conflict if we hadn't, if we had invested a lot of time (...)” (I3)</p> <p>“So it's [the implementation of ESOPs] all relatively complex (...) And in the end, there were simply other issues in our case, so unfortunately we didn't deal with it any further.” (I1)</p>	<p>ESOP implementation is time intensive and complicated.</p>		<p>The implementation of ESOPs in start-ups is time-consuming, complex and requires prioritization, so external support is crucial for a smoother and successful implementation process.</p>
<p>“Yes, so introducing such an employee participation programme has been very unattractive due to the tax complexities to date. Yes. That's now changing a bit for the better. But, yes, I would probably have used a standard contract now and would have agreed it with our lawyer.” (I5)</p>	<p>External support plays an important role in simplifying the process of introducing ESOPs.</p>		
<p>“We had a law firm with us. (...) Yes, the costs of having to change something or of it not being 100% accurate or of claims arising that you don't really have under control, or something are far too high.” (I6)</p>			

<p>“We made it relatively uncomplicated; we had a law firm anyway that specializes in all the issues with which we also did the financing round. (...) And then they simply drew up the standard contract for us with the conditions that had previously been discussed. We paid ourselves silly again, but that was actually it.” (I3)</p>		
<p>“We did it with our legal counsel, who also advises us on financing rounds. He tells me that every law firm actually has this as standard these days. It's more about what terms you want for your employees. There are clear differences here, especially when it comes to vesting clauses and negative vesting if an employee leaves the company.” (I7)</p>		
<p>“And then we actually always offer three different packages, the lower the cash component, i.e. the fixed salary, the higher the VSOP variants,(...). Very important for us and I think very important for any company that takes employee retention very seriously.” (I7)</p>	<p>Discussing the issue of compensation with the employee at an early stage of the application process is important.</p>	<p>Founders emphasize the importance of transparency in relation to ESOPs and address them during the interview and salary negotiation process to assess a candidate's long-term commitment and motivation.</p>
<p>“I think it's particularly important in the early phase, i.e. in the initial discussions, to have a certain degree of transparency and to explain what it [the form of compensation] actually means.” (I8)</p>		
<p>“So it [the ESOP] was actually always part of the application process before we were hired, in any case it was already discussed.” (I3)</p>		
<p>“(...) because it shows that employees really believe in the company (...). And that's why we always reveal it right from the start for final positions” (I9)</p>		
<p>“I would be really transparent about it from the start and also say in the job interviews, i.e. also in the salary negotiations, that this is an important part, because you can also see from it, so for us this is also a criterion, is an employee only motivated in the short term or can he also imagine staying with the company in the long term.” (I7)</p>	<p>Discussions about compensation and ESOPs during the recruitment process are also used to understand the candidate's long-term motivation.</p>	
<p>“You don't just incentivize monetarily, but you also incentivize with participation, that's emotional, that people say I have a share in a company.” (I2)</p>	<p>Start-ups rely on individuals with a strong passion for the mission and a long-term commitment.</p>	<p>ESOPs in start-ups are used as a financial incentive connected with emotional engagement and creating a sense of ownership.</p>
<p>“But I would basically say that the people who really take on responsibility have to be passionate about the mission and the problem, especially in a younger company. And in that context, of course, both sides want the person to get sticks.” (I1)</p>		
<p>“For me, it's also a time to show appreciation to employees with whom we want to work on a long-term basis. It's a great tool.” (I7)</p>	<p>Founders emphasize the important role of employee involvement in maintaining commitment and participation.</p>	
<p>“That's why there's employee participation, it keeps people involved.” (I2)</p>		
<p>“As a start-up, you naturally also use this as a remuneration method when you perhaps don't have that much cash lying around.” (I1)</p>	<p>In most start-ups, offering competitive salaries can be</p>	<p>Struggling with the dilemma of attracting and retaining top</p>
<p>“And because we're logically at this stage and can't generate too many sales and therefore can't pay a salary, we're using incentive schemes like ESOPs” (I8)</p>		

<p>“...we just want to make a few key hires, which are logically also expensive and drive the payroll extremely high. I think you can logically compensate for the salary and therefore simply have a longer runway.” (I3)</p>	<p>challenging, making stock options a vital compensation method.</p>	<p>talent, start-ups are strategically utilizing ESOPs to compensate for higher salaries.</p>
<p>“But of course, we can't pay an investment banker's salary in most start-ups. So of course, you have to work with stock options.” (I1)</p>		
<p>“We mention this specifically for key positions that we want to fill. For example, we have something like Head of X, Y, Z. We like to advertise with the VSOP, we can't afford to pay like corporates. And that's why we use these incentives.” (I9)</p>		
<p>“But it is a really good system. So, the basic idea is, I think that's really good, because as a start-up, well, I usually don't have one thing, and that's money. And somehow, I still want to have motivated and promising people” (I4)</p>		
<p>“So it's not just that they have their own motivation to pay less money, but also that if someone comes along, and unfortunately that happens relatively often, and makes another offer, someone wants to grab one of ours (...) and who would get another offer, which we couldn't offer at all, that would be bad.” (I3)</p>	<p>ESOPs can minimize the costly risk of losing a valuable employee to a competitor.</p>	
<p>“As a young company, you're always in a bit of a dilemma at the beginning, aren't you? You're not an attractive employer and then of course you try to keep people in the company.” (I2)</p>		
<p>“And this understanding that if the company performs well and outperforms, then I can actually turn down x times more salary. That's a risk that I'm taking or a risk in the sense that I'm foregoing a better salary, but over 5 years I could perhaps earn 10,000 euros more money since my year, but in the 5 years I can also make 1.5 million from the 50,000 that I've then accumulated.” (I7)</p>	<p>In the start-up landscape, strategically hiring key talent at higher salaries can be balanced by leveraging ESOPs.</p>	
<p>“I would say it's always, always more important, especially for the company with scaling, especially the higher or more senior positions you try to get.” (I7)</p>		
<p>“There are so many differences. (...)You can't just send an employee a contract like that, you have to actually say, so to speak, here's a contract and you can talk to the lawyer about it for half an hour. (I2)</p>	<p>The employees who receive ESOPs often lack prior knowledge and usually don't know much about the topic.</p>	<p>In general, the topic is difficult for employees to understand due to its complexity and there is an uneven level of awareness of ESOPs which can lead to an asymmetry of interest.</p>
<p>“No, there are not many employees asking for it. In fact, it's more in the sense that what we bring up is even split in two. There are many employees who don't understand it (...) And there are employees who are already familiar with it from previous start-ups (...)” (I7)</p>		
<p>“Well, I think there are just so many complex issues that people simply don't have anything on their radar, and they let themselves be blinded by them.” (I2)</p>		
<p>“Everything, all the vesting and all the shares on top that don't belong to the job. (...) I think some people underplay it and some employees are easily blinded by it.” (I2)</p>		

<p>“No, well, I think it's not the employees' responsibility, it's more the company's responsibility to inform them. The issue is that this contract, for us it's almost 35 pages, and it's simply a legal text.” (I7)</p>	<p>There is a lack of knowledge transfer on the subject and a lack of knowledge among prospective employees, which can lead to a broader information asymmetry.</p>	
<p>“(…) we didn't learn what it [ESOPs] means at university. So I took care of it on my own, simply because I know it will come to us sooner or later. But the fact that you probably don't necessarily know it now as a future employee is a logical conclusion for me. (…) one hundred per cent that there is an information asymmetry between founder and employee.” (I8)</p>		<p>Employees may face uncertainty and potential disadvantages and the challenge of limited transparency in employee share ownership programmes where negotiations take place without the direct involvement of employees.</p>
<p>“No. (…) That's [explain the employee how ESOP work with help of a lawyer] far too expensive” (I2)</p>		
<p>“There are many employees who don't understand it yet and they don't really see the added value. They also do relatively little about it.” (I7)</p>		
<p>“They [employees] are sometimes very short-term orientated. (…) unfortunately, it's also the case that, from a purely legal point of view, you have a certain obligation, but as a company you can always get out of it by not paying it out.” (I7)</p>	<p>While potentially beneficial, ESOPs can have a negative impact on employees due to legal clauses.</p>	
<p>“(…) some contracts are designed in such a way, including ours, that there is a so-called negative vesting for a certain period of time, so that all the money you have earned, if you leave the company anyway goes back to the company, which of course is not always so good for employees and yes.” (I7)</p>	<p>Full transparency in employee share ownership programmes is difficult because employees are not involved in the negotiations, making it difficult to understand how their shares will be treated in future financing rounds.</p>	
<p>“That's why, and this is essentially super unfair, but you'll never be able to share complete transparency with employees through such participation programmes. (…) I always have the disadvantage that as an employee, whether it's VSOP or ESOP, I'm not sitting at the negotiating table and in the end actually have no connection to how my shares will be disposed of in the next possible financing round.” (I5)</p>		
<p>“(…) it [ESOPs] can also be very negative for the employees in some cases because there are legal clauses in there that tend to be a disadvantage for the employee in certain cases. (…) simply be in favour of ensuring transparency from the outset and disclosing what individual clauses actually mean and going through this with the employees in advance. Because I actually see the biggest risk in terms of reputation. (…) the employee doesn't get what they hoped for or wanted and perhaps misunderstood it and you really break it down from the outset” (I8)</p>		

Table 3 – Data Analysis

Source: Own illustration; based on the qualitative content methodology of Gioia (2012)

ESOPs are considered standard practice in the start-up ecosystem, and investors also recognize their importance in creating positive incentives.

The interviews revealed that all founders were concerned with the issue of employee ownership, with the prevailing view being that the introduction of an ESOP is considered standard practice. The participants I1, I2 and I4 named values of around 10 per cent as a typical figure for the size of an ESOPs pool for start-ups. With regard to vesting, a duration of 4 to 5 years was consistently mentioned in the interviews and was considered the default value, as stated by founder I5: “And vesting was fixed over a period of 4 years. So, it is the normal number in a program.”

In the interviews, there was a common opinion that investors have a positive attitude towards ESOPs and that they are recognized as a standard and integral part of the start-up landscape. This opinion was confirmed in particular by founders financed by external capital, e.g. I7: “So we introduced it right from the start. also has the background that we are classically financed. (...) and nowadays it's actually standard practice demanded by investors to build up a classic ESOP pool.”

Above all, investors recognize the benefits that go beyond the financial aspect and see ESOPs as a crucial component in attracting and retaining young talent. In addition, ESOPs are seen as effective tools to motivate experienced professionals to join young companies and contribute to their growth as described by founder I2: “The investor says, (...) the people at the beginning, these are the most important people you have, you have to get the smartest people and preferably senior people and if you could bring the cash down a bit at the beginning. (...) so they're more positively incentivized.”

The implementation of ESOPs in start-ups is time-consuming, complex and requires prioritization, external support is crucial for a smoother and successful implementation process.

A common topic from the interviews is the recognition of the inherent complexity of introducing employee share ownership programmes and that this can be underestimated at the start of implementation. One interviewee (I1) pointed out that the complexity of ESOPs in his company led to a scenario where implementation was postponed several times and ultimately not implemented: “So it's [the implementation of ESOPs] all relatively complex (...) And in the end, there were simply other issues in our case, so unfortunately we didn't deal with it any further.” Respondents agree that bringing in external expertise from law firms, at the outset is crucial to managing the complexity of the process. The predominant approach is to involve

legal advisers at an early stage to draw up standard contracts tailored to the terms under discussion. Despite the costs involved, respondents were unanimous in stressing the need for external support to ensure the accuracy, compliance, and effectiveness of ESOPs, as it was pointed out that the cost of faulty contracts or subsequent restructurings can be very high, and it is therefore important to protect against this. I6 described the concern that accompanied the founders during the implementation, especially with regard to subsequent adjustments or errors due to lack of knowledge: “We had a law firm with us. (...) Yes, the costs of having to change something or of it not being 100% accurate or of claims arising that you don't really have under control, or something are far too high.” This illustrates the challenges and potential hurdles that start-ups can face when dealing with the complexity of implementing ESOPs.

Founders emphasize the importance of transparency in relation to ESOPs and address them during the interview and salary negotiation process to assess a candidate's long-term commitment and motivation.

From the interviews, it is clear that the timing of the introduction of employee stock ownership plans varies, with some founders emphasising the integration of ESOPs as a key aspect during the interviewing process and others later in the salary negotiation process. Although there is no uniform agreement on the exact timing of the introduction of ESOPs, some founders agree that starting these conversations early can provide insight into the key motivations of potential employees. For example, one interviewee (I7) emphasizes that the topic of ESOPs is consistently brought up in the interview prior to the hiring decision: “I would be really transparent about it from the start and also say in the job interviews, i.e. also in the salary negotiations, that this is an important part, because you can also see from it, so for us this is also a criterion, is an employee only motivated in the short term or can he also imagine staying with the company in the long term.” This interviewee emphasized the importance of transparency from the outset, explaining that discussions about ESOPs should begin early in the recruitment process so that the employer can assess the candidate's motivation - whether it is short-term or indicative of a long-term commitment to the company.

ESOPs in start-ups are used as incentive connected with emotional engagement and creating a sense of ownership.

ESOPs in start-ups are seen as an effective tool for fostering emotional engagement and creating a sense of ownership among employees. As one interviewee (I2) noted, the value of incentives goes beyond financial rewards: “You don't just incentivize monetarily, but you also incentivize

with participation, that's emotional, that people say I have a share in a company.” This kind of compensation extends to the emotional realm where employees feel a genuine interest in the organization. Another interviewee (I1) emphasizes the importance of passion and commitment when taking on responsibility in a start-up: “But I would basically say that the people who really take on responsibility have to be passionate about the mission and the problem, especially in a younger company. And in that context, of course, both sides want the person to get sticks.” The way one gets involved reflects a mutual interest in creating a lasting connection where employees are not just contributors but real stakeholders in the start-up's journey.

Struggling with the dilemma of attracting and retaining top talent, start-ups are strategically utilizing ESOPs to compensate for higher salaries.

The Interviewees are aware of the challenges associated with start-ups, particularly the financial constraints that often accompany these ventures. Given the limited financial resources, they emphasize the strategic use of ESOPs as an important compensation method when competitive salaries are difficult to offer. There is a consensus that start-ups, which typically lack significant financial resources, use ESOPs to attract and retain qualified talent, especially in key positions that are critical to the company's growth.

The risk of losing key employees to competitors is a critical challenge in the start-up landscape. The risk is particularly high for key positions, whose departure could lead to a significant loss of knowledge and operational setbacks as mentioned by founder I3: “So it's not just that they have their own motivation to pay less money, but also that if someone comes along, and unfortunately that happens relatively often, and makes another offer, someone wants to grab one of ours (...) and who would get another offer, which we couldn't offer at all, that would be bad.” By offering their employees a stake in the company, start-ups create a tangible reason for key people to stay involved and invest in the company's success.

In general, the topic is difficult for employees to understand due to its complexity and there is an uneven level of awareness of ESOPs which can lead to an asymmetry of interest.

In the interviews, the asymmetry in employees' knowledge of ESOPs was repeatedly emphasized. The complexity of ESOP contracts makes them difficult for employees to interpret and understand as explained by founder I7: “There are many employees who don't understand it yet and they don't really see the added value. They also do relatively little about it.”

Although the responsibility of companies to inform employees about ESOPs is recognized, some explained that the comprehensive explanation of these plans is often neglected due to the

high costs involved: “No. (...) That's [explain the employee how ESOP work with help of a lawyer] far too expensive” (I2). Some employees who are familiar with ESOPs are more interested in them, while others are less interested due to a lack of prior knowledge and prefer a higher salary component. This disparity in employee knowledge consequently contributes to inconsistent awareness of ESOPs and also asymmetric demand within the organization.

Employees may face uncertainty and potential disadvantages and the challenge of limited transparency in employee share ownership programmes where negotiations take place without the direct involvement of employees.

The interviews reveal that promoting transparency and understanding in the context of employee participation programmes is a major challenge. Ensuring full transparency for employees was identified by the founders in the interviews as one of the main challenges in using ESOPs: “(...) it [ESOPs] can also be very negative for the employees in some cases because there are legal clauses in there that tend to be a disadvantage for the employee in certain cases. (...) simply be in favour of ensuring transparency from the outset and disclosing what individual clauses actually mean and going through this with the employees in advance. Because I actually see the biggest risk in terms of reputation. (...) the employee doesn't get what they hoped for or wanted and perhaps misunderstood it and you really break it down from the outset.” (I8)

This is mainly due to the legal requirements that employees are not involved in the negotiations, as founder I5 explained: “That's why, and this is essentially super unfair, but you'll never be able to share complete transparency with employees through such participation programmes. (...) I always have the disadvantage that as an employee, whether it's VSOP or ESOP, I'm not sitting at the negotiating table and in the end actually have no connection to how my shares will be disposed of in the next possible financing round.” As the employees are not listed in the shareholder agreement and are therefore not directly involved in discussions, it is difficult for them to understand how their shares are developing in the further development of the start-up.

5. Discussions

5.1. Theoretical and managerial contributions

Comparisons between the literature review and this study show both confirmation of previous research and new perspectives that shed light on how ESOPs are implemented in start-ups, what motivates founders and what challenges they may face. Based on the research question, which

relates to the organization of implementation, motivation and challenges, the findings could also be structured in this way.

The literature is confirmed and enriched by the findings on ESOP implementation and design. The first finding of this study on design and implementation underlines that the standardization of ESOPs as an integral part of the start-up ecosystem is widely recognised by founders and investors. This result confirms a managerial contribution that also allows for a specification of the design of ESOPs in start-ups, which has been less concretized in the literature. In the interviews, a common benchmark of about 10 per cent ESOP pool was identified as a typical value in the industry and a vesting period of about 4 years was confirmed.

In addition, the issue of investor perception of ESOPs has received little attention in the literature. As a result, the study can enrich the literature by showing that investors also consider ESOPs as standard in the context of start-ups and emphasize the strategic value of ESOPs for talent management and general company development. The perception of ESOPs by investors plays an important role in the context of start-ups, as investors have a major influence on the financial resources of start-ups. The complexity of the issue is emphasized in the literature (e.g. Westendorf, 2007) and is in line with these results, but is of great importance in view of the difficulties faced by start-ups. An important new finding, however, is the recognition of the urgency of seeking external legal advice, which is usually categorized as costly. This use of external help shows that it is a priority for start-ups. The third finding, also related to implementation, concerns the timing of when ESOPs are presented to and negotiated with employees. This has received less attention in the literature to date, as the literature focuses more on the use of ESOPs for senior employees who are offered to them at a certain career stage (Pendleton et al., 2021). The result of the interviews is that employees are often exposed to the topic during the application process. However, it was not possible to form a uniform opinion on the exact point in time, as founders were also interviewed, but their implementation of ESOPs has not yet been finalised.

The findings of this study, which deal with the motivation for implementing ESOPs in start-ups, confirm the results from the literature. The main motivations recognised in the literature, e.g. in studies by Pendleton et al. (2021) or Kruse et al. (2004), such as the empowerment of employees or the promotion of interests, are confirmed in the fourth finding for the start-up context. The emotional attachment identified in the interviews is in line with the literature and shows that ESOPs not only serve as a tool for attracting and retaining top talent, as Aldatmaz

et. al. (2018) emphasize, but also promote employee engagement. In particular, the study emphasizes the complex role of ESOPs, which goes beyond financial incentives and also includes emotional engagement and a strong sense of ownership among employees. Furthermore, ESOPs are recognised for their role in promoting employee engagement with the company, which was acknowledged by Pugh et al. (2000) and confirmed in the interviews. The motivation for introducing ESOPs formulated by Mahmood (2020) and Henning et al. (2023) in the context of aligning interests was not mentioned by the founders interviewed.

The challenges associated with the implementation of ESOPs are addressed in the literature as a risk that employees take with ESOPs, e.g. in Pendleton and Robinson (2022), and presented for the context of start-ups in Hartman et al. (2011).

New contributions of this work to the existing literature are gained with regard to difficulties in knowledge transfer and the right level of transparency within the company.

These critical aspects regarding the awareness and knowledge of employees are confirmed in the seventh result. A certain asymmetry in employee knowledge on this topic was emphasized in the interviews. This asymmetry exists both between the employees themselves, but also between employees and management. The latter can lead to employees' lack of knowledge being exploited as they are unaware of the complexity of ESOP contracts and their exact meaning.

A key new finding of the study, which has received little attention in the literature, is that employees who understand this form of compensation well are more likely to be open to ESOPs and demonstrate this early in the application process. Employees who have had little exposure to ESOPs and know little about them are more likely to be discouraged from exploring the topic. They are less likely to enquire about ESOPs, see fewer long-term benefits and appear to be more risk averse. This lack of knowledge presents a barrier to employees understanding the intricacies of their participation options, highlighting a general problem in ensuring clear communication and understanding within such programmes. One interviewee and the paper by Pendleton and Robinson (2022) suggest that this can lead to a scenario where the sale of shares for profit is very far in the future and employees are often unaware of this. A lack of knowledge can lead to employees clinging to unrealistic, quick success scenarios that rarely materialize.

This problem of employees' lack of knowledge goes hand in hand with the problem of transparency, which is emphasised in the literature by Vanderslice et al. (2000) and is consistent with the findings of the interviews. The founders emphasise the importance of transparency in

the early stages of the recruitment process, including interviews and salary negotiations. Vanderslice et al (2000) also see the benefits of workshops and open communication in ESOPs which, in line with the interview findings, could lead to appropriate knowledge sharing and promote transparency to a great extent. Anderson (2009) also points to conflicts of interest between direct shareholders and employees who are not directly involved but receive ESOPs, which was also recognised by the founders as a major challenge for the right level of transparency. The difficulty is to ensure the right level of transparency for employees in relation to the future development of the company and their shares. This is particularly due to the fact that most start-ups opt for VSOPs as their preferred method of employee ownership. The simplification in terms of bureaucracy, namely the simple allocation of shares to employees without constant adjustments to the shareholders' agreement, harbours disadvantages. As employees are excluded from the shareholders' agreement, they are not involved in the negotiations and therefore do not have access to all the information that is available to direct shareholders.

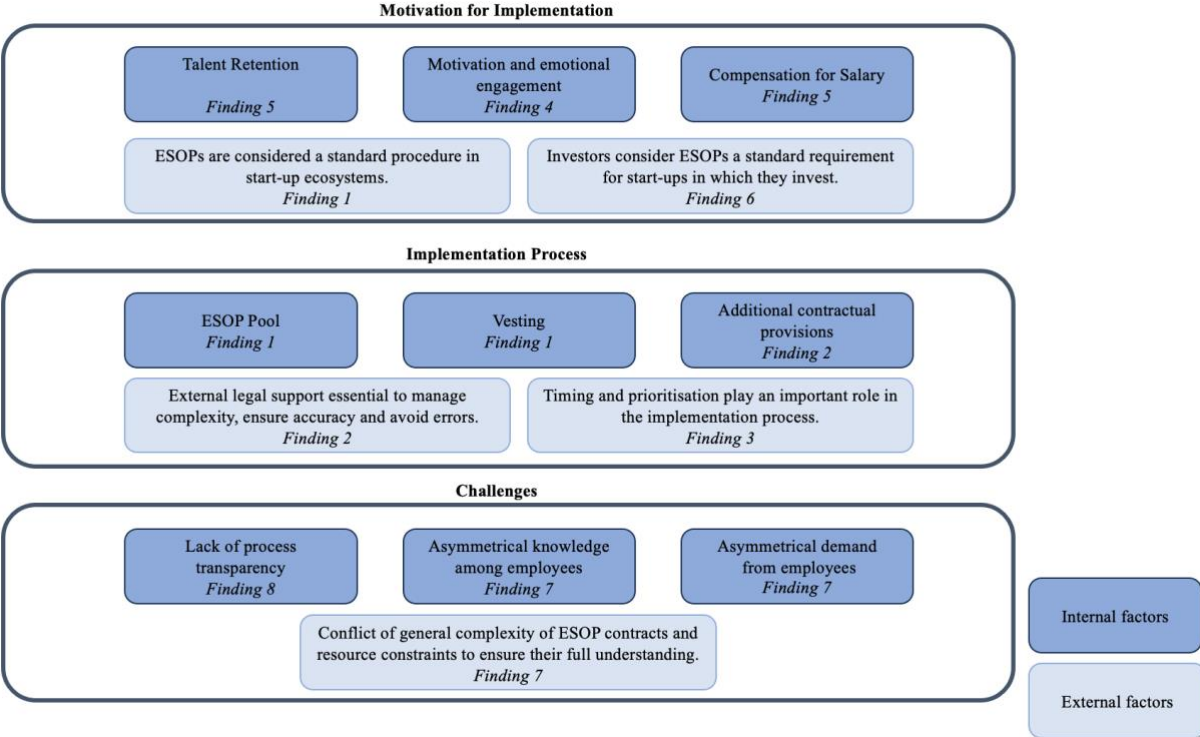


Figure 1 – Findings: ESOP implementation in Start-ups
 Source: Own illustration based on the findings of this study

The figure shows the visual representation of the research results and findings from the interviews. The visualization focuses on the three main findings about the drivers of ESOPs: motivation, implementation, and challenges.

The main motivating factors identified in the literature review, namely retaining talent, increasing employee engagement and salary compensation, were confirmed by the results of the interviews. The motivation to introduce ESOPs is also influenced by external factors, namely the fact that ESOPs are considered standard for start-ups and are also demanded by investors.

In terms of implementation, the study highlights the perceived complexity of the topic and the associated need for legal advice as an external influence, as well as the need for prioritization and timing. In addition to the theoretical results, the size of the ESOP pool and the duration of vesting were confirmed as managerial contributions.

The most important new contributions of this work were identified with regard to the challenges faced by start-ups during and after implementation. These include issues of transparency within the company, but also on the part of employees, issues of demand for and knowledge about ESOPs. The limited financial and time resources that characterise start-ups play an important role in overcoming these challenges and act as an external influence on them.

5.2. Limitations

When conducting this master's thesis on ESOPs in start-ups, certain limitations had to be considered due to the qualitative methodology chosen to investigate the research question. Qualitative research involves interpretation, which makes it susceptible to the subjectivity of the researcher. This carries the potential for bias in the analysis, as perspectives and biases can influence the interpretation of the data. In addition, qualitative findings are often context specific, making it difficult to generalise the findings across the field. In the case of this study, the unique characteristics of each start-up and the individual experiences of the founders make it difficult to generalise the study's conclusions to a wider context. There were challenges in reaching and selecting interviewees, which contribute to potential limitations in the diversity of the sample. One reason for the difficulty in finding interviewees may be that founders may be reluctant to talk about ESOPs, a topic that involves intricate details of the internal workings of their companies. The difficulty of finding interviewees was exacerbated by the requirement that they meet the criteria of a founder, and these individuals tend to have busy schedules. The sample size and diversity of the study is therefore potentially limited, which affects the

transferability of the findings to other sectors and start-up stages. The quality of the information depends on the knowledge of the respondents, which leads to variations in the depth of the results. There is also a risk of positive bias, as respondents may highlight successes of their ESOP implementation rather than challenges, distorting the overall picture. Given the dynamic nature of the start-up ecosystem and possible changes in ESOP dynamics over time and the duration of this work, this also limits the findings. In addition, the study does not fully analyze the employee perspective, which is crucial for a full understanding.

5.3. Future Research

Further research on ESOPs in start-ups should consider the limitations mentioned above and shed light on other issues. For example, a cross-country comparative analysis could be conducted to analyze how specific legal frameworks and government incentives influence the adoption and effectiveness of ESOPs. An analysis of differences in the implementation of ESOPs in different industries or sectors could provide insights into sector-specific challenges and benefits. A comparative study of different funding rounds could shed light on how the stage of development of a start-up affects the design and outcomes of ESOPs. In addition to comparative analyses, another possibility would be a more historical examination that would shed light on the evolution of ESOP trends in recent years, particularly in relation to economic conditions and changes in the start-up landscape. Assessing the impact of economic conditions on ESOP adoption rates and changes in response to external factors could provide valuable strategic insights. A greater focus on the selection of start-ups to be analyzed could be ensured by examining the diversity within the founding teams, particularly in terms of gender.

A clear focus of future research derived from this work should be on the employee perspective. Research could look at employees' knowledge of ESOPs, their risk tolerance and the strategies used by organizations to ensure understanding. Investigation of possible solutions to improve employee understanding and whether less knowledge leads to less risk taking and therefore less demand and implementation of ESOPs seems important for the field.

6. Conclusion

This study examines the complex landscape and potential of using employee share ownership plans in start-up companies. Building on the existing literature, the study not only confirms the motivations for introducing ESOPs, but also reveals new perspectives, particularly with regard to knowledge transfer and transparency for employees who receive ESOPs.

While much of the literature has focused on these benefits of ESOPs, this study highlights the complexities associated with their implementation. In particular, it highlights the crucial role of knowledge transfer and the general expertise of employees as recipients of ESOPs. This aspect emerges as an important but under-researched dimension that represents one of the major challenges in the design and implementation of ESOPs. The importance of seeking external support in formulating and structuring ESOP agreements is also highlighted by this, recognizing the complexity of these agreements and the problem of the adequate level of knowledge.

The simplification intended by the predominant use of VSOPs in start-ups, namely the simple allocation of shares to employees without frequent adjustments to the shareholders' agreement, has considerable disadvantages. As the employees are excluded from the shareholders' agreement, they are not involved in the negotiations. As a result, they are not included in the discussions and may have difficulty understanding crucial aspects, such as the deviations that may arise during a financing round specifically for the ESOPs.

This aspect emphasizes the deep connection to corporate culture and sheds light on how individual companies and founders deal with transparency in this context. Understanding this dynamic is critical to deciphering the complex relationship between the implementation of ESOPs and the right level of transparency afforded to employees.

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Appendix

Appendix 1

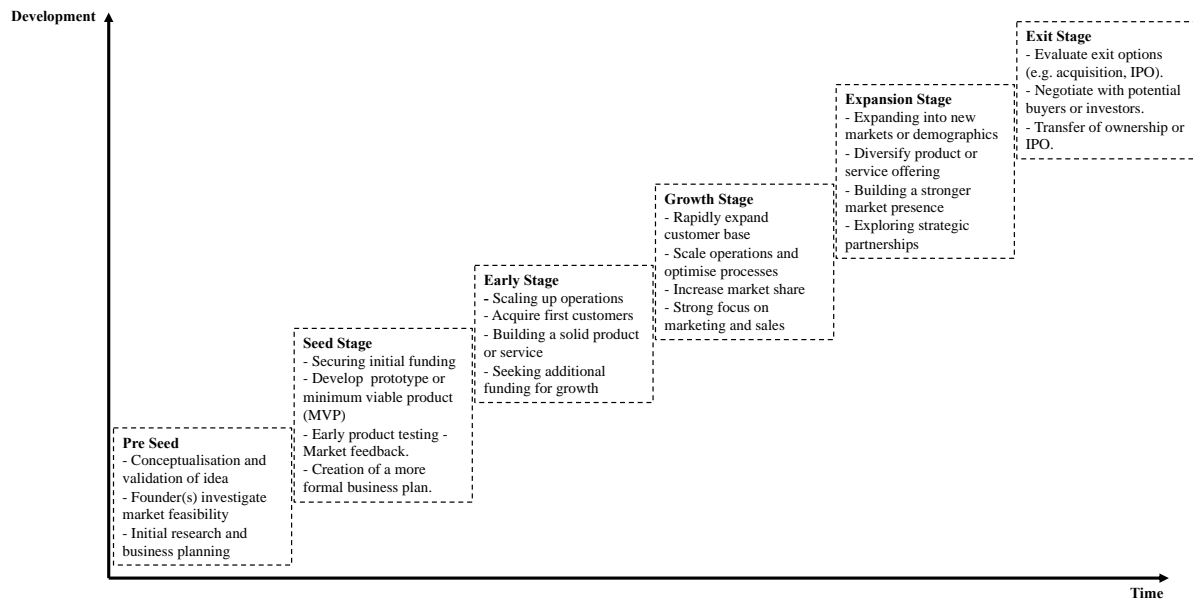


Figure 2 – Stages of a Start-up
Source: Passaro et al. (2016)

Appendix 2: Interview Script detailed

1. Introduction and Background:
 - 1.a. Recording permission.
 - 1.b. Number of employees
2. Overview of ESOPs in Start-ups:
 - 2.a. Founder's knowledge on ESOPs.
 - 2.b. Current ESOP Status
 - 2.c. Motivation to implement ESOP
 - 2.d. Challenges
 - 2.e. Potential external help
 - 2.f. Timing for ESOP Implementation
 - 2.g. Future Changes and Company Structure
 - 2.h. Impact on future funding
 - 2.i. Investors Perception
 - 2.j. Details on design on ESOPs
 - 2.k. Employee Demand, Knowledge and Negotiations
 - 2.h. Founder's Perspective and Learning
3. Conclusion
 - 3.a. Founder's Lessons Learned
 - 3.b. Appreciation for exploring the topic

Appendix 3: Overview ESOP Models

	ESOP	VSOP
Participation in profits	After exercised	Possible
Employee's own investment	Yes, strike price	Usually no
Right to information and disclosure	After exercised	No
Participation in shareholder meeting	After exercised	No
Notary required (GmbH)	Yes	No
Taxes	If exercised, wages if applicable (Dry Income)	No Dry income, Taxation of the entire inflow as wages

*Table 4 – Different forms of ESOPs
Source: Hahn (2023)*