



JUPITER WEALTH

# Employee Share Ownership Plans

# Carrot or Stick?

KNOWLEDGE × SECURITY × PROSPERITY

In the private sector, finding - and retaining - good staff is one of the biggest challenges companies face.

Apart from remuneration and benefits packages, which can be challenging for start up businesses and the SME sector, incentivising staff who have joined the company due to a shared vision and goal can be achieved by giving employees, and in particular key employees, a stake in the business. This way, there is an alignment of goals - long term growth and success for the company and personal reward, success and a voice in the company for the employee. In many cases, the employees will be seeking a form of liquidity event to crystallize the value of their shareholding, whether by company sale, exit or listing.

Employee Share Ownership Plans can be relatively simple and straightforward to set up. However, as seen with the rise, and fall, of BrewDog, if not set up properly with consideration, transparency and appreciation of different scenarios that can affect the company, such schemes can fail the very people they were set up to benefit.



# Financial Investment – Risk vs Reward

At the very outset, it is perhaps worth stating the obvious. As a wealth manager, owning unlisted shares, especially in start up companies, is high risk. Most employees should be reminded of this on a regular basis, even if the company is growing and performing well.

“The value of investments can go down as well as up”

When the shares an individual holds are shares of the company they work for, there is a natural tendency to become more comfortable with the risk – after all, they are able, collectively, to help influence and grow the company. However, there are factors outside of an employee, and company’s control, that can influence and impact the growth of a company, including macroeconomic factors, or systemic risk such as the Covid pandemic.



# Laying the right Foundations

A well-thought through strategy, and good advice at the outset would make the scheme more robust and viable.

Key points for founders to consider would include:

- How much of the company's equity (if any) would be available to employees, and which employees (all or key employees), and potential dilution impact of grants of shares
- The types of shares to be granted and the way in which these are to be allocated to employees - this could be way of share options, actual shares or virtual/phantom shares, payments in lieu of bonus payments to certain employees, or vesting to employees who attain certain milestones with the company (long service rewards)
- The rights attached to those shares e.g. non-voting or voting, ordinary or preference shares
- A methodology for valuation of shares
- Rules regarding exits and selling terms e.g. good leavers and bad leavers etc.
- Succession planning rights for death in service, including whether spouses and children of deceased employees can step into their place
- Taxation issues for employees
- Impact of listing of company shares and/or additional third party investment into the company



Some high profile mistakes made in the drawing up of employee share ownership schemes include a well known fintech bank, where information provided to former employees proved to be inaccurate and as a result of those relying upon the information, they faced significantly higher tax bills than had been expected, leading to a number of complaints being raised, and the matter coming into the press.



More important than anything, there needs to be flexibility built into the schemes themselves, since rules and regulations change and schemes need to be able to adapt to such changes. Where companies have employees based in a number of different countries, accommodating each of their specific needs and circumstances (and laws) can be challenging. Instead, what most companies tend to do is seek to accommodate most of the employees who are likely to be in the same country, and make the scheme as neutral as possible. It is then incumbent on each employee, especially those who are not based in the company's home country, to make sure they know the treatment of the scheme in their personal circumstances.

The key for any employee share ownership plans is clear, open and transparent communication on an ongoing basis by the founders and management to employees and former employees.



# Structuring ESOPs

The ESOP is commonly set up as a separate legal entity or structure – this could be a purpose trust, or a foundation.

A purpose trust is a trust is set up for a particular reason or purpose, namely to hold a portion of shares for a potentially changeable range of beneficiaries – in this case, eligible employees or former employees. Foundations could also be utilised since the objects of the foundation could be to hold the portion of shares for eligible employees or former employees.

Along with the trust deed or charter and by-laws, there would be a set of rules and regulations to the ESOP. These would contain the details of eligibility, vesting periods and exercise rights, exits and liquidity events, succession rules and transferability, methodology for calculating entitlements and share valuations, and so on.

## Management of the ESOP

For more well-established companies, the management of such schemes could be outsourced to professional service providers. However, in the case of smaller start up companies, members of the board could be delegated to manage the ESOP along with appointed employee representatives. This is important since the employees would then have the right to information about the performance of the company and the scheme, and a channel to raise any questions or concerns they have.



# How can Jupiter Wealth help?

Through our wealth planning and family office, and corporate advisory services, we can support you in drawing up a blueprint for your own scheme, helping appoint specialist advisors and guiding you through the process of establishing this, providing you with ongoing support and guidance, working alongside your advisors to make sure your scheme grows along with your business and remains aligned with your goals and ambitions.

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