Index Ventures



Rewarding Talent

A guide to stock options for European entrepreneurs

Behind every human advance is a story of teamwork and collaboration. History celebrates individuals – the big names. But, as every great entrepreneur knows, it's the team that turns the dream into reality.

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1 The Index Ventures experience

One giant leap. One giant team.

NASA estimates more than 400,000 engineers, scientists and technicians dedicated a decade of their working lives to the first moon landing.

So while Neil Armstrong and Buzz Aldrin made the historic touchdown, they represent only 0.0005% of the entire Apollo 11 team. That's why, in the years leading up to the mission, Armstrong and Aldrin travelled across the US to personally thank their fellow team members for their contribution.



Our insight
The untapped potential of employee stock options

At Index Ventures, we're proud to back the most ambitious entrepreneurs, and support them on their journey to realize their vision.

We were born in Europe more than 20 years ago, and today we have feet firmly planted on both sides of the Atlantic. From our hubs in London and San Francisco, we use our deep knowledge to invest in outstanding startups. We have 160 companies in our portfolio, equally split between Europe and the US.

World-changing tech companies can start anywhere – but we recognise Silicon Valley's sophisticated model of scaling and investing in startups as second to none. We adapt and apply best practices from Silicon Valley to our startups in Europe, to prime them for success.

One of the key ingredients is employee ownership. In Silicon Valley, employee stock option grants have helped attract the world's best talent to small startups with limited cash, but near limitless potential. The result is that these startups have the people they need to succeed early on.

In Europe, employee ownership is less common – and there's no clear playbook for startups to follow. This is exacerbated by the complexities of doing business on a continent made up of 30 different countries, all with different cultural norms, regulations, tax incentives, and so on.

This handbook is designed to help European founders make critical decisions. Who do you offer stock options to? How many? When? How do you adapt your policy as you grow, and as you move into different geographies? How can you ensure employees understand the scheme?

We've included the basic information you need to design your stock option plan and policies, ready-to-use allocation models, and advice from those who've been through it – plus our own perspective as investors. You'll also find case studies from Index portfolio companies throughout the book, demonstrating the range of best practice. Founders and executives from the likes of Just Eat and Criteo share their approaches to employee ownership, their successes and their mistakes, and the valuable lessons they've learned in the process.

Alongside this handbook, we've developed the OptionPlan app, which will help you determine option allocations for your team at Series A.

You can find it on our website at:
www.indexventures.com/OptionPlan

Our take
Bringing employee ownership to Europe

In the US, option grants are driven by intense competition for talent. There are established benchmarks for option grants to employees at all stages and levels. Thousands of employees across hundreds of startups have benefitted financially following company exits.

Europe has seen fewer exits, and option grant benchmarks haven't been available, so founders have been forced to make up their own rules. But competition for talent is heating up, and with more high-profile exits, individuals are more willing to exchange cash for stock options, especially in major tech hubs.

We therefore expect the next generation of European startups to offer options more widely to employees. By staying ahead of this trend, startups can attract and retain the best talent out there. However, this must be coupled with changes in national policies, which encourage the use of stock options across the continent.

At Index, we believe that a fresh approach to employee ownership is key to creating European tech giants on the scale of Google or Amazon. Until then, too much of Europe's top talent will simply join the European arms of US firms, relocate, or stick to lower-risk corporate jobs.

The methodology
How we put this handbook together

This handbook is based on what we believe is the most extensive research ever conducted on employee stock options in European startups, which included:

- Cap table analysis by funding round across 73 companies in the Index European portfolio
- Analysis of over 4,000 individual option grants from more than 200 startups across Europe and the US, supported by Option Impact from Advanced HR
- In-depth interviews with founders, CFOs and executives of 27 Index-backed European companies from seed stage to post-IPO
- Survey on ESOP practices completed by executives from 53 European startups and former startups, representing over 11,000 total employees
- Review of regulatory and tax policy in the US and key European markets, supported by Taylor Wessing, Wilson Sonsini, and several other law firms

Key findings
A top-level summary

We found big differences in employee ownership between the US and Europe. They are presented throughout this book, but here are a few key points.

1 **European employees own less of the companies they work for than US employees.**
For late-stage startups, they own around 10%, versus 20% in the US.

2 **Ownership levels vary much more in Europe than the US.**
In Europe, employee ownership in late-stage startups ranges from 4% to 20%. In the US, ownership is more consistent, as stock option allocation is driven by market forces.

3 **Employee ownership correlates to how deeply technical a startup is.**
An AI or enterprise software startup requires more technical know-how than a straightforward e-commerce startup. These employees are more likely to seek stock options.

4 **Ownership policy details adopted by startups vary between the US and Europe.**
For example, provisions for leavers, and accelerated vesting following a change in control.

5 **In Europe, stock options are executive-biased.**
Two-thirds of stock options are allocated to executives, and one third to employees below executive level. In the US, it's the reverse.

6 **European employees still don't expect stock options much of the time.**
US employees joining a tech startup with fewer than 100 staff would typically expect stock options straight away. This is much less true in Europe, although expectations are steadily rising.

7 **European option holders are often disadvantaged.**
In much of Europe, employees will be paying a high strike price, and they will be taxed heavily upon exercise as well as sale. Leavers often get nothing.

8 **There is wide variation in national policy across Europe, with the UK most supportive of employee ownership.**
Regulations and tax frameworks are radically different across Europe. The UK's EMI scheme is most favourable, better than what is available in the US, and France is also good. Other countries, including Germany, lag behind in our opinion.

Stock options 101
A top-level summary

Options are a special type of contract. They grant the holder the right – but not the obligation – to buy or sell an asset at a set price, on or before a certain date.

In established US practice, stock options grant the holder the right to buy shares (exercise their options) at a set (or strike) price, within a ten-year period.

The option allows the owner to buy a certain number of shares. The right to exercise will vest over a four-year period; typically, there will be a one-year cliff before the holder has any rights, then vesting will be linear, allowing the holder to buy a further 25% of their shares by the end of years one, two, three and four.

If they want to exercise their options, the holder must pay the exercise price (strike price x number of options). In return they will receive ordinary shares in the company. The holder may be able to sell these shares immediately, or retain them in the hope they will further appreciate in value.

It only makes sense to exercise options if the current share price of the company exceeds the strike price. Exercise requires a cash payment, so the decision to exercise also depends on how long the holder thinks they will have to wait before they can see a cash return by selling the shares. Any tax incurred will also influence this decision.

Stock options are the instrument of choice for employee ownership in US startups. They are better than giving shares to an employee because there is no premium or tax to pay upfront, making them risk-free for both employee and company.

In Europe, the rules and tax treatment of stock options varies widely between countries. In some countries, it still makes sense to use stock options. In others, alternative instruments are used instead. But in each case the purpose remains the same – to incentivise employees, by rewarding them if the company's value increases.

To keep things simple, we've referred to all of these instruments as 'stock options' in this handbook, even though their legal status may be very different. These include warrants, Restricted Stock Units (RSU), and virtual stock options.

You'll find a detailed glossary of legal and financial terminology in the Appendix.

2 Startup ownership

Born into the family.

You could be born, have your first day at middle school, last day at high school and leave home for college in the twenty years it took Pixar to create the first Toy Story.

Even now, the studio's films can take four years to create. Which is more than enough time for the team to grow. The children born into the Pixar family are called 'production babies': unofficial members of staff deemed so important their names even feature in the credits.



Employee ownership: why it matters

It can help you hire, retain, motivate and align

The labour market is fiercely competitive. Major corporates, internet companies, banks, and consultancies all vie for the top candidates, particularly for technical roles. With high salaries, attractive benefits packages, and stability on offer, how can startups compete?

A compelling small company culture is one advantage startups have over big heavyweights. Being part of a close-knit team helping to create something truly innovative is exciting – and this can be a big attraction for employees.

But startups can also offer a more tangible benefit: ownership. Owning a stake in a company that could become valuable a few years down the line is enticing.

In fact, providing stock options can benefit founders in several ways.

Hiring
Offering stock options can help you secure the best talent, even when you're up against companies with much deeper pockets.

Retention
Once you've hired top talent, you need to hold onto it. Stock options vest over multiple years, can be topped-up, and can come with certain penalties for leavers. This gives your employees an ongoing incentive to stick with you.

Motivation
Having a personal stake in the success of the company encourages employees to work harder and be more ambitious.

Alignment
Stock options direct all employees towards the same goal – the company's overall, long-term success. They act as an incentive for collaboration – and putting the needs of the company above personal ambition.

The Silicon Valley flywheel

Employee ownership pulls in top talent

Employee ownership has been at the core of Silicon Valley thinking for over 30 years. The story of the part-time masseuse who joined Google in its infancy, and ended up a millionaire, has now been played out thousands of times, in all sorts of startups. This has drawn thousands more talented employees into the startup ecosystem.

Employee stock options are standard practice in Silicon Valley and across the US, where grants are driven by the market. Widely available benchmark data helps founders determine grants for any given role at each startup stage. In contrast, levels of adoption vary across Europe. Grants here are mainly determined by the founders' philosophy: the culture they want to create, and how mission-driven they want to be.

Ambitious founders should think and act globally from day one. This starts with a forward-thinking, consistent approach to employee ownership. Sharing the pie with employees – in other words, offering them equity – is a great way to grow the size of the pie over time.



Bringing Silicon Valley practices to Europe

Founded in Paris

2006

No. Employees

2,800

Index initial investment

Seed round, 2007

Offices

France, US, UK, Spain, India, Turkey, Sweden, Russia, Germany, Singapore, Korea, Brazil, Japan

Criteo is the global leader in digital performance display advertising, partnering with over 3,000 international advertisers to deliver highly-targeted campaigns.

The best of both worlds

Criteo was founded in France, and it retains a Paris headquarters and R&D centre. But in 2013 it listed on NASDAQ (CRTO), and the US is its largest market. Some would see this as a headache, but Jean-Baptiste Rudelle, Criteo's co-founder and CEO until 2015, viewed this as an opportunity.

> "We've implemented best practices from both markets. The combination makes our company stronger."

Learning from the US

Employee ownership is rare in France – and it was even rarer when Criteo was starting out.

> "It's just not part of our culture. Interview candidates in Paris asked us about meal tickets, not about share options."

But things changed when Criteo expanded into the US. Right away, Jean-Baptiste saw that the company would have to adapt to US standards.

> "Our second hire – an Office Manager – asked about share options during her job interview. This would never have happened in France, but Silicon Valley was very different."

Criteo decided to offer equity to everyone in the US, regardless of role or seniority.

> "The Silicon Valley attitude is: we're asking people to go on an adventure with us. If we find treasure, everyone deserves a piece. You can see the logic."

In 2010, five years after Criteo was founded, the company began offering stock options to all of its employees.

Finding the treasure

When Criteo floated on NASDAQ in September 2013, at least fifty employees became millionaires overnight. Jean-Baptiste recalls one particular employee, who joined as a part-time intern and worked his way up.

> "He took a risk, and it paid off. I'm grateful to everyone who was part of our journey."

All quotes:
Jean-Baptiste Rudelle
Co-Founder & CEO, Criteo

How ownership evolves over time

From one to many

Founders, investors and employees

A startup's success depends on three groups of people: founders, investors, and employees.

You – the founder or co-founder – are the visionary, and the final decision-maker.

Investors place their faith in you and your vision, contributing capital to kickstart and scale your business, and offering advice and expertise along the way.

Your startup is only as great as the people building it – your employees. It's a big risk to join an unproven business like yours, especially when well-established companies offer similar, more assured positions. Employees are your most valuable asset, and you need to treat them accordingly.

Together, these three groups determine the fate of your company. Company ownership is a great way to recognise and reward everyone's commitment.

Cap tables

Your cap table breaks down your company's ownership. It lists all the shareholders, and the number, class, and percentage of shares each holds.

Founders and investors are the main shareholders. This includes early investors, such as friends, family and angels, and later investors, such as venture capital funds. If you issue stock options to employees, you'll have an ESOP on your cap table, representing the total option pool available.

All too often, we've seen founders make regrettable decisions during early capital raises: giving away too much equity too soon, or on unfavourable terms. These mistakes can unnecessarily dilute your stake in the company and make it difficult to attract further funding.

The evolution of ownership

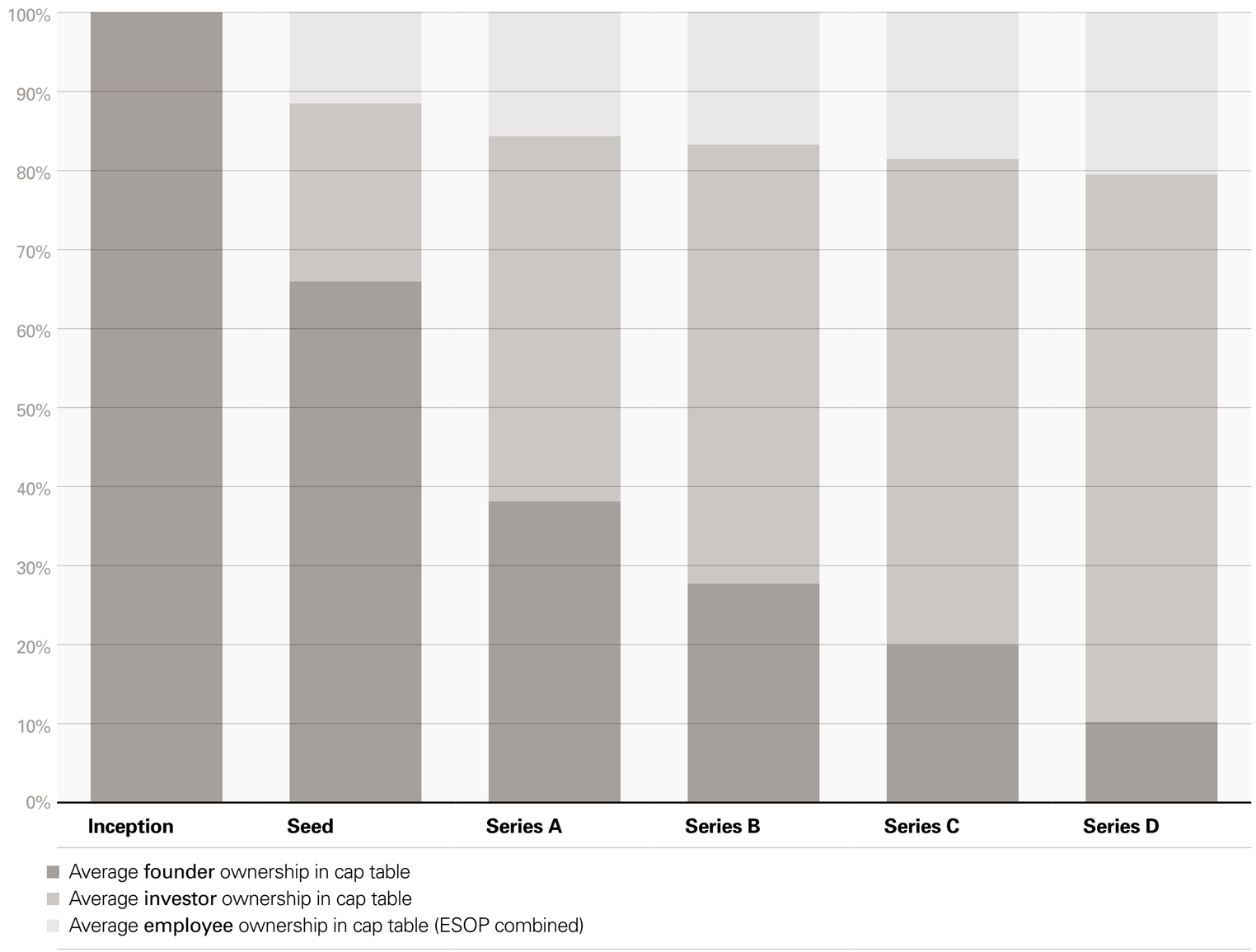
Funding rounds are a useful proxy for the stage and scale of a startup, as it moves from Seed to Series A, Series B and beyond. However, there is an awful lot of variation between startups at each stage. For the purpose of having a shared understanding, the table on the right sets out some typical characteristics of Index-funded European startups at each stage:

Funding Rounds	Seed	Series A	Series B
Type of investor	Angel investors (individuals/syndicate), seed-stage and micro funds	VC investors	VC investors, potentially growth or strategic investors
Typical round	$1m ($0.5–2m)	$5m ($3–20m)	$20m ($10–40m)
Pre-money valuation	$5m ($3–8m)	$25m ($20–60m)	$100m ($50–150m)
Development phase	Develop an MVP and initial signs of traction	Commercially viable product, testing, go to market strategies	Ramp up, go to market, internationalise
Typical headcount growth	From 0 to 10	From 10 to 60	From 60 to 150
Hires made	**Initial team** · Mainly product and engineering	**Ramp up** · Continued engineering and product · First customer-facing roles (marketing, sales, customer success) · Initial executive level hires	**Build-out** · Emphasis on commercial hires · Central teams – finance, HR, ops · Multi-layered management and leadership

On day one, you (and your fellow co-founders) will own 100% of your company's shares. As you raise capital from third party investors, you'll issue additional shares. And as you hire employees (or advisors), you may offer them stock options. Stock option holders are not shareholders. They appear on a separate line on the cap table, in your ESOP. The total number of issued shares and outstanding stock options in your ESOP is known collectively as your fully diluted equity (FDE).

Employee ownership levels are relatively consistent in the US. In Europe, levels are more varied, ranging from 4% to 20% by Series C or D. We'll explore the factors driving these variations in chapter 4.

Evolution of ownership in US startups across funding rounds
(where Founding CEO remains in place)



Source: Option Impact from Advanced HR

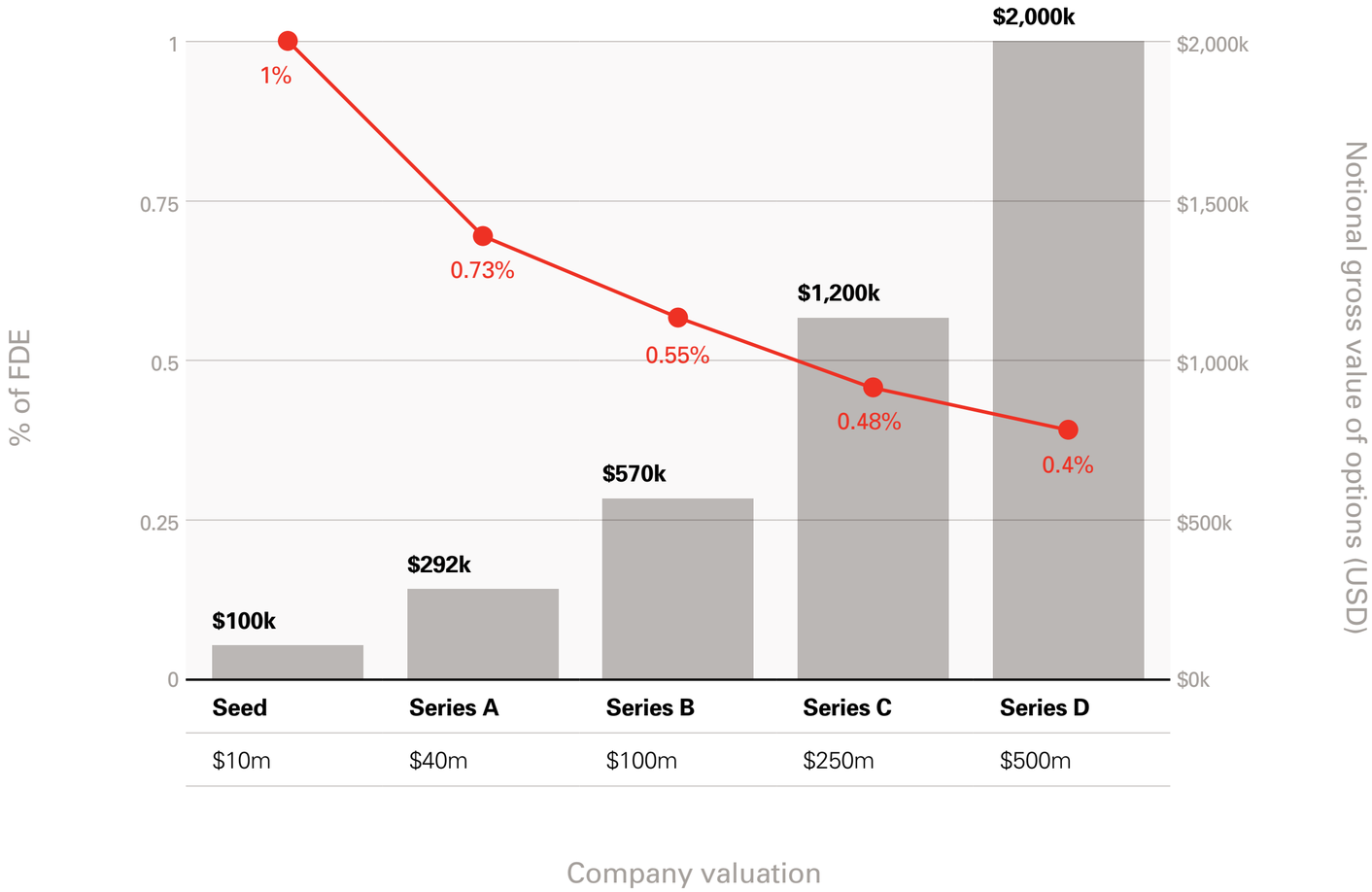
The impact of dilution

When you raise additional capital, pre-existing shareholders are diluted. This dilution is proportional to the amount of capital raised, and inversely proportional to the company valuation you achieve. Any options granted to an employee at any point in time are diluted in the same way.

This level of dilution might appear unattractive to an employee granted options early on. But it doesn't take account of valuation increases as the company scales up and attracts further funding. In other words, an early employee's options will convert into a smaller percentage of the company but may still be worth more in dollars terms.

This table shows the impact of dilution on a seed-stage hire, initially granted options over 1% of the company's FDE. It also shows the notional gross value of these options, for a strongly-performing startup as it scales.

Typical employee option dilution over multiple funding rounds



Source: Index Ventures analysis

An employee owning 1% of the company's FDE in common shares at a notional gross value of $100,000, will own only 0.40% of the company at Series D, as a result of dilution. However, the value of this diluted stake might be as high as $2 million. This shows how valuable stock options can be.

Common and preference shareholders

There are two main share classes:

- Common (or ordinary): owned by founders, employees, and seed investors
- Preference (or prefs): usually owned by institutional investors.

Stock options, when exercised, become common stock. If the company is sold at a lower valuation than the preferred shareholders paid, they will be the first to get their money back. Generally, anything left after repaying the liquidation preferences will be distributed among common shareholders. Later stage companies may have multiple layers of prefs at multiple valuation points. There are also more complex ways of structuring prefs. If the exit valuation for the company is lower than one or more of the previous investment rounds, option holders (and other holders of common stock) will only receive proceeds, if at all, after the pref holders have been paid back.

3 Seed stage option grants

Food's own finishing school.

elBulli: the world's best restaurant in 2002, 2006, 2007, 2008, 2009. And in 2011? Closed for good. Though not before head chef Ferran Adrià had launched a long line of successors.

Each year, he invited 40 interns to live together, learn together, perfect their craft together. After six months, they'd leave, to set up restaurants all over the world. Like Alinea's Grant Achatz or Noma's Rene Redzepi. Former apprentices, following their old master to the top of world cuisine.



We define seed stage as everything before Series A funding. This likely includes hiring your first few employees – probably no more than ten.

At this stage, your company will have few formal processes. You'll still be iterating your product offer, target market, and business model. So your employees will need to be highly flexible. You won't necessarily have formal hierarchies or job titles, as you'll still be figuring out both the skills you need, and the skills you have in your current team.

Compensation packages for your early team need to strike a balance. On the one hand, money will be tight, which makes options an attractive way to compensate your team. On the other, you don't want to give away large chunks of your business to people whose contribution is unproven.

This is a conundrum, and it comes at a time when you want to be focusing on your product. So, like many aspects of running a startup, it can feel more like an art than a science.

The dangers of IOUs

Think twice before making vague promises

In the US, it's common for companies to establish a formal ESOP as part of their seed funding round, and to start making formal allocations and grants. In Europe, where the costs and complexities of ESOP setup are greater, this is much less likely, although it is becoming more popular.

It's easy to run into problems with option grants when you have no formal ESOP in place. Any agreement you make is essentially an IOU – a loose commitment to offer something in the future.

This means you should be extremely careful, ensuring that any offer is clearly understood by both parties. Some founders make the mistake of agreeing equity terms on a handshake, and while this is often done in good faith, it can come back to bite either party.

Best practice: dos and don'ts for early stage equity discussions

Do

- Let your employee know roughly when the grant will be made, and when they can expect to see formal terms
- Be clear on whether the grant is based on a percentage of the company's FDE before or after the next fundraise
- Consider backdating the vesting period to when the employee started
- Aim to give yourself maximum room for manoeuvre, while still reassuring employees
- Keep comprehensive records of any verbal agreements regarding future option grants

Don't

- Make promises you might not be able to deliver on
- Be vague to the point that your employees are confused or demoralised

> "When entrepreneurs make loosely-defined promises to their employees, it can be an absolute nightmare."
>
> **Sarah Anderson**
> Director, RM2

US and European allocations

How much equity to give early employees

On average, startups that approach us for seed funding have ten employees – but it can be anywhere between zero and twenty. This early talent may well determine the company's ultimate success or failure. They are also the ones taking the biggest personal risk, as the probability of a seed-funded startup making a successful exit is less than one in fifty.

If they're experienced software engineers, or have taken a large pay cut to join, they will likely expect some level of ownership, even in Europe. Four or five of the first ten employees in a typical European tech startup could be experienced technical hires. So you'll probably be forced to think about equity, even if you can't grant formal options yet.

There's no definitive answer here. But US benchmarks for seed-stage option grants can be a useful guide – bearing in mind that European employees are generally less willing to compromise on cash compensation in return for more stock options.

Benchmarks for options granted in US seed-stage startups
Average FDE (in %)

Company function	Level of employee: **Senior**	**Mid-level**	**Junior**
Engineering	1.10%	0.40%	0.20%
Product & Design	0.80%	0.40%	0.20%
Business Development	0.60%	0.40%	0.15%
Community & Marketing	0.60%	0.40%	0.05%

Source: Option Impact from Advanced HR (US data)

In the US, it would be common for the first ten employees to all be promised options as part of their job offer. In Europe, it may be more like four of these ten. And it's not unusual to see no equity promise at all.

There isn't a large dataset to go on here, but option promises at this stage certainly tend to be lower in Europe. The next chapter has more detail on the reasons for this, but in summary they are: less competition for talent and a lower appetite for risk – which translates to a preference for salary over stock. Naturally, this general picture will vary with the maturity of a startup market.

Dev shops
You may be building your technical team in Eastern Europe, hiring talented engineers from 'dev shops' for much less than you could in Western or Northern Europe. These hires will be less likely to take a pay cut in return for stock options.

"In the UK, you now have a roster of startups which have achieved exits at values of $100m or even $1 billion. Because of this, candidates are more interested in the idea of stock than in the rest of Europe."

Reshma Sohoni
Co-founder and General Partner, Seedcamp

"More startups globally are offering equity and cash to compensate new hires. Whilst this is a global trend that will likely converge, overall, the size of the equity component in seed-stage job offers is growing in Europe."

Carlos Eduardo Espinal
General Partner, Seedcamp

Our advice? At this early stage, don't get too caught up in finding a perfect – and perfectly fair – approach to option grants.

Instead, focus on offering what's necessary to secure an individual hire, at a salary level you can afford. This might require no promise of stock options. Early on, a more ad-hoc approach is fine providing that overall grants do not disturb the cap table. Following your Series A, you'll need to standardise your approach. At that point, you can assess the role each individual will play in your future business, and use stock options to motivate and retain them.

That said, the best talent may insist on option grants. If you think a particular hire could be transformative, they may be worth 2%, or even as much as 4%, of your FDE. This is particularly true if, for example, you're not from a technical background, and they have proven expertise in building a technical team.

"At that stage, you are unsure of who is going to continue the adventure with you (…) We see a lot of role and title inflation going on at this stage, which is best avoided."

Reshma Sohoni
Co-founder and General Partner, Seedcamp

Aggregate employee ownership

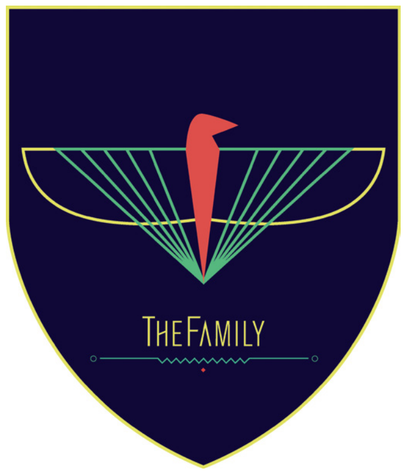
Comparing ESOP allocation in the US and Europe

Seedcamp recommends setting aside 10% of your equity for your ESOP. This is typical in Europe and the US - although accelerators including Y Combinator are now advocating 20%. But this doesn't mean you should allocate or promise all of this amount to your early employees.

Creating a formal ESOP plan involves legal work, and may not happen until Series A. This explains why in practice you may have informal IOUs at this stage, rather than formal allocations.

This mix of formal grants and informal IOUs makes it difficult to collect benchmark data on aggregate employee allocations in seed-stage startups. However, our research suggests that in the US, 4-5% of the ESOP pool will typically be allocated, leaving 5-6% unallocated. In Europe, 3-4% will be allocated, leaving 6-7% unallocated.

Overall, therefore, there's only a modest difference in seed-stage ESOP size and allocation between Europe and the US.



Making employee ownership ‘the new normal’ across Europe

Founded in Paris

2013

No. of portfolio companies

231 active startups

Index initial investment

Seed round, 2013

Offices

France, UK, Germany

Moving at startup speed, The Family transforms portfolio startups, special projects and virtual infrastructures into a highly connected community of entrepreneurs, operators and fellow investors.

According to Oussama Ammar, one of The Family's founders:

"90% of French startups think about stock options in terms of short-term dilution."

Few offer equity to all of their early employees, and Oussama sees this as a big mistake.

"Too many French entrepreneurs underestimate the psychological impact of having everyone onboard."

The Family doesn't just encourage employee stock options: it insists that every startup it invests in creates a plan.

"It's one thing we feel really strongly about."

It's good to talk

The team recommend startups allocate 20% of their options pool during their seed round, convincing investors to increase their pre-money valuation to accommodate this carve-out – the same model as Y Combinator.

"We like a standardised approach. In Europe, there are too many custom decisions, which slows things down and makes employees wary. In fact, we've been running training sessions for lawyers in Paris and Berlin to 'certify' them to work with our companies. They also need to understand that dilution caused by stock options isn't a bad thing that they should stop their clients doing."

In other words, rather than treating stock options as an ad hoc incentive, they become a core part of the remuneration package – and one that is discussed openly.

"Transparency is fundamental to a healthy startup. If a remuneration policy needs to stay secret, there's something wrong with it."

All quotes:
Oussama Ammar
Co-Founder, The Family

4 Series A ESOP basics

A crowded court.

Tennis can be a lonely sport. Out on court alone, players battle beneath the gaze of thousands of spectators, each waiting and watching for the slightest error.

But for Serena Williams, it's a team sport. From family to trainers, coaches to Yorkshire terriers, Team Serena has supported Williams in her rise to become one of the greatest players of all time. So when Serena Williams steps onto court, she's far from alone.



How much of your company's FDE should you set aside for your ESOP? If you already have an ESOP component in your cap table, should you top it up?

You'll need to answer these questions as part of your Series A fundraising.

How much is enough?
The theory and the practice

Expanding your ESOP is a board-level decision. Given the legal and administrative overheads, you won't want to revisit it between rounds of funding. So, at Series A, the size of your ESOP should aim to cover your potential talent needs through to your Series B fundraise.

> **ESOP due diligence at Series A**
> You're required to disclose all option grants promised to your existing employees. Make sure you factor these into the allocated portion of your ESOP, to be clear on how much unallocated ESOP remains.

You'll need to tread a careful balance. You want to make sure your ESOP allocation is sufficient, but if you over-allocate, you risk diluting your stake, and your existing investors' stake.

The table shows an indicative example illustrating the impact of ESOP size, whether at 10, 15 or 20%, on shareholder dilution.

How ESOP top-ups can dilute existing shareholders
– an indicative example for a Series A startup

	Pre Series A	Post A - 10% ESOP	Post A - 15% ESOP	Post A - 20% ESOP
Founders	65%	47%	43%	40%
Existing investors	25%	18%	17%	15%
New investors	0%	25%	25%	25%
ESOP – existing	10%	7%	7%	6%
ESOP – top up	–	3%	8%	14%
ESOP – total	**10%**	**10%**	**15%**	**20%**
Total ownership	100%	100%	100%	100%

Source: Index Ventures' analysis

In theory, you should base your ESOP allocation on your hiring plan between Series A and B.

However, your Series B fundraise could be 12–18 months in the future. Sticking to a long-term plan might feel over-ambitious, especially when you're focused on shorter-term product and growth goals – not to mention the fundraising itself.

In any case, unexpected opportunities or challenges are bound to impact your hiring plan. Your company might grow quicker than expected. Or, you might meet an executive with huge potential to transform the business, who expects a substantial option grant.

In practice, most founders take a top-down approach. It makes sense to top up your ESOP to a round figure, and VC investors will expect this. Typically, it will be 10% or 15%.

Right-sizing your ESOP

The correct approach depends on your team, philosophy and geography

In the US, a typical ESOP is 10% at seed stage, increasing to 15% at Series A. It then grows with each funding round – up to 20% by Series D. The ESOP is topped up as more employees are hired and leadership teams are put in place. (See the company ownership table in chapter 2.)

In Europe, the most common seed-stage ESOP is also 10%. But our research indicates that, on average, this figure doesn't increase with successive funding rounds. Instead, the allocated portion of the ESOP is merely topped back up to 8–10% at each stage, after accounting for the dilution of existing option holders. That means European employees often end up with only half as much ownership by Series D as their US counterparts.

We believe the main reason for this discrepancy is competition for talent. Simply put, that competition is currently much greater in the US. But Europe is catching up fast. And as competition increases, we expect to see larger stock option grants to employees – particularly in major tech hubs like London.

So how can you find the best level of equity to set aside for your ESOP? Here are some factors to consider.

The founding team

Tech startups usually have between one and four co-founders. If you're the sole founder, you'll need to hire for a wider range of skills, and offer more equity to secure these hires early on. Crucially, if you're not a technical founder, you'll need to find a non-founding CTO.

As companies grow, few co-founders have the depth of experience to act as functional leads. You'll need to offer attractive option grants to hire seasoned leaders, and make room in your ESOP to secure them.

Your technical DNA
What type of company are you building? What skillsets do you need to build it?

You might focus on leading-edge technical challenges (such as Internet of Things hardware) or deep tech (such as virtual reality or machine learning). If so, you'll need a large and exceptional technical team.

Competition for such talent is fierce. And you'll be contending with the deepest pockets around – including Google, Facebook, Amazon and Apple. These hires will expect high offers of equity participation, so you're likely to need a larger ESOP than average.

If you're building a more straightforward e-commerce company, your ESOP can be smaller.

Your philosophy
What kind of company culture do you want to create? How mission-driven will you be?

You might mirror a Silicon Valley mindset, using equity to win and retain the best talent, and encourage alignment across your team. To offer options to all employees, including large options to attract exceptional individuals from major companies, you'll need a substantial ESOP.

If you're more concerned about dilution, you can consider allocating equity to employees on a case-by-case basis, or offering cash compensation instead. You might also hire less experienced individuals you believe will grow into their roles, as they'll be less likely to expect stock options.

Where you are
Generally, the size of a company's ESOP is closely linked to the maturity of the local ecosystem. In regions that haven't seen many high-profile successful exits, people are less aware of – or perhaps more sceptical about – the potential value of stock options. Whereas thriving local ecosystems create more competition for talent, which means startups must offer larger grants to secure the best people.

Unsurprisingly, London – Europe's largest startup hub – has the highest expectations overall. Across the rest of the continent, there's a very mixed picture. In some places, legal and tax rules also affect the attractiveness of options. (See chapter 6.)

We expect these dynamics to shift over time, but the direction of travel is clearly towards rising employee expectations in all geographies.

"Employee ownership is a consequence of the maturity of the ecosystem. As the market matures, employees get more sophisticated, and are more willing to trade-off salary for options."

Martin Mignot
Partner, Index Ventures

Deciding your ESOP size

As European ecosystems continue to grow, and more deep-tech innovation startups emerge, there will be greater competition for talent. A large ESOP will help you stay ahead of the curve and attract the best hires.

We've set out a plausible scenario for post-Series A hiring plan and individual allocations in the OptionPlan app that accompanies this handbook. We also apply this scenario in chapter 7. If you were to follow this scenario entirely, you'd need a 12% ESOP to cover your needs up to your next round of funding.

It is extremely unlikely that your company's situation will exactly match our default scenario. So we recommend using our OptionPlan app to customise your own post-Series A option plan, and to more accurately gauge the size of ESOP you need. However, it is very likely to fall within the range of 10-15%.

Watchlist: share capital and transfer restrictions

Protecting your stock

Share capital

Your startup might begin with a relatively limited number of authorised shares, in the thousands or even hundreds. We recommend increasing your share count via a stock split as part of your Series A fundraising. While there's no perfect number, 10 million is a good figure to aim for. This won't affect dilution: existing shareholders will simply get an extra zero or three zeroes on their current holdings.

Increasing your share capital will allow you to be more precise with your option grants, particularly with junior staff, who are likely to receive less than 1/1000th of your FDE. Plus, it's psychologically more encouraging to receive a grant measured in the hundreds or thousands of individual options, rather than just one or ten, even if the overall ownership level is the same.

Transfer restrictions

A lack of local regulation can make it relatively easy for employees to sell exercised options, without approval, on secondary markets. We therefore recommend you introduce transfer restrictions in your company's articles of association, and in your ESOP plan rules themselves, which require employees to seek board approval before selling any shares.

More and more companies are implementing robust restrictions to limit trade in the secondary market. There's more on this in chapter 10.

5 ESOP rules

A genius for collaboration.

In 1879, Thomas Edison united different nationalities and disciplines into one remarkable team.

He brought together an English machinist, Swiss clockmaker, German glassblower and American mathematician, all to discover the secret of electric light.

On the 22nd October, the team cracked it – and the world's first light bulb burned bright with the determination of five inspired individuals.



Following your Series A fundraising round, you need to go through the legal process of drawing up your actual ESOP. Once it's in place, you'll be ready to formalise any grants promised to existing employees, and offer new stock options.

Your board will need to approve your ESOP rules. It's important to make them as clear and consistent as possible, so you can avoid changing them later on, or creating exceptions. This chapter covers the major terms, particularly where there are significant differences between Europe and the US, or between different parts of Europe.

Vesting schedules and the 'cliff'

The traditional four-year vesting schedule

If stock options could be converted into shares immediately, they wouldn't be effective for retaining employees. A vesting schedule – which lets employees exercise more options over time – gives staff the peace of mind that their stake in the company is accumulating.

A four-year vesting period is standard practice in both the US and Europe, and tends to be the same regardless of role or seniority. This starts with a one-year 'cliff', during which no options are vested, giving companies time to weed out bad hires without suffering dilution.

Vesting is generally linear:
- 25% immediately following the cliff
- 50% after two years
- 75% after three years
- 100% after four years

If an employee leaves the company before they are fully vested, they will retain rights over their vested portion. The unvested portion is dissolved and returns to the unallocated ESOP pool.

In the US, vesting is almost always monthly, for specific tax reasons. In Europe, vesting is often monthly too, but can be quarterly or annual, to reduce administration.

In recent years, alternatives to this traditional model have emerged. To learn more about how companies like Snap approach vesting, go to chapter 10.

Strike prices
Different rules in different places

In some European countries, such as France, strike prices are set based on the latest fundraising valuation. In others, notably the UK, you can offer grants at a reduced strike price without any tax penalty.

Some founders and investors believe a discounted strike price misaligns employee and shareholder interests. We don't agree. By obtaining the maximum discount possible, you give employees a major financial benefit – and a strong motivation. It also helps prevent demotivation if your company goes through a bad patch and you're forced to take funding at a lower valuation, as the options may still be valuable. Sophisticated individuals will also realise that higher strike prices imply less benefit, and will therefore push for larger grants – using up more of your ESOP.

"Issue options at the lowest strike price you can. Maximise the financial benefit to the employee, and therefore the motivational benefit you can get from a given number of options granted."

Neil Rimer
Partner, Index Ventures

Leavers
How to handle leavers' options

What do you do about options when employees leave your company?

In the US, leavers typically have 90 days to exercise any vested options. After this, any remaining options are forfeited. In a private company, this means they must quickly decide whether to take the risk of using cash to buy an illiquid asset. Depending on the number of options and strike price, this may be unaffordable. In the US, exercising options may also trigger a tax liability – even if the shares aren't immediately sold.

This practice makes leaving a company much less attractive. If an employee joined early, the strike price may be very low – a 60% discount on the last-round valuation is not uncommon – but exercising options can still be expensive. In the example we used earlier, an employee granted 1% of FDE as options at seed stage, at a seed-round valuation of $10m, would need $40,000 to exercise all their options. A tax bill would add to the financial burden. It may be years before the company exits and these shares can be sold – and there's always the risk that the company loses value, or fails.

A few US companies are now adopting extended exercise periods, to appeal to savvy candidates who understand the implication of leaving before an exit. But this is still rare. You can find more on this in chapter 10, along with some other ways to create liquidity for longstanding employees, such as secondary private markets.

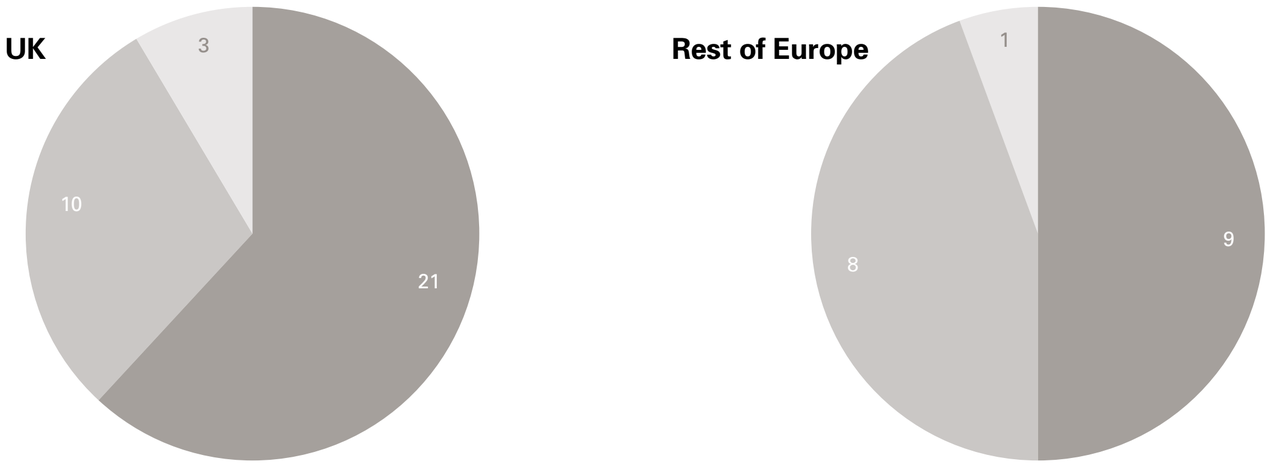
Our survey of European startups shows a more mixed picture than in the US. As you can see in the chart below, a significant minority of European startups (particularly outside the UK) allow leavers to retain their vested options, but without the right to exercise them until exit.

That's because, in much of Europe, minority shareholders must be consulted ahead of major company decisions. If leavers exercise their options immediately, the number of shareholders grows, which can create administrative headaches. Allowing leavers to retain their vested options avoids this, and benefits the employees themselves: they don't have to pay for their shares upfront. This is particularly important in Europe, as strike prices can be high, and tax liability after exercise can be much higher than in the US.

These factors don't apply in the UK – but even so, more than 25% of startups offer the same terms.

It is also worth noting that a few companies in our ESOP survey have the drastic policy of dissolving all options for leavers, whether vested or unvested.

What happens to stock options held by leavers?



Source: Index European ESOP survey

"You should be generous to leavers with respect to stock options. These individuals have helped you build your company, so don't try to claw back their vested options. They have earned the right to exercise and become shareholders. You also don't want them talking badly about you after they leave – this could damage your talent brand."

Martin Mignot
Partner, Index Ventures

We advise against simply accepting the 'default' US approach on exercise periods for leavers. There could be alternatives that suit you better. As you evaluate different options, find out about the burdens associated with consulting minority shareholders in your country, and ask yourself what aligns with your company philosophy. What would be fair? In Europe, extended exercise periods often make sense.

The UK is an exception. The 90-day window used in the US is a good starting point here, because the EMI Option Plan used by almost all startups allows for low strike prices and no tax bills on exercise. (For more on EMI options, see chapter 6).

Good and bad leaver provisions
ESOPs in Europe often provide a mechanism for cancelling the exercise rights of 'bad' leavers. People fired for major disciplinary breaches, or who leave to join a direct competitor, almost always fall into this group. Sometimes it also applies to those terminated for poor performance, although it's rarely enforced in such cases.

It's very different in the US, where there are very tight restrictions on who is considered a bad leaver; typically involving dishonesty, fraud, negligence, or breach of confidentiality. Options are considered a core part of an individual's compensation, and cannot be clawed back by the company.

We support founders following the US approach on leavers, to reassure employees and demonstrate the real value of options. We're now seeing companies in Europe following this advice, and reducing leaver provisions.

Change of control and acceleration provisions

What happens to options during a change of ownership

The ESOP will spell out what happens to employee options during a change of ownership – i.e. a merger, acquisition or IPO. In such a scenario, standard US ESOP terms dictate that vested options become exercisable. New owners purchase them on the same terms as they are offered to all shareholders, whether that means cash, shares in the new company, or a mixture of the two.

During an IPO, shares from exercised options become tradable shares in the listed company. Unvested options will generally continue to vest following IPO. In an acquisition, unvested options lapse, and the new owners can decide what new incentive structures they wish to create for existing staff.

Exceptions are sometimes made for key executives, or the executive team as a whole. In particular, the CEO, CFO and General Counsel are often subject to acceleration provisions, which partially or fully accelerate the vesting terms for their option grants. This is because these individuals are critical to a successful exit. Without acceleration rights, they have an incentive to delay until their options are fully vested.

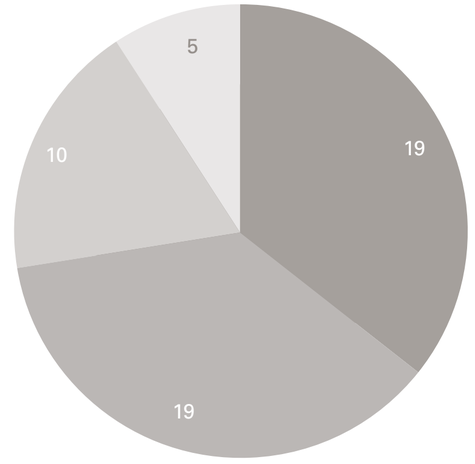
In such cases, there's usually a 'double-trigger' acceleration provision: acceleration only happens if there's both a change of control and that individual is terminated or demoted. This protects against new owners who terminate – or effectively terminate – key executives after taking control, thereby preventing them from vesting further options.

Acceleration without a double trigger, and acceleration for non-executive staff, are both rare in the US. This is because it reduces the sale proceeds for each common stock shareholder and option holder.

Again, the European picture is different. Many entrepreneurs grant acceleration to all employees who hold options, and don't include double-trigger provisions. It's not clear why, but there does seem to be a cultural element, with European entrepreneurs feeling this is a fairer approach.

It's not clear why, but there does seem to be a cultural element, with European entrepreneurs feeling this is a fairer approach.

Which employees benefit from acceleration provisions?



- All
- Few
- None
- Complicated / Board Discretion

Source: Index European ESOP survey

"You cannot over-estimate how big a deal vesting acceleration rights can be. They can make or break an acquisition. And granting different acceleration rights across an exec team are a recipe for rancor when you get to your exit."

Clint Smith
Experienced US Corporate Development Executive and Startup Board Member

"All-employee acceleration is bad practice because you are sending the message that an acquisition is the end of the road. Buyers would definitely disagree with that."

Dominique Vidal
Partner, Index Ventures

It's up to you and your investors to decide the right approach. But we recommend having either no acceleration provisions, or double-trigger partial acceleration for the executive team only. A more 'generous' acceleration policy could seriously impede your chances of a successful exit.



An ESOP policy driven by founders' philosophy

Founded in London
2008

No. Employees
130+

Index initial investment
Series B, 2013

Offices
UK, US

SwiftKey upgrades smartphone keyboards to make typing faster. Founded in London in 2008, SwiftKey's technology is now found on more than 300m devices worldwide. In April 2016 SwiftKey became part of the Microsoft family, working together to empower every person and every organization on the planet to achieve more.

"We saw stock options as a piece of the puzzle in terms of motivating people to work hard and feel good about what they're doing."

The founders offered personalised share packages for their first hires. When it came to creating a standardised scheme, they found very little established practice, and were instead guided by their vision of company culture. SwiftKey's approach to ESOP policies was innovative for its time and employee-friendly.

All quotes:
Ben Medlock
Co-Founder, SwiftKey

Give everyone a stake

The decision to award all new hires options in the company was a no-brainer for the founders.

"We knew that if we wanted to motivate employees, it was a far better idea to give them a stake in the company than to try and compete with the tech giants on salary levels."

Three-year cliff

SwiftKey chose to implement an unorthodox three-year cliff to help align the team.

"We wanted to minimize churn. And it worked – we had practically no attrition in the first four years."

The aim was to get people committed to the SwiftKey journey, so the founders hired individuals they felt would contribute to the growth of the business.

In other words, rather than treating stock options as an ad hoc incentive, they become a core part of the remuneration package – and one that is discussed openly.

Accelerated vesting for all

Driven by their sense of fairness, the founders decided to provide full acceleration rights for all employees during a change of control.

"Morals and values played a huge part in both my and Jon Reynold's [his co-founder's] upbringing. It was important for us to do what we felt was right. We were asking people to sign up for three years before their options were worth anything, so we felt they should all benefit in the event of an acquisition."

Annual top-ups

SwiftKey gave everybody a small option grant when they joined, and rewarded high performers with an annual equity retention programme.

"That felt like the natural thing to do. In a startup, you can be flexible in rewarding people that make the most difference. We looked at the unit of impact, not the level of seniority."

Leaver provisions

Ben and Jon decided leavers should be allowed to hold on to their vested options, given the significant financial burden associated with exercising shares.

"It felt fair – these employees had contributed to the value of the company, and we wanted them to benefit if and when that value was realised."

Liquidity events

For those employees with a tenure longer than three years, SwiftKey offered a secondary sale of a portion of their vested options with oversubscribed investment rounds.

"It's common for founders to do this, so why not for employees?"

The right approach today?

SwiftKey's values-based approach to employee equity and stock options was certainly unconventional and innovative in its day. And the founders were happy with the results. But a decade later, is a similar approach advisable for entrepreneurs considering their ESOP policy? The UK ecosystem has matured, competition for talent has increased, and standard practices are becoming established. So while founders' philosophy is still important, stock option terms such as a one-year cliff, four year vest, and no acceleration on change of control would be our recommendation.

All quotes:
Ben Medlock
Co-Founder, SwiftKey

6 Legal and tax differences across Europe

Many hands make light work.

Medieval cathedrals took centuries to build. Generation after generation of architects, sculptors, artists and stonemasons, working together to create some of the world's most remarkable buildings.

But not Chartres. When the original cathedral burnt to the ground in 1194, local worshippers came together to raise funds for a new cathedral, built at breakneck speed in just 70 years. Today, the cathedral stands as the great masterpiece of Gothic art.



Founder philosophy, technical DNA, and the maturity of the local market can all have a big impact on a startup's approach to employee ownership. But on a practical level, the tax and regulatory framework they operate in makes a huge difference, too.

The importance of tax policy
Governments use tax as a lever, and many use it to support entrepreneurs. In the UK, the SEIS scheme offers a 50% tax break for those investing up to £100,000 in early-stage startups, and startups can use the R&D tax credit towards software engineering costs. As well as helping startups in general, some countries' tax policies make employee ownership more attractive.

Which countries are favourable for stock-options?

Different countries, different policies

Each country in Europe has its own legal framework and tax code, as well as a unique set of cultural norms. There is no common EU standard. That means the situation needs to be considered country-by-country.

To make things simpler, we've given each country a score for stock option 'friendliness', as well as summarising various rules and regulations. We've identified six factors that contribute, scoring each on a five-point scale:

1 **Plan scope**
For late-stage startups, they own around 10%, versus 20% in the US. Can all employees and company types benefit from stock options?

2 **Strike price**
Can options be offered at a strike price below last-round valuation, without adverse tax treatment – reflecting that they are illiquid, high-risk, and non-preferred?

3 **Minority shareholders & bureaucracy**
When option holders exercise, they become minority shareholders, who may need to be consulted on various company decisions; does this make stock options unattractive to companies? How much of an administrative burden and cost is associated with creating and maintaining the plan?

4 **Employee tax (timing)**
Are employees taxed only when they sell shares, or when they exercise – or even at the point of grant?

5 **Employee tax (rate)**
Which rate is applied – income, capital gains, or something else? Are employee social contributions payable, and if so, how much are they?

6 **Employer taxation**
Is taxation for employers deferred? Which rate is applied? Are employer social contributions payable, and if so, how much are they?

When are employees taxed?

There are four points at which stock options may be taxed:

1 Grant

A few countries treat the issue of options as a taxable benefit, with tax based on the fair market value of those shares. This is a strong disincentive for both employers and employees.

2 Vesting

Some countries tax option holders when their options vest, even if they don't exercise immediately. However, this is more common with other equity-based incentives than with stock options.

3 Exercise

Many countries tax employees when they exercise options and buy shares. Tax is applied to the spread between strike price and fair market value at the time of exercise, and is treated as income (rather than a capital gain).

4 Sale

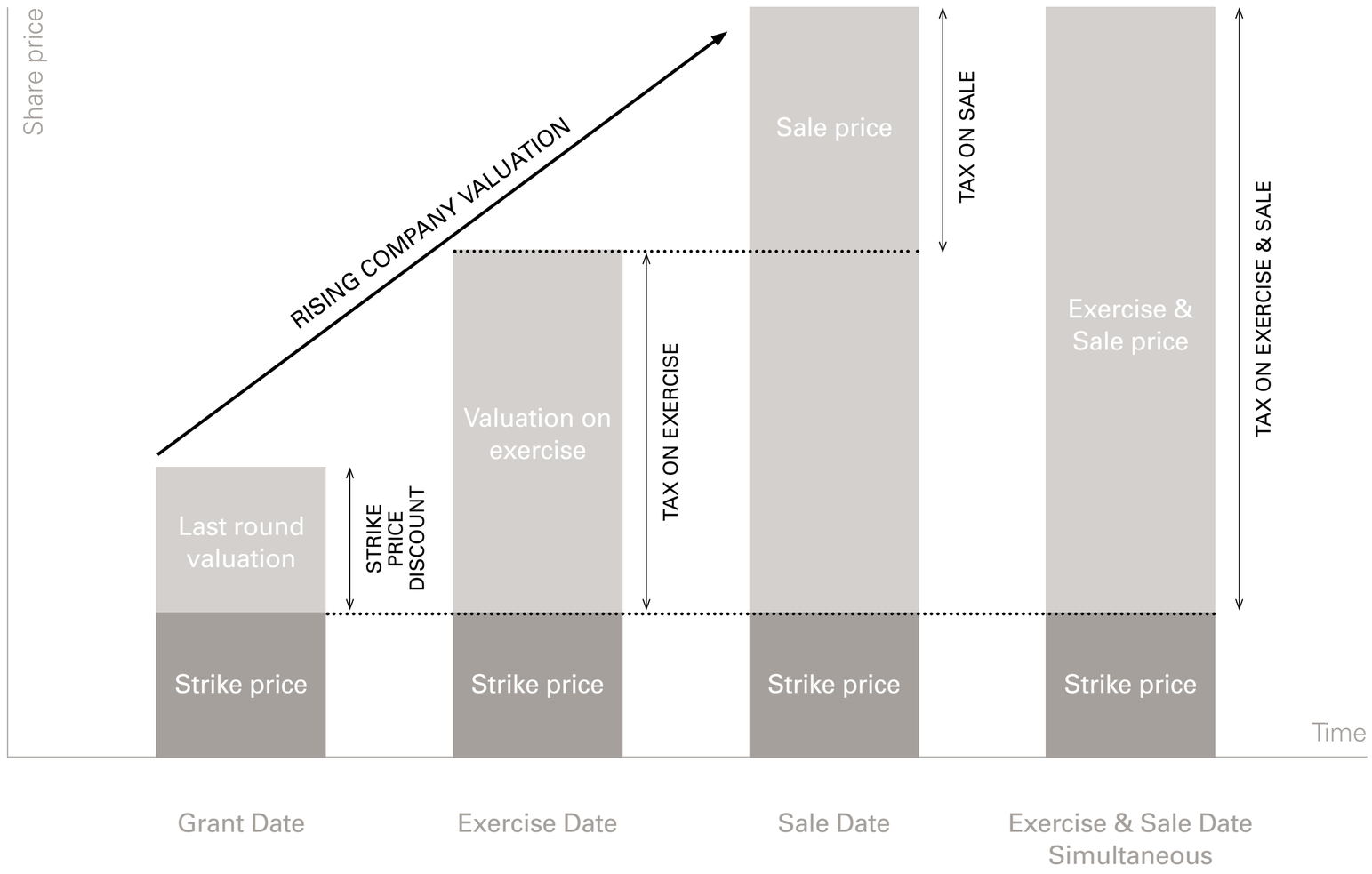
Almost all countries tax employees when they sell their shares, but the tax rate applied varies. Some countries treat the profits as income; others, as a capital gain.

In practice, exercise (3) and sale (4) often happen simultaneously. This is important because employees may have to pay higher income tax rates attached to exercise, than lower tax rates attached to sale.

The two most common circumstances where this could happen are:

- Employees with vested options, when the company exits through a trade sale (this is much more common than exit through IPO).
- Former employees with vested options, where the company has a policy where leavers retain options but cannot exercise until an exit (this is common in Europe as we saw in chapter 5).

Understanding taxation of share options
Average FDE (in %)



Our analysis
In our analysis, countries fell into three groups. Unsurprisingly, practice mirrored policy – companies operating in 'friendlier' countries were more likely to have all-employee option schemes.

Table with points per factor per country 5= best, 1 = worst	**Plan scope**	**Strike price**	**Minority shareholders & bureaucracy**	**Employee tax (timing)**	**Employee tax (rate)**	**Employer taxation**	**Total**
Group 1: Top ranking							
UK	4	5	4	5	5	5	28
US	4	4	4	4	3	4	23
France	4	3	4	5	3	4	23
Ireland	3	3	4	4	3	4	21
Group 2: Runner-ups							
Sweden	3	1	3	5	4	3	19
Denmark	1	2	3	4	2	4	16
The Netherlands	1	3	3	3	1	3	14
Finland	1	2	3	3	2	2	13
Group 3: Ripe for change							
Germany	1	1	2	3	1	2	10
Spain	1	2	2	3	1	1	10

Top ranking
UK, US, France, Ireland

These countries have implemented (or, in the case of Ireland, are about to implement) programmes to support the use of stock options and similar schemes to reward startup employees.

These countries adopt more than one of the following policies: deferring when tax is payable; reducing the effective tax rate on sale; allowing strike prices below previous-round valuations, and reducing the burden on companies to pay tax or social charges on stock option awards.

> "So long as the UK government maintains the most entrepreneur-friendly policies, including those around stock options, it will retain its position as the leading European startup hub."
>
> **Jan Hammer**
> Partner, Index Ventures

All of these countries scored 20 or above.

The UK government's EMI scheme, first introduced in 2000, is particularly worthy of mention. It has created one of the most startup-friendly environments in the world, and has undoubtedly contributed to the county's leading position in Europe. Moreover, the scheme is still relatively young; the benefits are likely to grow in years to come.

Runner-ups
Sweden, Denmark, The Netherlands, Finland

These countries scored between 12 and 20 points in our analysis. They haven't implemented specific policies to support the use of stock options and similar incentives for startup employees. Even so, startups can and do use them. Startups in these countries often prevent employees from being able to exercise vested options until a change of control. This avoids the complexities of having minority shareholders on the cap table.

In these countries, reducing tax rates for stock options is the top priority, followed by moves to defer employee taxation. These changes would create more 'winners' amongst employees at successful startups. These individuals would then act as advocates, drawing in more top talent to these startup ecosystems.

> **The Belgian challenge**
> In Belgium, employees are hit with a tax at the moment they accept an option grant – currently 18% (sometimes discounted to 8%) of the stock's assumed value. Consequently, Belgian startups issue few stock options.

Sweden and the Netherlands are making positive steps, and from 1 January 2018, new laws will be more tax-friendly for early-stage startup employees.

Ripe for change
Germany, Spain

These countries scored below 12, placing them at the bottom of our grid. Not only do they lack specific programmes supporting stock options; administrative barriers make the use of stock options a serious headache for companies.

Many startups in Germany and Spain have therefore resorted to offering 'virtual options', which mimic stock options but don't guarantee ownership in the same way. These are simple to implement and administer, and avoid some of the tax burden. But there are disadvantages.

Unlike with real stock options, VSOPs are generally structured as an employee benefit, which companies can choose to remove without-cause. Leavers often forfeit all rights to virtual options. These differences may make savvy hires sceptical. Because of this, virtual options don't bring the same benefits in terms of attracting and retaining talent.

We encourage startups using VSOPs in these countries to allow employees to retain vested virtual options if they leave the company. But we also encourage governments to change policy, and make 'real' stock option schemes more viable.

"Few early hires stay with a startup all the way through to IPO. If leavers require a lot of cash to exercise their options, including taxation at exercise, they probably won't bother, unless the company is clearly nearing a successful exit. Meanwhile, virtual schemes often offer nothing for leavers. Without the right policies in place, stock options can therefore seem worthless to employees. This can damage a company's talent brand and is bad for the local startup ecosystem as a whole."

Dominic Jacquesson
Director of Talent, Index Ventures

Take-aways

Across Europe, approaches vary. The UK is the 'friendliest' country – even ahead of the US. France has a good approach, and Sweden and Ireland are making progress. But other countries, including Germany, lag behind.

Policies drive practice. The onus is on policymakers to work with entrepreneurs, and foster a better environment for both startups and talent.

Here are six key objectives for policymakers:

1 Create tax-favourable schemes open to as many startups and employees as possible.

2 Offer assured valuations reflecting illiquidity, below what investors are likely to pay, enabling favourable strike prices.

3 Be aware that corporate laws intended to protect minority shareholder interests can sometimes discourage stock option grants.

4 Defer employee taxation to the point of sale.

5 Apply capital gains – or better – tax rates to employee share sales.

6 Reduce or remove corporate taxes associated with the use of stock options.

"I'd welcome a new and more inclusive approach to ownership of startups in Germany. Awarding at least early team members is crucial – they will eventually start their own companies, or end up investing in the new generation of startups. Ownership and participation in success are much more than making individuals better off: it is the foundation for further entrepreneurship and innovation."

Philipp Moehring
Europe, AngelList

United Kingdom

Examples of Index-backed companies with UK HQ:
Just Eat, Deliveroo, Farfetch, Funding Circle, Secret Escapes

Current situation:
Introduced in 2000, and modified a few times since, the Enterprise Management Incentive scheme, or EMI, is the most advantageous stock option scheme for both startups and employees in Europe or North America.

Pretty much all UK tech startups adopt EMI option schemes. For larger startups and private companies, there are other tax-advantaged schemes available, such as the CSOP (Company Share Ownership Plan) – see page 107 for more information on this.

UK score: 28

Plan scope	Company requirements: · Less than 250 employees globally · Independent – i.e. not controlled by a larger parent, or spun-out from a larger parent or corporate incubator where control is retained · Gross assets under £30m for the group Employee requirements: · Employees working 25+ hours a week or 75% of their working time · Maximum £250k strike price value of unexercised options for a single employee (determined by the market value on date of option grant) · Aggregate limit of £3m strike price value of EMI options can be granted
Strike price	Assured valuations can be agreed with the tax authorities which are frequently 70% below last-round valuation, and for pre-revenue startups can be as low as the nominal value of the shares
Minority shareholders & bureaucracy	Minority shareholders have rights to be informed, but not consulted, if there is already majority support for corporate decisions EMI plans are relatively easy to set up and to maintain, with standard templates and online registration and submissions
Employee tax (timing)	Only at point of sale
Employee tax (rate)	Gains in excess of an employee's annual capital gains allowance (£11,300) are subject to capital gains tax of 20% If EMI options held more than 1 year between grant and sale, reduced 10% tax rate applied (Entrepreneurs' Relief)
Employer taxation	No employer taxes Corporation tax deduction equal to gains made by employees. The costs of setting up and administering the scheme can also be deducted

United States

Examples of Index-backed companies with US HQ:
Climate Corp, Discord, Robinhood, Slack, Confluent

Current situation:
Companies can choose between two main forms of stock option: incentive stock option (ISO) and non-qualified stock option (NSO). The differences are outlined in the table below.

For early-stage companies starting in, or expanding into the US, we recommend setting up an ISO from the outset. This option is more favourable to employees if held and exercised within specific time frames. The benefits of an ISO outweigh the slightly higher setup costs.

NB : This table on the next slide does not include exceptions – such as what happens when an employee exercises early.

US score: 23	ISO	NSO
Plan scope	Limitations: · Available to employees of the company, any parent or subsidiary · Maximum $100,000 combined fair market value of stock that become exercisable in a calendar year · Maximum 10 years to exercise after issue · Maximum 3 months to exercise after termination of employment	Available to anyone
Strike price	409A valuations every 6 months provide assurance, and are frequently 60% below last-round valuation. Varies according to prefs structure and closeness to exit	
Minority shareholders & bureaucracy	Minority shareholders have rights to be informed, but not consulted, if there is already majority support for corporate decisions ISO and NSO plans are relatively easy to set up and to maintain, with standard templates	
Employee tax (timing)	At point of sale, although in practice also often taxed at point of exercise	At point of exercise and at point of sale
Employee tax (rate)	At point of exercise, may be an income adjustment for alternative minimum tax (AMT) purposes At point of sale, if held more than one year after exercise and two years after grant, treated as long term capital gain tax (0% to 20% based on size of gain and filing status) If holding requirements not met, treated as a NSO, and taxed as income at point of exercise (see detail opposite)	At point of exercise, subject to income tax (10% to 39.6% rate), and social security (6.2%) and Medicare (1.45% to 3.8%) At point of sale (if later than exercise), subject to short term or long term capital gains tax depending on how long shares held. Short term capital gains tax rate is the same as income tax rates
Employer taxation	No employer taxes Generally not allowed any tax deduction	No employer taxes Deduction equal to the amount of ordinary income recognized by the option holder

France

Examples of Index-backed companies with French HQ:
Criteo, BlaBlaCar, Alkemics, Drivy

Current situation:
For smaller private companies, the most tax-efficient way to reward employees with equity-based incentives is the BSPCE scheme. It was introduced in 2000 and amended a few times since. In effect, it is more like an RSU instrument than a pure stock option, but is tax-advantaged.

Eligibility for the scheme is restrictive, but it has major advantages, and it is used by almost all French tech startups. Employers don't need to pay any tax or social security contributions, and employees don't pay any tax until a sale of shares.

Preferred employee scheme:
BSPCE (Bons de Souscription de Parts de Createur d'Entreprise)

France score: 23

Plan scope	Company requirements: · Less than 15 years since company formation · Privately held · 25% of the share capital held by individuals as opposed to institutions · Pays corporate income tax in France Only available to employees
Strike price	No assured valuation. Generally equivalent to the last-round valuation, although moderate (20-30%) discounts can be justified later-stage on the basis of prefs structure
Minority shareholders & bureaucracy	Minority shareholders have rights to be informed, but not consulted, if there is already majority support for corporate decisions
Employee tax (timing)	Only at point of sale
Employee tax (rate)	Gains subject to special taxation rates (19% if the employee's tenure has been more than three years at the date of sale, else 30%) and, social tax (15.5%)
Employer taxation	No employer taxes

Ireland

Notable Index-backed companies with European HQ in Ireland:
Slack, Dropbox, Squarespace, Zendesk, Intercom

Current situation:
The international HQ for many tech giants, and home to a burgeoning startup community, Ireland will finally introduce a tax-advantaged share option scheme in January 2018 called KEEP (Key Employee Engagement Program). Full details of the scheme aren't available yet, but it will defer taxation on stock options to sale rather than exercise, and at capital gains tax rates. The current scheme requires employees to pay income and social tax at the point of exercise, 'or' but 'and within 30 days of their leaving date.

Preferred employee scheme:
Stock options

Ireland score: 21	Stock options	KEEP from 1 January 2018
Plan scope	No tax favourable plan until 1 January 2018	Not formalised as yet, but we expect some similarities in scope with the UK EMI scheme: Company requirements: · Private company · Less than 250 employees globally · Balance sheet not exceeding €43m Employee requirements: · Full-time employees or directors working 30+ hours a week · Less than 15% ownership of the company · Maximum €100k strike price value on date of grant; maximum €250k in any three consecutive years · Option value less than 50% of the individual's annual pay in year of grant
Strike price	Generally, based on the last-round valuation. Modest discounts are possible, but are not assured	Unannounced as yet, but no indication that fair market valuations will be assured by the tax authorities
Minority shareholders & bureaucracy	Minority shareholders have rights to be informed, but not consulted, if there is already majority support for corporate decisions. Most startups have standard US leavers policy – exercise vested options within 90 days or lose them	
Employee tax (timing)	At point of exercise and at point of sale	At point of sale
Employee tax (rate)	Gain on exercise subject to income tax (20-40%) plus universal social charge (0-8%) and employee PRSI (0-4%) Gains on sale in excess of the annual capital gains allowance (€1,270) are subject to capital gain tax of 33%	Gains on sale in excess of the annual capital gains allowance (€1,270) are subject to capital gain tax of 33%
Employer taxation	No employer taxes	Unannounced as yet, but we expect no taxation

Sweden

Example of Index-backed companies with Swedish HQ or significant presence:
King, iZettle, KRY

Current situation:
Following sustained pressure from local tech entrepreneurs, the Swedish government will introduce a tax-favoured scheme in January 2018. This will allow capital gains tax to be applied to stock options granted by smaller startups.

Until this new scheme comes into effect, Swedish startups, and larger companies most often use a warrants scheme (teckningsoptioner). Employees are required to purchase the warrants upfront – which is a major disincentive. This does mean, however, they can benefit from capital gains tax rates on any upside, deferred to the point of sale.

Standard stock options are less often used by startups, since they trigger (high) income tax and social charges at the point of exercise – and social fees for the company – as well as capital gains tax at sale. Some later-stage startups (including Spotify) do use them, as the warrant purchase costs and administration complexity become prohibitive.

Preferred employee scheme:
Warrants

Sweden score: 19	Warrants	New scheme from 1 January 2018
Plan scope	Available to anyone	Company requirements: · Less than 10 years old · Fewer than 50 employees at time of grant · Balance sheet < $8.5m (approximately) Only available to employees
Strike price	The strike price is usually set at the last investment round price. The employee has to pay for the warrant, based on a Black-Scholes formula. Typically, the warrant payment is 5-20% of the last-round valuation	The scheme is still not live, but we expect the strike price to be set at the last investment round price
Minority shareholders & bureaucracy	Most Swedish startups don't allow employees to exercise vested options until a change of control, so they don't become minority shareholders	We expect most Swedish startups to continue the practice of not allowing exercise before a change of control
Employee tax (timing)	Only at point of sale	
Employee tax (rate)	Gains on sale subject to capital gains tax of 25%	
Employer taxation	Not liable to pay employer social security contributions	

Denmark

Example of Index-backed companies with significant Danish presence:
Trustpilot, Just Eat, Zendesk

Current situation:
In Denmark, almost always, startups use warrants as an employee incentive tool, which are taxed as income at the point of exercise, and as capital gains at point of sale.

Last year, the government introduced a tax-advantaged treatment for stock options in Denmark (Section 7H of the Danish Tax Assessment Act). The new rules means that taxation is now deferred until sale, and subject to capital gains. However, whist we welcome this change, it is only available to companies with one class of shares, and therefore not catered to VC-backed companies, which usually have two main share classes: common and prefs.

Preferred employee scheme:
Warrants

Denmark score: 16	Warrants
Plan scope	No tax favourable plan
Strike price	Generally, based on the last-round valuation. Modest discounts are possible but require a valuation exercise. If startup has a US presence and 409A valuation, this may be accepted by the Danish tax authorities
Minority shareholders & bureaucracy	Minority shareholders have rights to be consulted on range of issues. Many startups don't allow employees to exercise vested options until a change of control, so they don't become minority shareholders. Danish startups don't use the standard US policy of 'exercise within 90 days of leaving' Leavers who are terminated without cause are entitled to all their options, vested or unvested
Employee tax (timing)	At point of exercise and at point of sale
Employee tax (rate)	Gains on exercise are taxed as income at a progressive rate of 8-56% Profits on sale are taxed as capital gain (up to 42%)
Employer taxation	When the employee pays the income tax, the company can deduct some expenses

The Netherlands

Examples of Index-backed companies with Dutch HQ or significant presence:
Adyen, Elastic

Current situation:
With no tax-favoured schemes in place, Dutch entrepreneurs still often grant options to employees, using the standard tax framework. This means that they are taxed as income at the point of exercise.

Despite efforts to position Amsterdam as a startup tech hub, the law has not changed since 2005.

Preferred employee scheme:
Stock options

> **A small step in the right direction in the Netherlands**
> From 1st January 2018, 25% of the gain at exercise will be considered non-taxable, on up to €50,000. The Dutch employer must be granted a valid 'R&D Declaration' in the year in which the options were granted, and the employee must exercise the stock option between 1 and 5 years after grant date.

The Netherlands score: 14	Stock options
Plan scope	No tax favourable plan
Strike price	Modest discounts are possible, but are not assured
Minority shareholders & bureaucracy	Most startups have standard US leavers policy – exercise vested options within 90 days or lose them
Employee tax (timing)	Only at point of exercise (assuming employee has <5% ownership, otherwise also taxed at point of sale)
Employee tax (rate)	Gains on exercise subject to income tax (8.9% to 52%) plus social tax (up to 27.65% on annual income up to €33,791).
Employer taxation	On exercise, the company pays about 16% of the gains as social security taxes (only up to employee total income €53,701).

Finland

Example of Index-backed companies with Finnish HQ:
Supercell, Armada Interactive

Current situation:
There is no tax-advantaged scheme in Finland, and no active plans to introduce one. Most startups do setup stock option plans. Options are taxed as income at the point of exercise, and as capital gains at the point of sale (if not simultaneous).

Preferred employee scheme:
Stock options

"In Finland, policy over-looks employees who are important contributors to the success of startups. Taxing employees' stock options as income makes it difficult for Finnish companies to recruit talent from abroad. We need to change that."

Marianne Vikkula
CEO, Slush

Finland score: 13	Stock options
Plan scope	No tax favourable plan
Strike price	The strike price is usually set at the last investment round
Minority shareholders & bureaucracy	Most startups don't allow employees to exercise vested options until a change of control, so they don't become minority shareholders
Employee tax (timing)	At point of exercise and at point of sale
Employee tax (rate)	Gains on exercise are taxed as additional income in the year of exercise (7.8% up to 55% – inclusive of municipal, church and broadcaster levies) Profits on sale are taxed as capital gain (30-34%)
Employer taxation	On exercise, the company needs to pay about 20% of the gains as social charges

Germany

Notable Index-backed companies with German HQ:
Raisin, SoundCloud, Auxmoney

Current situation:
The lack of a tax-advantaged scheme, a high administrative burden, and established norms means most German startups avoid issuing real options, in favour of a virtual stock option plan. However, several of the German companies in the Index portfolio have nevertheless still chosen to set up real stock option plans.

Preferred employee scheme:
Virtual stock options

"Although it is rare to see, there is no legal principle why vested virtual stock options cannot be retained, in the case of leavers. It would be possible to design virtual stock option schemes this way."

Hassan Sohbi
Partner, Taylor Wessing (Germany)

Germany score: 10	Virtual stock options	Stock options
Plan scope	No tax favourable plan	
Strike price	Typically use the valuation from last funding round, but no restrictions apply to a virtual scheme	
Minority shareholders & bureaucracy	Simple legal document to be signed by all shareholders; Inexpensive to implement and administer; No administrative burden of having a long list of shareholders; Flexibility to design custom plans at discretion of Board; Minority shareholders have extensive rights to be consulted on corporate decisions, which makes use of stock options challenging Few startups allow leavers to retain virtual options	
Employee tax (timing)	At point that employee receives cash benefit - usually, only during a liquidity event	At point of exercise and at point of sale
Employee tax (rate)	Taxed as income (14% to 45%), plus social security contributions (around 20%). Also solidarity surcharge (equivalent to 5.5% of income tax) and church tax (equivalent to 8-9% of income tax) Social security contributions to some extent deductible for income tax purposes. Church tax can be avoided	At point of exercise, subject to income tax, social security contributions, solidarity surcharge and church tax At point of sale, subject to a tax rate of 28%
Employer taxation	Social security contributions tax at 20%	No employer taxes

Spain

Notable Index-backed companies with Spanish HQ:
Typeform, Privalia

Current situation:
In 2013, the Spanish government approved the 'Ley de Emprendedores', an entrepreneur-friendly law to encourage startup creation. Its impact has been limited, and Spanish entrepreneurs and investors continue to face significant challenges. It is not possible to grant stock options in the -most common - SARL business entity, and as a result Spanish startups usually grant virtual stock options, locally referred to as SARs.

Preferred employee scheme:
Virtual stock options (SARs)

"Until recently, we granted virtual options at zero strike price to maximise employee gains. We also now allow leavers to retain vested virtual options if they have been at the company longer than one year."

David Okuniev
Co-Founder & co-CEO, Typeform

Spain score: 10	**Virtual stock options (SARs)**
Plan scope	No tax favourable plan
Strike price	Typically use the valuation from last funding round, but no restrictions apply to a virtual scheme
Minority shareholders & bureaucracy	Simple legal document to be signed by all shareholders; Inexpensive to implement and administer; No administrative burden of having a long list of shareholders, or legal fees; Flexibility to design custom made plans at discretion of Board
Employee tax (timing)	Few startups allow leavers to retain virtual options At point that employee receives cash benefit - usually, only during a liquidity event
Employee tax (rate)	Income tax (19% to 45%, up to 48% in Catalonia) and social security contribution tax (6.35%). Discounted tax rates are available for SARs held for more than two years
Employer taxation	Social security contributions at 30.9%

7 ESOP allocation: how much, and who gets it

Science, a team pursuit.

We often think of Nobel Prize winners as lone Einsteins. But today, world-changing discoveries are often made by world-spanning teams.

Take Peter Higgs. It's his name that's now associated with the God particle. But Higgs couldn't discover it alone. It took decades and 6,000 researchers to make that breakthrough. So, while the world might remember individuals, it's the teams behind the name that shake the earth's foundations.



It's not easy to determine how much equity employees should get – particularly if you're a first-time founder. In Europe, there's not much benchmark data. Often, all you have is a gut feeling, and the views of a small handful of advisors. This chapter aims to close this critical knowledge gap.

When it comes to employee stock options, there are a few big questions that almost all founders ask, regardless of sector, stage or market:

- **'How much equity should I give to new hires?'**
- **'How do I deal with the differing expectations for different roles?'**
- **'How do I design a system that will be consistent and fair in the long run?'**

In other words: 'How much, and who gets it?'

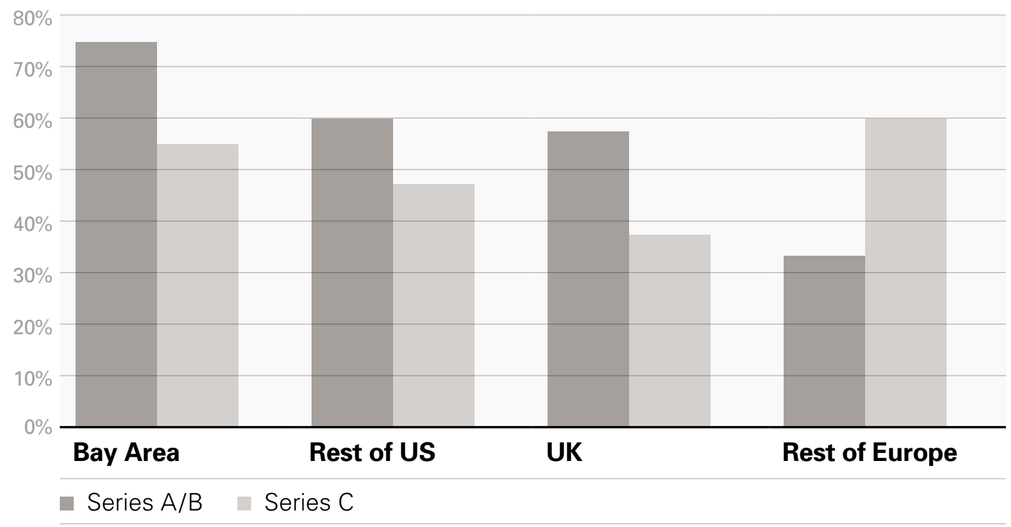
Equity for all?
Aligning your team

Should you offer your whole team stock options, or only some individuals? It's a fundamental question, and one that may come up several times as you grow your business.

The argument for all-employee ownership is simple. It means every hire is invested in your business. It signals that you believe in every employee, and encourages collaboration, and a sense of responsibility. It also means you can address everyone with a single voice – for example, at off-sites and all-hands meetings. Your employees are no longer just employees – they're co-owners, and this can be a major element of your company culture.

The opposing view, still common in Europe and in late-stage companies, is that many employees prefer tangible benefits – like a bigger salary, pension contributions, health care or a gym membership – to stock options.

All-employee ownership levels by stage



Source: Option Impact from Advanced HR (US data), Index European ESOP survey

Unsurprisingly, our research shows that all-employee ownership in Series A/B companies is most common in the Bay Area, at 75%. As you move east, this figure drops, to 32% in continental Europe.

For Series C+ companies, all-employee ownership are less common in the US and UK. This isn't surprising: the collegiate feel of a startup diminishes as it grows, and the diluting effect of issuing options to all employees can be significant in a large company. Plus, later hires are likely to include more commercial and support staff, who are typically less attracted by equity.

Interestingly, however, continental Europe shows an inverted trend. Later-stage companies are more likely to have an all-employee scheme here than anywhere else. It seems that, in Europe, large companies use equity to foster a sense of community that is otherwise lost as they grow. This certainly chimes with our experience.

It's up to each founder how they approach employee stock options. But we strongly believe making a small grant to every new hire, at leastup to Series C, can bring huge benefits. Something like 5% of base salary works well. This award would not apply to employees who receive a larger grant as part of their package, such as C-suite employees.

FARFETCH

Farfetch for All: using employee ownership to recognise and reward a whole team

Founded in London
2008

No. Employees
1,500+

Index initial investment
Series B, 2011

Offices
UK, US, Japan, Portugal, Russia, China, Brazil

Farfetch is the global platform for luxury fashion, connecting customers in over 190 countries with an unparalleled offering from the world's best boutiques and brands from over 40 countries.

"For years, Farfetch granted options only to very early stage employees and senior hires, and on an ad hoc basis to high performers, without a robust methodology."

"We needed a programme that would foster a feel-good factor and unite the whole team under a common goal. If we succeed, the company succeeds – and vice versa."

Since January 2017, every full-time Farfetch employee is offered an option grant.

More than just a token gesture

When it came to deciding on option grant sizes, Sian recalls:

"We conceived a successful exit for the business, and considered what a meaningful payout would look like for employees at each career level."

They decided not to take tenure and performance into account when it came to option grant sizes,

"Otherwise, decisions would have had to be made on a case-by-case basis. Fortunately, the option grants ended up broadly correlating with salary differences."

All quotes:
Sian Keane
EVP, People

Communication is key

When it comes to introducing a new company-wide programme, internal communication is crucial.

"We were not prepared enough."

Farfetch Founder and CEO, Jose Neves, announced the programme at the company's All-Hands meeting, and employees immediately began asking questions. Questions their managers couldn't answer.

"Not everyone understood. Even the managers didn't have all the information."

Farfetch knew most employees would struggle to understand a formal legal document. So they produced a simple five-page booklet, explaining the key points. They gave the programme a catchy name – Farfetch for All – and branded the booklet in their house style to make it more engaging. This proved to be a big hit with the team.

A recruitment tool

Not only has the programme motivated the existing team, it has also helped recruit new talent.

"People come to interviews knowing about Farfetch for All. And if they don't, we talk about it when they join. It has become a key part of our culture and our employer brand.

The next step

The Farfetch team forecast growth over the next three years, and plan to add options through equity-retention programmes on an annual basis.

"We've created a pot for top-ups, specifically for high contributors after the two-year vesting mark."

Lessons from Farfetch

Even though they implemented their all-employee options programme further down the line, the success of Farfetch's approach proves it's never too late to make an impact.

All quotes:
Sian Keane
EVP, People

Upfront vs delayed grants

Delayed grants can help you optimise for performance

You also need to decide when employees receive stock options. In the US, they're usually part of the offer package. But in Europe, few candidates expect them – which gives you more flexibility.

We suggest a simple system, which you can tailor to your needs. It splits grants into four categories:

1. **New hires**
2. **High-performing or high-potential employees**
3. **Promotions**
4. **Refreshers**

We outline the first three below. 'Refreshers' are covered in the next chapter.

New hires

In certain roles, new hires will probably expect an option grant upfront. Such grants usually form a major part of compensation for executive hires (C-suite and VP level), and individuals will probably negotiate this before they join. For these roles, you should always offer an option grant upfront.

Some software developers, if not all, will ask about stock options before they join. Especially if they've worked at startups before, or if they're in a major startup hub. To keep things simple and consistent, we suggest granting all developers upfront options too. Other technical hires, such as product managers and data scientists, may expect the same, but the picture varies more by location.

Overall, we recommend being consistent with each role. Avoid upfront grants unless there's a compelling reason to offer them.

High performers

Holding off on upfront awards for new hires has one big benefit: you can find out who the real stars are, and compensate them accordingly. This helps you hold on to your best people, and keep them motivated. US companies rarely have this luxury – but in Europe, with the likely exception of executives and developers as discussed above, you can design a system that truly rewards performance.

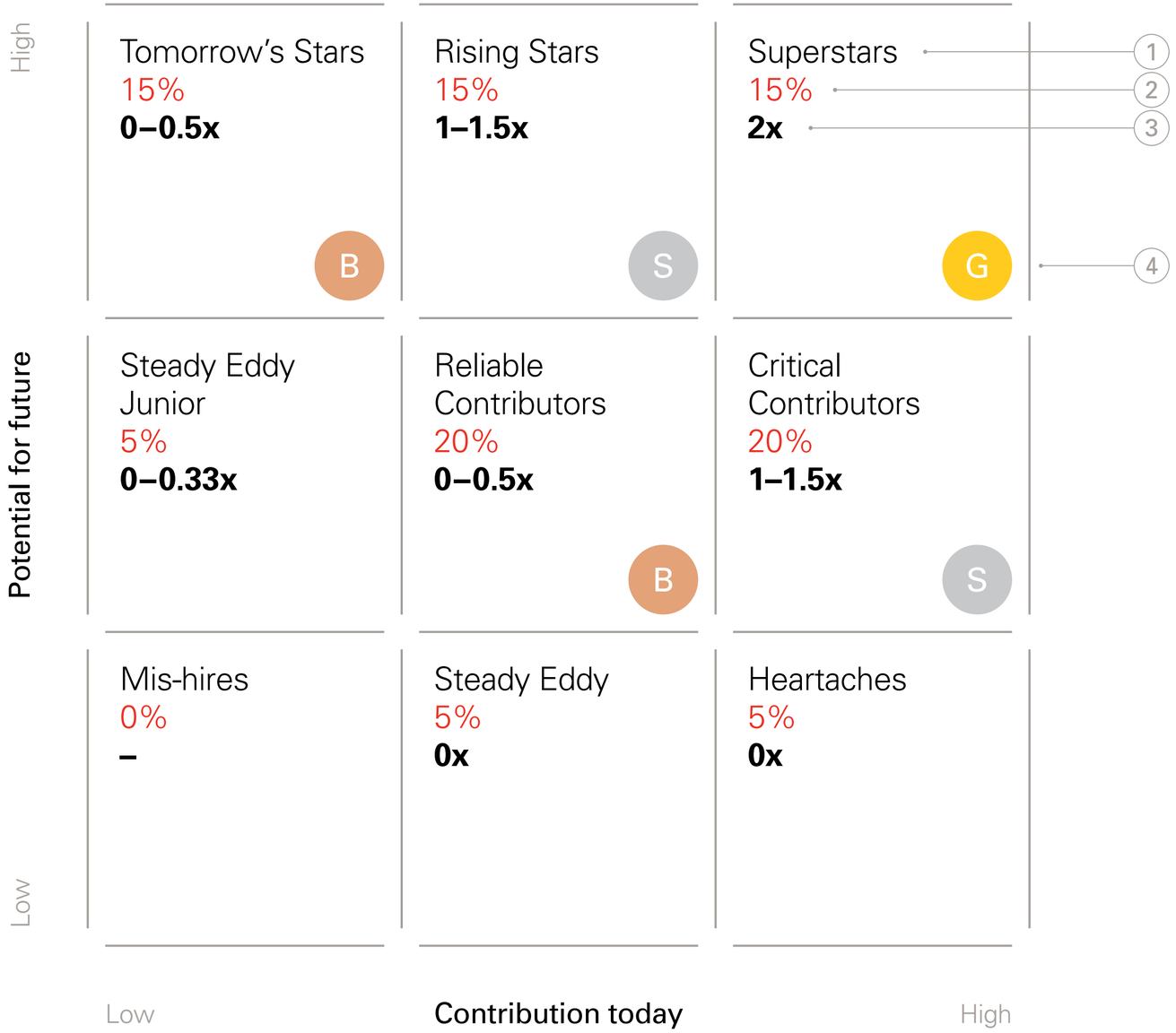
"Giving a big upfront grant makes it hard to optimise for someone's actual contribution. You don't really know how good someone is when you hire them – but you know a lot more about them a year or two in. In the US you are usually forced to make a maximal grant when the individual is hired based on their title, but it is far better to dole out the equity over time based on the person's actual contribution not their title."

Clint Smith
Experienced US Corporate Development Executive and Startup Board Member

We recommend reviewing new hires at 6 or 12 months, and tailoring their stock options package based on their performance. Depending on your rate of hiring, you may want to make this an annual or bi-annual exercise for all staff.

Index Ventures recommends using its Performance Evaluation Matrix to help you calculate stock options awards. (This doesn't apply to executive and technical hires, who will likely receive their grants upfront.) There are two dimensions: an employee's performance so far, and how you think they'll perform in the future. By assessing both on a three-point scale, you can place every employee in a nine-box grid.

The Index Ventures Performance Evaluation Matrix



1. 'Tagline' for individuals in this box
2. Typical percentage of a startup team who might fall into this box
3. Multiple of 'base' option grant that individuals in this box might be given
4. Employee level – Gold, Silver, or Bronze

The percentage breakdowns are a rough example, based on a typical startup. In this case, around 15% of your staff will be 'Superstars', who contribute highly today and have great long-term potential. Another 15% will be 'Tomorrow's stars', who you believe will add significant value in the future, even if their current performance is merely good.

The percentages are approximate, but should help you avoid a common founder's pitfall: rating every employee a Superstar. Even if your overall team quality is high, it pays to distinguish the truly great from the good.

You can use the multiplier in each box, together with the base option grant award for each function and level (see page 91), to determine the right grant for each employee.

In some boxes, the multiplier is a range. That's because there's no magic number: you should do what feels right for you and your business. You could set a zero multiplier for all 'Bronze' employees, which would mean 50% of your staff (excluding executives and developers) receive no option grant beyond their small initial allocation. In other words, you focus on motivating and retaining just your top talent. Alternatively, you may opt for a 'flatter' profile. This is likely to keep the overall team happier – but you may risk losing top performers if they don't feel like their extra effort is being rewarded.

Promotions

When promoting existing employees, we recommend 'topping up' their stock options to match what a new hire would receive in the same role. If they are already over-market (which is common with early hires), find a different way to reward them.

"Always try to identify and reward your shooting stars – junior people who end up being top performers."

Dominic Jacquesson
Director of Talent, Index Ventures

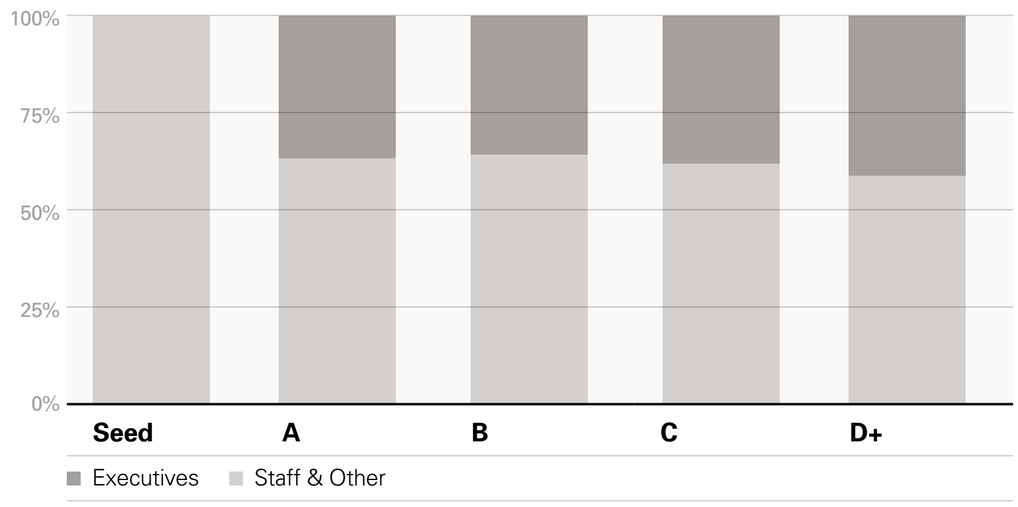
Allocation by seniority
Balancing executive and staff equity

Once you've secured Series A funding, one of your core challenges will be to scale up. You may bring in new types of talent – particularly 'go-to-market' functions (sales, marketing, customer success) and support teams (recruiting, finance, business operations). You're also likely to make new executive hires.

This raises a question: how do you allocate options based on seniority?

European companies tend to allocate a high proportion of their stock options to executives – approximately ⅔ of the total in late-stage startups. In the US, this ratio is reversed. This reflects the fact that many European employees receive no options at all.

How options are split between non-founder executives and staff by funding stage, US



Source: Option Impact from Advanced HR (US data)

Executive grants
Equity for your C-suite and VPs

Executives include 'C-suite' employees and VPs. Most Series A and B startups have no more than three true C-level executives – some combination of a CTO (Chief Technology Officer), CFO (Chief Financial Officer), COO (Chief Operating Officer), CMO (Chief Marketing Officer) and CRO (Chief Revenue Officer). Most experts recommend calculating executive grants as a percentage of total company shares – 1% of FDE for each would be typical in both the US and Europe. But there are exceptions, particularly for COOs and CTOs.

"You should bring in one phenomenal individual every year at exec level – and it needs to be a person you could not have hired the year before. Don't miss the opportunity."

Dominique Vidal
Partner, Index Ventures

COOs
Equity for COOs can be as high as 1.5% – and it can happen as late as Series B. That's partly because the nature of the role varies hugely from company to company. If you're hiring a COO, carefully evaluate how complete their skillset is. Can they also fulfil a CFO role? Do they have proven experience in scaling startups?

CTOs
CTO equity is correlated with a company's geography and technical DNA. For Series A or B, 1% is typical in the US, and 0.7% in Europe. This reflects the higher proportion of tech-enabled business, particularly in e-commerce, in Europe. In the US, there are more pure software businesses, where proprietary technology is the key differentiator.

VPs
VP grants vary widely based on experience, and the importance of their function. As a rule of thumb: 0.3% to 0.7% of FDE at Series A, or 0.2% to 0.6% of total equity at Series B, works well. Product and Engineering roles will be at the high end of this scale, whereas HR and Finance will attract smaller grants. VP Sales will also be lower, because commissions are typically part of their package.

Following your Series A, you might expect to hire around four executives: three at VP level, and one at C-suite. As you scale towards Series C+, a team of 6 to 10 VP-level executives is typical.

Executives and performance
Executives rarely receive top-up option grants for high performance. Instead, they negotiate option grants up front, the value of which grows in line with the company valuation.

With the allocations suggested above, you can make a very crude calculation that at a $1 billion valuation upon exit, a C-suite executive with 1% would stand to make $10 million, and a VP executive with 0.3–0.7% would make $3–7 million. These figures are before dilution and tax have been taken into account – nonetheless, this example expresses clearly the scale of the financial opportunity on offer.

Staff grants

Options for employees below executive level

We suggest a different method for calculating option grants outside of the executive team. This is because the numbers can be misleading: a 0.05% share of FDE sounds trivial – whereas a grant of $12,500 (the same 0.05% at a $25m valuation) sounds much more compelling.

Instead, your starting point should be base salary. This has two further benefits. Firstly, salary is a reasonable yardstick for the value of each employee. Secondly, it allows you to maintain a standard approach, even with later fundraising. Grant sizes stay the same in cash terms, but the number of options granted automatically declines as the valuation – and therefore share price – increases. This means you offer consistent rewards, but those who joined earliest see the biggest benefit.

As you hit your Series A, you can expect to hire roughly 40 to 50 new staff below the executive level.

Potential hiring plan following Series A, up to Series B

Functions	Level	Total
Executive roles	C-Suite	1
	Vice President	3
Engineering, Product and Business Development roles	Director	2
	Senior	10
	Individual	15
Marketing, Finance and HR roles	Director	2
	Senior	4
	Individual	5
Sales and Customer Success roles	Director	1
	Senior	2
	Individual	5
		50

We've defined the three 'Functions' groups in this table for guidance, based on what we see in the US in terms of option allocation levels. Those in the first group tend to receive the highest allocations, with declining average allocations for the second and third groups. These distinctions can vary considerably from company to company.

Arrange roles into categories to suit your company's structure. As you scale, you may well create additional groups to become more fine-grained in your allocations. But avoid this when you're still a small company (under 100 employees). It will make your option plan more complicated both to implement and explain.

Likewise, there are three tiers of seniority defined here, to keep things manageable for smaller companies. Again, as your team grows, you might want to make more detailed distinctions between levels of staff.

In the table on the previous slide, we've used the term 'Senior' to define either a highly experienced and capable individual with no people management experience, or someone with slightly less experience, but who is managing a small team. We find that option allocations to these two classes of employees are closely aligned. 'Individual' means someone with less experience (perhaps less than five years in a role) and who is not managing other people.

A 'Director' heads a functional area, but is not senior enough to be part of the executive team.

Calculating initial grants

Our OptionPlan app will help you

We have another nine-box grid to help you calculate grants for employees below executive level – the two axes being seniority, and function.

These percentages are somewhat higher than current European norms. We think they represent good targets for a new startup – but it's important to remember that there's no magic number, and may be influenced by the factors identified in chapter 4. In any case, the relative award sizes between levels and functions should be a useful guide, even if you choose to adjust them proportionally up or down.

We've also created a app to help you with the process of figuring out what percentage allocations are right for you. Visit www.indexventures.com/OptionPlan

By customising grant levels and hiring plans, you can quickly test and refine your allocation strategy against various benchmark levels, and check the impact on your overall ESOP.

Size of initial option grants by level and function, expressed as a % of base salary

	Individual	Senior	Director
Engineering, Product, Business Development	33%	50%	75%
Marketing, Finance, HR	15%	20%	33%
Sales, Customer Success	5%	10%	33%

Source: Index Ventures recommendation for 'default' grant sizes in Europe

Special cases
How and when to bend the rules

These guidelines should help you set up a clear, consistent ESOP. But there are always tricky cases. Here are three common scenarios worth thinking about.

Relocating US executives

In a global marketplace, talent moves around. More and more US executives are coming to Europe, particularly the UK. And, given the relative immaturity of the European startup market, you may well end up looking for US talent.

But the price can be high. For a US executive, relocation is a risk and a hassle, and compensation is generally higher in the US than Europe.

We believe the guidelines laid out in this chapter will be flexible enough for you to attract US talent – but you may need to treat experienced US candidates as 'Silver' or 'Gold' (as per the Performance Evaluation Matrix on page 85) upfront. And for executive hires, expect to be at the top end of expected equity ranges.

"American executives typically demand much bigger option packages than European executives. European companies have largely been happy to accommodate these demands, perhaps because they are not, as yet, coming under pressure to bring their European executives up to parity. We expect to see a gradual equalisation of packages as local executives get wise to these disparities; as the number of European exits increases, there will be more tangible evidence of the value of options."

Clare Johnston
Founder & CEO, The Up Group

Poaching from big corporates
As you grow, you might need to hire experienced people from corporates in the sector you're looking to disrupt. And in some sectors – particularly finance – their existing salaries will be much higher than you will have established in your team.

Realistically, you'll be talking to a subset of candidates who are willing to take a significant drop in salary to work with you, because they want to be involved in a smaller and more dynamic environment. But stock options are likely to be an important part of the package here, and you may need to negotiate additional stock option awards to offset the drop in cash earnings.

A mechanism for trading cash with equity can be attractive for ambitious hires such as these. You need to set clear parameters – namely, a trade-off ratio (which can be as simple as 1:1, or not), and some kind of cap on just how much salary can be converted into an additional option grant. Transparent guidelines for future salary increases may also be helpful.

If you do this, it's a good idea to give other senior hires the same flexibility, so it doesn't look like special treatment. That said, industry hires will often come later – when strike prices are higher – so early joiners will already be in a good position.

Rarer skillsets
Intense competition for talent means big hitters like Google and Facebook offer very attractive hiring packages, particularly in engineering, data science, AI and design. This makes hiring for these skillsets tough.

"Demand for deep tech candidates is exploding. The tech giants, as well as the leading VC-backed companies such as Palantir, are willing to offer cash compensation of $100k+ for top graduates, with RSU grants of $50k on top. This makes generous stock option grants a must."

Dominic Jacquesson
Director of Talent, Index Ventures

However, the approaches laid out above, plus the intrinsic appeal of being part of a startup, should help you compete. We would advise against offering additional benefits that create a two-tier system: it can seriously damage morale, and once you've started, it's hard to stop.

Worked examples of option allocations
How to apply the rules

Worked example A: Cecille, Senior Developer promoted to Director

Senior Developer, hired immediately post-A:	**Promoted to Director of Engineering two years later**
Series A valuation: $40m FDE: 1m Therefore, current share price: $40	Current valuation: $100m FDE: 1.25m Therefore, current share price: $80
Four-year straight line vesting	
Base salary: $100,000	New base salary: $160,000
Initial grant (part of offer): 40% x $100,000 = $40,000	If hired externally: 75% x $160,000 = $120,00 grant, equivalent to $120,000 / $80 = 1,500 options (representing 0.12% of FDE)
No. of options granted: $40,000 / $40 = 1,000	Unvested options remaining from initial grant: 50% x 1,000 = 500 New options to grant: 1,500 - 500 = 1,000
Representing 0.1% of FDE	Total options granted = 2,000 Representing 0.16% of FDE

Worked example B: Tom, Superstar Marketing Manager

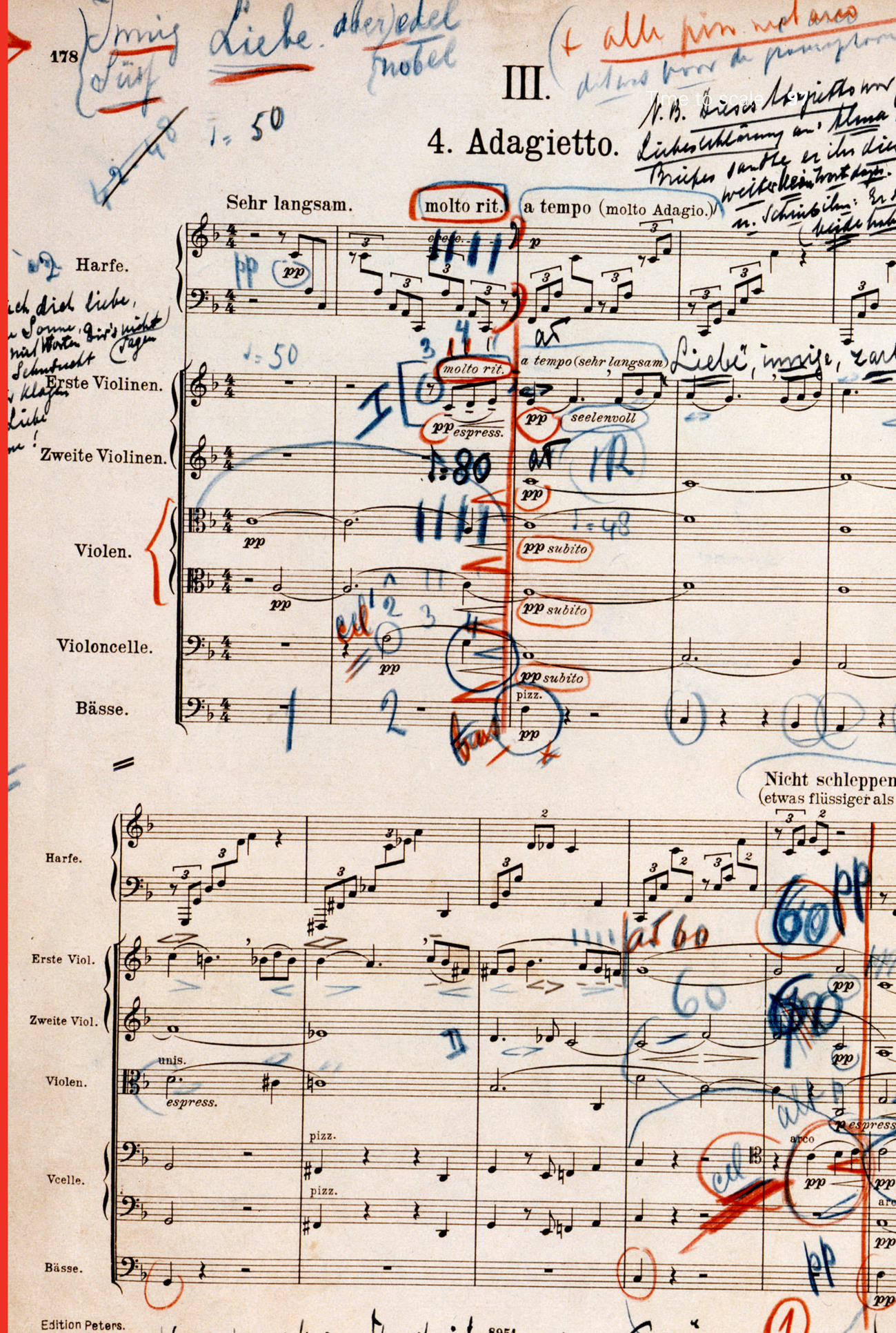
Marketing Manager, hired six months post-A:	**Identified as a Superstar twelve months later**
Series A valuation: $40m FDE: 1m Notional valuation 6m later: $50m Therefore, current share price: $50	Current valuation: $60m Therefore, current share price: $60
Four-year straight line vesting	
Base salary: $100,000	Base salary increased: $120,000
Initial grant (all employees): 5% x $100,000 = $5,000	As per grid, Superstar Marketing Manager option grant: 2 x 20% of salary = $48,000
No. of options granted: $5,000 / $50 = 100	Option grant: $48,000 / $60 = 800 options, less 100 options granted after he joined (ignore ¼ vested) = 700 additional options
Representing 0.01% of FDE	Total options granted: 100 + 700 = 800 Representing 0.08% of FDE Total unvested options remaining: 800 - 25 = 775

8 Time to scale

The Royal *We.*

You can play your own part to perfection, but if a single violinist plays a single string off-key, the whole thing falters. That's the philosophy of the Royal Concertgebouw Orchestra.

120 of the world's finest musicians, based in Amsterdam, amplified by one another's presence, and moulded by one of the world's finest conductors to create something even more remarkable. A majestic symphony of teamwork and acoustics.



So far we've looked at a typical Series A startup, with a headcount under 100, no employees of more than three years' standing, and a simple organisational structure.

Of course, every company is different – but as you scale, things will get complicated. In this chapter, we'll explore some common challenges, and how to navigate them.

Expanding internationally
Don't get hung up on parity

As your company becomes more successful, you're likely to expand beyond your HQ country. Whether you're setting up offshore engineering centres or sales and marketing outposts, you'll need to hire international employees. This raises some questions:

1. Do these hires get grant options?
2. If so, do you use your existing option plan, or a separate one to suit the local market?
3. What methodology should you use to calculate any grants?

There are cultural and practical factors at play here.

Culturally, you may feel all your employees should be treated the same, regardless of where they are. But it's not always clear what that means, given that spending power, taxation, and other benefits vary considerably from country to country.

Don't get too hung up on equalising your stock option offers between countries. It's standard for salaries, benefits and pensions to fluctuate from country to country. Stock options are no different.

> "We have had engineers in both London and Eastern Europe from early on. We had been basing our option grants on salary percentages, but with salaries significantly lower in Eastern Europe, this didn't feel fair. Now, we assume equivalent salaries for employees in both locations, so we can calculate equal option grants."
>
> **UK late-stage startup**

On the practical side, regulation and tax requirements around granting options vary considerably between countries. So adapting your ESOP approach may be in everyone's interest.

Specialised legal advice on making local ESOP arrangements can be costly and time-consuming. If possible, delay setting up a local scheme until you're confident that you're going to stay in a particular location.

To help you navigate each market, we've laid out the most common expansions in this table:

Suggested approach to option plans for most common international expansions

Country of origin	Country of destination	Favoured approach
UK	US	Set up a separate US ISO sub-plan, with periodic 409A valuations (to determine the strike price)
	France	Either adopt a tax-favoured French sub-plan specific to the subsidiary, else set up a cash bonus scheme for French team
	Rest of Europe	Grant non-EMI options from the UK plan, else set up sub-plans where rules or tax require it
Rest of Europe	US	Set up a separate US ISO sub-plan, with periodic 409A valuations (to determine the strike price)
	UK	Adopt a UK EMI sub-plan, which will allow you to make tax-efficient grants with potentially lower strike prices
	France	Either adopt a tax-favoured French sub-plan specific to the subsidiary, else set up a cash bonus scheme for French team

Note: These are complex decisions – always get qualified legal advice before you act

Particularities of the French system

France is a curious case with respect to stock options. For startups HQ'ed in France, the BSPCE plan is tax-favourable, compared to most other European countries. However, for companies establishing a French subsidiary, it is financially prohibitive to issue options to French employees, and alternatives will need to be explored – such as cash bonus schemes.



Taking a bite out of Europe

Founded in Copenhagen

2001

No. Employees

2,500+

Index initial investment

Series A, 2009

Offices

UK, Ireland, France, Spain, Italy, Denmark, Switzerland, Norway, Australia, New Zealand, Brazil, Canada, Mexico

The first Just Eat website was launched in Denmark in 2001, followed by the UK website which was launched in 2006. They went on to grow across much of Europe – including France, Spain, Italy, the Netherlands, Belgium, Ireland and Norway – as well as into Canada and Mexico.

"We did our best to offer options to all non-UK employees."

"We set aside £1k in legal costs per employee, in each country, to set up a scheme. Within this budget, we did our very best to create a programme which was tax-efficient overall for both staff and the company."

Each country required subtle nuances of policy, and Just Eat ended up with multiple ESOP sub-plans. After the UK, they found Ireland to be the most option-friendly country, followed by Scandinavia, and then the Netherlands.

France and Belgium presented the biggest barriers. In France, Just Eat were unable to offer options over the group entity, so they set up a specific scheme for the French subsidiary. In Belgium, they structured bonuses that mirrored some of the benefits of an option scheme, albeit with higher taxes and less employee protection. Mike explains:

"Even when we couldn't achieve as good a result in one country as another, people knew we had tried our best, so we still got a motivational benefit."

Just Eat carefully positioned their grants as "something to put in a drawer and forget about for now – but which might be worth something in the future" – rather than as a core part of compensation.

"The main benefit was motivational – we were able to talk to all our employees as shareholders, which was great for pulling the team together."

All quotes:
Mike Wroe
CFO, Just Eat (2008–2016)

Single or multiple valuations?
Option strike prices can be more advantageous in some markets than others. An advantageous strike price increases the benefit to your employees of a given grant, and means each of your options 'work harder'. Obtaining discounted strike prices involves getting locally approved valuations, which can be messy: options will be worth different amounts in different places.

The important thing is to make sure you've provided the same inputs for valuation in each country. These may be revenue forecasts or performance metrics. You also need to be consistent with exchange rates, to avoid accounting gymnastics.

The US and UK are the two major markets where you'll benefit from discounted strike prices. So, to reduce complexity, you may end up applying one valuation across them both.



Lessons learned from US expansion

Founded in the UK

2003

No. Employees

1,000+

Index initial investment

Series A, 2009

Offices

UK, US, South Africa, Australia

Mimecast makes email and data safer for more than 27,000 businesses and millions of employees worldwide. The company expanded quickly from London, establishing a presence in South Africa, the Netherlands, Australia and the US. They went public on NASDAQ in 2015, with a number of key management positions now residing in Boston. The team learned valuable lessons when extending their stock option programme to employees in the US and abroad.

1. Get used to US expectations around stock options

In the US, the proliferation of successful tech companies means people expect option grants upfront.

> "Everyone takes it as a given, and believes they are entitled to them – particularly when your company is smaller."

But even in the US, employees don't generally understand the mechanics of stock options.

> "They do not always differentiate between a share and an option or know what vesting or exercising mean. Most employees are not aware of the differences between NSOs and ISOs. They know they want stock options, but they don't know how they actually work!"

2. Be prepared to adapt your ESOP to suit US policies

As it's a more mature market, the US tech ecosystem has standardised policies. This meant Mimecast had to adapt their ESOP rules. Vesting schedules and leaver provisions were particular sticking points: established UK policies were seen as prohibitive in the US.

> "You need to accept there will be differences between geographies. Do what you have to do to run your business well, and to hire the best talent."

All quotes:
Peter Campbell
14th employee and now CFO, Mimecast

3. Give everyone a stake, even in new markets

Mimecast decided to grant options to every employee in each new office, valued or not. Peter explains:

"You run into hurdles if you start considering each employee on a case-by-case basis. We wanted every employee to feel as if they had a part in the ownership of the business and its future, We wanted everyone to know that they would have a share in the value that they helped to create."

4. Get an external firm to do your 409A valuation – as soon as possible

At first, the team calculated their own valuation, using the UK valuation and stock price. But this can be risky, and Peter recommends you leave it to the experts.

"Don't go to a Big Four. Smaller firms can do a good job for $5,000. Get your auditors on side for your valuation – it will matter down the road."

5. Keep your option plan as vanilla as you can, and take advantage of employee-friendly regional benefits

Mimecast started operating in the UK and granted stock options from an EMI scheme.

"It is a really beneficial option plan – in a class of its own."

Mimecast moved to the US in 2008, and ended up granting NSOs.

"In retrospect, if I was doing it again I would look in more detail at different structures or awards that would create the optimum future value for employees."

All quotes:
Peter Campbell
14th employee and now CFO, Mimecast

Moving people between countries

It's best to ask a lawyer

If an employee takes up a new role in your company in a different country, tax and legal issues can get tricky. Seek legal advice to avoid nasty surprises. You should also contribute towards the employee's legal costs.

> "We wanted to move staff around to help with setup and scaling – but differing rules and regulations made things tricky, even within Europe. Often, we simply couldn't do it, and were forced to work on a 'day trip' basis."
>
> **Mike Wroe**
> Former CFO, Just Eat

Growing headcount

More levels means more complexity

As your company grows, you'll be adding new functions and levels of seniority. Calculating equity rewards will become more complex. We've worked with later-stage companies with over 20 different employee functions in their stock option allocation matrix.

Growth may affect your company's eligibility for specific types of employee ownership programmes within your country. Again, make sure your lawyers keep track of any cliff-edges that might trigger a change in how you award options.

For example, if you've set up an EMI scheme in the UK, be aware of the ceiling limits. You will not be able to benefit once you've hit the 249 global employees mark, for instance, and will need to explore the later-stage tax-favourable UK schemes, known as CSOP (Company Share Option Plan) and Growth Shares. These plans can be structured in many ways to make them more efficient, so always seek professional advice as you scale.

Main differences when moving from EMI to CSOP in the UK

	EMI	CSOP
Limit on value of shares under options	£250,000 per person £3m company limit	£30,000 per person
Exercise price	Assured valuation available – often 70% discount from last round valuation, and can be 100% (for early-stage companies)	Unrestricted market value Assured valuation available – same methodology as EMI, but discounts tend to be lower for later-stage companies
Expected tax treatment	Capital gains tax on spread at sale 10% 'Entrepreneurs Relief' rate if over 1 year between the dates of grant and exercise, 20% otherwise	Capital gains tax on spread at sale, at 20%
Minimum holding period after grant	None	3 years, otherwise income tax applied

When do RSUs make more sense?

In recent years, late-stage startups have been taking private funding at extremely high valuations, rather than heading straight for an IPO. Facebook set this trend; Uber, AirBnB, Pinterest, and others followed. Faced with high strike prices and less valuation upside, stock options become a much less compelling tool for retaining top talent. In these conditions, US 'unicorns' have shifted to RSUs, an instrument previously used only by public tech companies. RSUs don't have a strike price – instead, they convert directly into shares over the vesting period, with income taxes due at the point of vesting.



Moving from stock options to RSUs

Founded

UK, 2002
Sweden, 2003

No. Employees

2,000

Index initial investment

Series A, 2005

Offices

UK, Sweden, Spain, US, Malta, Romania, Germany, Japan

King is a leading interactive entertainment company for the mobile world, with franchises including Candy Crush, Farm Heroes, Pet Rescue and Bubble Witch. King has 314 million monthly active users as of Q2 2017 across web, social and mobile platforms. King has developed over 200 games which are played across the world. The company went public in 2014, and was acquired by Activision Blizzard inc in 2016 for $5.9 billion.

King's founding team set out to develop skill-based web games. In 2012, the company's trajectory changed dramatically – the social and mobile gaming market presented an enticing opportunity. Candy Crush Saga was born, and rapidly became one of the world's most popular and valuable casual games.

"From very early on in its history, King had made small option grants to employees. But after the success of Candy Crush, we chose to broaden employee ownership, to help us retain and align our rapidly growing team."

Leading up to the IPO, King changed their approach to employee equity grants. They switched to granting RSUs for most employees, with options for some senior executives. All team members employed at the date of IPO received an equity grant. All new hires joining King received an equity grant on a monthly cycle thereafter.

Following the IPO, King introduced an annual refresher equity grant, primarily in the form of RSUs. All existing staff employed at a certain date were eligible for the grant, and it was awarded on or around the anniversary of the IPO. Terms and vesting schedules were the same for almost all employees. As had previously been the case before the IPO, grant sizes varied by employee function and level, but not by country.

All quotes:
Rob Miller
General Counsel at King (2012–2017)

Refresher grants and programmes

How to hold on to your stars

Other companies will inevitably try to poach your staff – especially if you're successful. Earlier-stage startups are particularly fond of hiring people from more scaled-up businesses. A generous offer from a rival startup can look all the more appealing to an employee when their stock options are coming to the end of their four-year vesting period.

You want your best employees to stay put. Equity retention programmes can help. These are more commonly called 'refresher' or 'top-up' option grants, which is how we'll refer to them for convenience.

> "I dislike the term refresher – it has no strategic meaning. I prefer to refer to it as an equity retention plan."
>
> **Dee DiPietro**
> CEO, Advanced-HR

Who needs a refresher, and when?
Refresher grants can be a great retention tool for employees approaching the end of their vesting schedules. You can do this on an ad hoc basis, but by Series B or C, we recommend you establish a more formal approach.

> "We didn't do refreshers very well – we hadn't expected we'd need to. It never became systematic, always ad hoc, which was a mistake. We lost good people, and others lost motivation."
>
> **Peter Campbell**
> CFO, Mimecast

> "If you keep refresher grants ad hoc, you will not scale the organisation beyond a couple of hundred people."
>
> **Dominique Vidal**
> Partner, Index Ventures

How common are equity retention programmes?

Geographic Area	No	Ad hoc	Regular/Annual
Europe	58%	21%	21%
Bay Area	6%	68%	26%
Rest of US	10%	74%	16%

Source: Option Impact from Advanced HR (US data), Index European ESOP survey

Even in Silicon Valley, ad hoc refresher programmes are more common than structured plans, though more mature companies are more likely to have one. In Europe, only 42% of startups have any kind of refreshers, ad hoc or otherwise.

Calculating refresher grants

Andy Rachleff of Wealthfront – an asset management startup, and member of the Index portfolio – has set the bar for refresher programmes in Silicon Valley.

Under his approach:

- all employees are granted annual refreshers, starting 2.5 years after their original option grant.
- the refresher is equal to a quarter of what the employee might expect to receive if hired for their position today.

It's worth reading Andy's blog post, The Wealthfront Equity Plan, outlining his approach, and the benefits he has seen as a result.

Whilst Wealthfront's approach is a great starting-point for developing your refresher programme, we recommend that you adjust it for a European context.

Which employees should receive additional stock options? We suggest you look to your highest performers, as determined by using the performance grid we introduced in chapter 7. You might decide to offer refreshers to your 'Gold' performers only, or include 'Silver' and 'Bronze', too. There's no need to include a cliff in the vesting schedule for the new options since you're granting them to already-proven employees.

> **Alternatives to refreshers for early joiners**
> For team members who joined early, even a generous refresher may feel small compared to their initial grant (which is now valued much higher). In this case, you might have to be more creative in coming up with incentives, financial or otherwise. Offering the opportunity to sell down some existing shares over time in a secondary offering is one possibility.

ESOP admin and tracking

How to stay on top of the paperwork

Running an ESOP involves a serious amount of paperwork. You'll need to keep track of all employee start dates, salaries and allocations, alongside the total number of shares in your company and your share price.

As your team grows, the size, dates and strike prices for every new grant should be carefully monitored. You'll also start to model out allocated and unallocated elements of your ESOP, and projected grants for future hires. New option grants will need to be approved by your board and formally registered with relevant authorities.

> "It makes it so much easier for the board to approve option grants when they have all the basic information at hand. Too often, this is not the case."

Neil Rimer
Partner, Index Ventures

Tip 1:
Avoid endless board meetings. Get approval for your standard allocation grid for option grants, so you won't have to discuss every award. Only exceptions to your approach (and awards to executives) will need further board discussion.

Tip 2:
We also recommend a pro forma approach to tabling option grants, to make sure you're giving board members all the information they need.

This would include:

Template for board approval of option grants

Name	Title	Salary	Bonus	Reason	Vesting start	Option # and value	FDE %	Standard or exceptional grant?

Separate this table according to Reason for the grant - new hire, high performer, promotion, or refresher.
Include a separate table, summarising your ESOP and FDE position before and after:

	Before grants	**After grants**	**FDE %**
Shares			
ESOP - allocated			
ESOP - unallocated			
Total			

You should work with a lawyer to make sure that all registrations and returns associated with your ESOP and grants are professional and above-board, with a full audit trail for future reference. We've seen grants that weren't lodged properly with tax authorities become invalid years later, causing real financial and emotional pain. Later-stage investors will also expect to see thorough record-keeping as part of their due diligence processes.

"Often, entrepreneurs don't hold onto the paperwork for option grants. Poor registration and record keeping are really common pitfalls."

Sarah Anderson
Director, RM2

In Europe, grants are generally approved and lodged annually or bi-annually to minimise administrative overhead.

Making grants before fundraising
You can take advantage of lower valuations and strike prices by awarding a batch of option grants ahead of new fundraising.

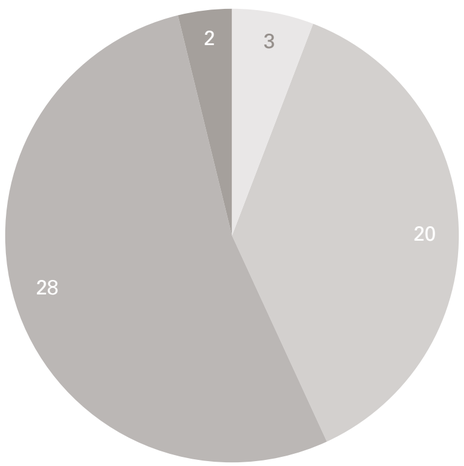
UK EMI grant valuations are only valid for 30 days
Assured valuations from the UK's HMRC last 30 days, so you'll want to register a batch of option grants during this window.

Employee ownership is a sensitive area. Founders generally keep control of the process, data and administration, until they can delegate to a suitable senior finance or HR leader. So at least until you appoint a CFO, you'll be holding the pen.

This can be quite overwhelming: 57% of respondents in our survey said their option plans take up 'quite a lot' or 'loads' of their management time.

> "Given the legal and tax complexities associated with options, I have found very few HR leaders able to run the process without the support of Finance."
>
> **Peter Campbell**
> CFO, Mimecast

How much management time does your option plan absorb?



Source: Index European ESOP survey

Even the most sophisticated spreadsheet will struggle to contain all your data when your team grows beyond 200+ employees.

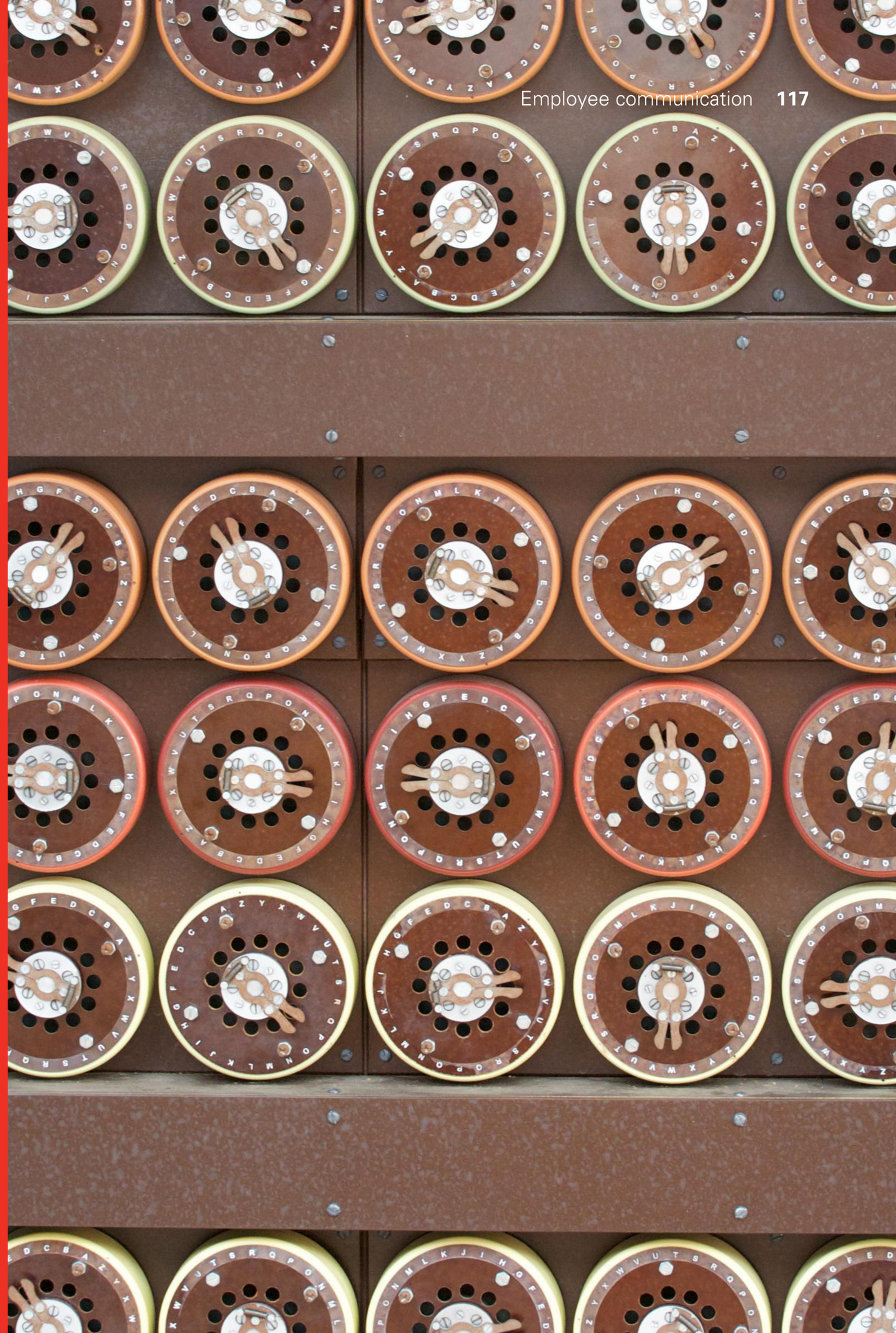
A lot of our companies in the US, and increasingly also in Europe, use Carta (previously eShares), a software tool specifically aimed at cap table management, including option grants for VC-backed startups. Thousands of US seed-stage startups use Carta, and the product is now being localised for the UK and other key European markets. Carta keeps a full history of grants made, and has a self-service portal for employees to check their grant details.

9 Employee communication

An army of codebreakers.

In 1939, Alan Turing pulled off one of the all-time great feats of codebreaking. Against odds of 150 million to one, he cracked the Enigma machine and, according to a grateful Churchill, shortened the war by two years.

But Turing didn't do it alone. Behind the scenes, thousands of women (or 'Bletchleyettes') worked for years to intercept and decipher enemy messages, giving Turing the material he needed for his breakthrough.



However much time and effort you put into crafting your stock option plan, employees may not understand it. This is a common problem – and it can be frustrating.

How you communicate your plan matters almost as much as the plan itself. Get it right, and your employees will understand the plan, and make the most of it. Everyone wins

Clarity matters

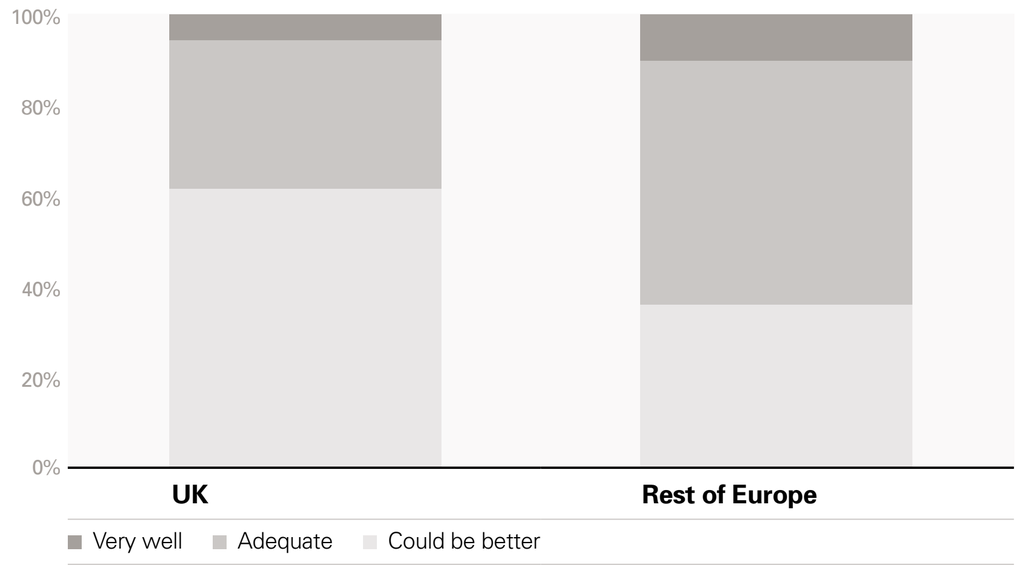
Your plan needs to make sense to everyone

Stock options can be attractive – and valuable – assets for employees. But they're also difficult to understand, particularly for people who aren't familiar with financial jargon and small print.

Your basic assumption should be that your employees don't know anything about options. Accept that not everybody will read every bullet point and footnote; at best, many employees will just skim the key information and move on.

So clarity matters. You may even choose to adapt your message for different groups, with different levels of expertise and interest.

How well do your employees understand the option plan?



Source: Index European ESOP survey

"Even in the US, very few employees know how options work. They just know that they want them!"

Peter Campbell
CFO, Mimecast

Misconceptions
Employees with limited knowledge aren't the only potential problem. You might find some employees have misconceptions about how stock options work. For example, they can have unrealistic expectations of how much you should grant them.

Conversely, some employees won't realise that options involve no risk on their part – they may expect an upfront payment required to 'buy' their options, and therefore they won't read any further.

Communication do's and don'ts

Give employees a clear summary, and help them understand risk

It's important to spell out your option plan clearly, without any room for misunderstanding or confusion. From day one, your message should be the same for every employee (there are some exceptions to this below.

Best practice: dos and don'ts for communicating option grants

Do
- Start with an offer letter to describe the terms of the grant
- Make it clear that holding stock options does not cost anything
- Highlight why your company can succeed
- Keep it brief, and focused on topics everyone will understand
- Outline best – and worst-case – scenarios, so your employees can evaluate the risk and potential reward
- Encourage them to review your ESOP documentation
- Tell them who they can contact with questions

Don't
- Tell all employees what their equity might be worth
- Oversell the value of their equity
- Create a sense of secrecy around your capital structure and financial performance
- Set false expectations (positive or negative)

Segmenting your audience

There's no one-size-fits-all approach

We recommend adapting your communication based on the different types of grants you'll make.

- Small all-employee grants for new hires
- Grants for new executives
- Grants for high performers or promotions

For each type of grant, you need to think about:

Transparency
You need to decide what is the right level of information to give employees, particularly around ESOP terms.

Managing expectations
You want your employees to get excited about their grant, without building up unrealistic expectations.

Written and verbal communication
You might find a face-to-face chat the best way to illustrate value potential. Handing out spreadsheets with phrases like 'value at exit' can lead to confusion.

Who, how and when
You need to decide which member of your team communicates grants – and be clear about the process they should follow.

Small grants for all employees
Giving a new employee a small option grant shows them the importance in your company culture of collective involvement and shared goals. Plus, it will make them feel good about their new job.

A small option grant is primarily symbolic, so there's no need to get into the details. Tell your employee that there's no risk associated – and that if the company is successful, their grant might turn into a nice cash bonus in a few years. But be clear that this grant isn't going to make them a millionaire.

Until you've reached around 50 employees, try to have this conversation 1:1 with new hires. After that, it could be done in onboarding cohorts, with an offer to follow-up 1:1 upon request.



How transparency builds trust

Founded in Palo Alto

2012

No. Employees

260

Offices

US, Brazil, UK

Carta (previously, eShares) is the leading cap table management platform for private companies. 5,000+ companies, their investors, and their employees rely on Carta's software for equity management, 409A valuations, and liquidity support. Founder and CEO, Henry Ward, advocates for transparency around employee equity. Here are Carta's tips to make stock options less of a dark art and create a culture of trust.

Clarity from the outset – a comprehensive offer letter

Most entrepreneurs are familiar with the potential benefits and risks of owning equity. Most employees, on the other hand, aren't. So a clearly worded offer letter is essential.

Carta publicly released a 'Better Offer Letter', based on the one sent to their own staff, for other company founders to use as a template. The innovative format uses visuals and plain English to explain how much the employee has been offered, what ownership percentage their shares represent, as well as their estimated payouts based on different exit scenarios. It also includes details of the company's capital structure and explanations of complex terminology like 'common' and 'pref' shares.

Be transparent – but don't oversell

In the early days at Carta, the entire company had access to the cap table.

> "Now, we allow each individual to see what percentage of our FDE they own. This is possible with Carta software – but only 5% of our customer base currently has this feature enabled."
>
> **Henry Ward**
> Founder & CEO, Carta

Even if your equity offer is light, employees will respect you for being upfront about what their stock options could be worth.

But tread carefully. Nothing erodes employee trust more than over-promising on rewards that may never materialize. Carta recommends issuing every grant with the disclaimer that all equity is worth $0 until your company reaches a liquidation event. It's also worth mentioning that even if the company exits at an unexpectedly lower value, preferred investors might get all the payout. Being frank and honest will help build trust with your employees while encouraging everyone to grow the company.

Educate employees to earn their support

You can give your employees a helping hand by educating them on how to exercise options. For example, let them know when you are about to close a fundraising round. When you complete an initial close, employees are locked out of exercising their options at the current price and tax levels. They may have to pay much steeper taxes if the value of the company's shares have increased.

At Carta, weekly All-Hands and monthly mini-board decks keep employees updated on company financials. This is another simple way to be transparent with employees, save them money and earn their support.

Given what the company does, Carta employees are at the extreme end of sophistication when it comes to understanding stock options. However, their approach to transparency still offers valuable lessons for others.

Grants for new executives

Incoming executives will expect more detail about their grant before they join, and maybe about your ESOP rules.

It's worth taking time to talk through the current valuation of the company and your hopes for future potential valuation.

Be straightforward about dilution – but unless you're asked, you don't need to go into too much detail (for example, by explaining layered prefs in the cap table).

You can decide whether to discuss change of control or leaver provisions. It may be easiest to refer them to your ESOP plan, but be ready to answer any questions.

Grants for high performers or upon promotion

Grants tell high performers and promoted employees that they're valued. They help retain and motivate – and make individuals feel like they're a key part of your future.

It's a special level of recognition, and should be treated that way.

Awards should be communicated in person, by your CEO or another relevant member of the executive team. The grant letter can be handed over during the meeting, as you emphasise how the employee fits into your ambitions for the coming years. Offer a follow-up meeting with the CFO for any questions they might have.

"At ROLI, we wanted to engage the whole team with the opportunity presented by stock options. So we took a multi-stage approach. First, we introduced the programme to the full team, then we gave people the chance to ask questions 1:1. Investing some time in this process really paid off – people saw that their success and the company's were closely aligned."

Corey Harrower
Chief People Officer, ROLI

10 Doing it differently

Together to the top.

At 11:30am, May 29, 1953, Edmund Hillary and Tenzing Norgay reached the summit of Mt. Everest after seven weeks. Down below, a team of twenty sherpas and over three hundred porters waited with around ten thousand pounds of baggage.

One of these bags had transported Hillary's camera up to the summit. But only one climber could be photographed, as Norgay didn't know how to use a camera.



Stock options and employee ownership were pioneered in Silicon Valley. In this chapter, we'll look at current trends and innovations in the Valley – and ask if they're right for European startups.

Innovative vesting schedules

Mixing things up

As we saw in chapter 4, standard vesting schedules are typically four years, with a one-year cliff. However, this time-based formula has been criticised in recent years for emphasising the closing of hires, over longer-term retention. The perception is that this has rewarded 'job hopping', with employees staying through their cliff, but moving on at the first sign that the company's growth prospects might not be spectacular.

When an employee leaves a company, so too does their knowledge and experience. Companies appreciate that stock options need to be structured to encourage long-term retention as well as to simply secure hires in the first place.

> **Falling tenures**
> In the US, employees aged between 25 and 34 had a median tenure of just 2.8 years in January 2016, compared to 7.9 years for workers aged between 45 and 54, according to the Bureau of Labor Statistics.

This has led to two alternatives to the traditional vesting schedule: back-loaded vesting, and performance-based vesting.

Back-loaded vesting

Instead of giving employees a quarter of their options per year, Snap gives its employees 10% in the first year, 20% in the second, 30% in the third and 40% in the fourth. This approach has been adopted by several European companies, including Farfetch.

Traditional vs back-loaded vesting schedule

Source: Option Impact from Advanced HR (US data), Index European ESOP survey

Performance-based vesting

It's becoming more common to reward executives with performance-based stock options, rather than time-vested ones. This means employees are only given stock options if they hit targets that drive your long-term value, like revenue growth.

This approach normally comes with two caveats.

First, it only applies to executives in roles that impact your top-line goal, like sales and marketing.

Second, it's still a good idea to use a traditional, time-based system for up to half of their stock. This is because there may well be external factors outside the control of a single executive which affect performance targets.

We expect to see more examples of European startups experimenting with back-loaded and performance-based vesting in coming years.

Extending exercise periods
Building an employee-friendly culture

The skills you need at the start of your company can be very different to the ones you need later on. Sector-specific and managerial skills tend to become more important as your business grows. Company cultures can evolve, with an unstructured environment giving way to more refined processes.

You might not need or even want an employee to stick with you all the way to an IPO or exit. And your employee might also want to move on after your early stage.

This doesn't need to be a bad thing. You should acknowledge your employee's help getting you to your current position, and aim to part on good terms. This way, your former employee remains an ambassador for your brand.

As we discussed in chapter 5, traditional ESOP terms in the US require an employee to exercise their vesting options within 90 days – or lose them all. This means a big cash outlay, with no guarantee of an exit date.

> "Analysis we've conducted shows that even when company valuation has increased more than 10x, only 60% of leavers in the US actually exercise when they leave a company. The remainder forgo the opportunity to make potentially terrific returns, often because they lack the cash resources to exercise so quickly."
>
> **Henry Ward**
> Founder & CEO, Carta

Founders and employees can both feel this is unfair. Hence, some US companies now offer extended exercise periods as formal policy, in proportion to an employee's tenure. This approach gives the employee time to secure the cash to exercise, and to better gauge the company's trajectory. It thereby helps to build an employee-friendly culture and attract new hires.

"We offer extended exercise period for leavers in proportion to their tenure. For each year of service, the employee is given an additional year to exercise."

Henry Ward
Founder & CEO, Carta

A significant proportion of European startups already effectively enforce extended exercise periods through policies that leavers retain vested options which cannot be exercised until exit.

Secondary sales

Giving back to your early employees

In 2000, the average time from formation to IPO was just six years. Now it's eleven, according to the McKinsey report 'Grow fast or die slow'. Unless there is an opportunity for secondary sales, employees can be waiting a very long time before they receive any financial benefit from their options, and become demotivated as a result.

Secondary sales offer investors the chance to buy stock from existing stockholders, instead of buying newly issued shares.

In recent years, secondary stock purchase mechanisms have become more established in the US. Usually, purchases are part of a fundraising drive, with secondary stock sold at a 15% discount compared to newly issued shares. Early employees with fully vested grants can be included in secondary purchases.

All early employees should be included to avoid favouritism, but we'd recommend capping the amount employees can sell at 15–20% of their total vested options. This makes sure there's still a retention benefit to their remaining options.

You might also set a limit to the amount of cash an employee can earn from a secondary sale (e.g. $500,000), with a simple pro rata mechanism if options supply exceeds investor demand.

"I'm not a fan of secondary sales for founders or executives only. I believe in allowing as many employees to participate as possible. It's also a great way to demonstrate the value of options to the wider team."

Neil Rimer
Partner, Index Ventures

Secondary markets have also emerged as a way to create liquidity for employees. Such markets received bad press in 2012, when pre-IPO Facebook stock changed hands at dramatically varying prices, with little oversight. This led to some describing secondary markets as a 'Wild West'.

"At our last fundraise, and with the encouragement of Index, we allowed employees to exercise and sell up to 25% of their vested options, which really boosted team motivation."

David Okuniev
Co-Founder & co-CEO, Typeform

Since then, companies have put in place methods to make sure secondary trades do not take place through back channels. For example, some ensure a right of first refusal, which gives existing investors the first opportunity to purchase shares – and retain control of the company.

Others now operate a structure to aggregate vested options across the company and offer them to pre-approved outside investors, often through an independent tender. This means secondaries no longer taking place through brokers or marketplaces like EquityZen.

It's still early days for these new methods in the US, so it's likely to be some years before we see them emerge in Europe.

"You really shouldn't consider doing a secondary sale unless there's excess investor demand for primary equity, above and beyond the funding requirements of the company."

Neil Rimer
Partner, Index Ventures

Balancing cash and equity
Adjusting to individual risk appetite

Joining a startup isn't for everyone. It takes a certain type of personality, often combined with a higher appetite for risk.

But a person's appetite for risk can change. Say an employee needs to secure a mortgage or wants to start a family: cash will become more important to them, even if they remain committed to your company mission.

To help, you can consider a formal cash:equity trade-off policy for new joiners. Job offers will feature a mix of cash and options, but with the chance to increase either one, in a fixed ratio.

You can keep this ratio simple at 1:1. Or, you can give more weight to cash, in recognition that equity awards are usually spread over a four-year vesting period (which implies up to a 1:4 ratio).

It's important to consider how valuable your equity has proven so far. Your cash:equity policy should specify limits for a maximum trade-off (for example, 15% of an employee's salary). Plus, you should state how you'll calculate future salary increases.

If you've offered an employee a much higher option grant for a salary sacrifice, you probably don't expect to return to mark-to-market method to assess their salary a year later.

In Europe, we've found risk appetite is generally more variable than in the US. A policy like the one above can therefore be a useful part of compensation negotiations with candidates.

Where next?

This handbook has brought together benchmarks from the US and Europe around employee ownership for the first time. We hope it's given you more clarity – and provided actionable and practical recommendations for your company stock option scheme. Our research into employee ownership and stock options at Index Ventures is ongoing and we will continue to expand and update our data.

Employee ownership will become an ever more pertinent subject as competition for talent gets fiercer and fiercer. Let's keep the conversation going – among founders, investors and employees.

Sparking debate

Regulation and tax practices vary massively across Europe – from some of the world's most favourable schemes for startups, to some of the most unhelpful. If the European tech ecosystem is to grow and thrive, it is our belief that entrepreneurs and government bodies need to work collaboratively. We need to address the barriers that taxation and bureaucracy pose to innovation and job creation.

Your next step

Try our OptionPlan app. We've made it simple to test and refine your allocation strategy against various benchmark levels, and to check the impact on your overall ESOP size.

Are you thinking about trialling an innovative approach to employee ownership and stock options at your startup?

If so, we'd love to hear from you. Reach out to Dominic Jacquesson at Index Ventures (talent@indexventures.com).

Appendix

Glossary

Cap table
List of all company shareholders, the number of shares, class and percentage of shares they hold.

Change of control
When ownership of a company shifts such that control moves from one party (or parties) to another. For example, when the company is acquired, or goes public. But it can include an investor obtaining more than 50% of the shares.

Cliff
Non-vesting period after options have been granted.

Dilution
When existing shareholders' equity share shrinks as new shares are issued, usually through fundraising. Dilution also affects stock option holders.

ESOP
Employee Stock Option Plan – the legal framework for giving options employees. The ESOP also lays out the standard terms and provisions for stock option grants by the company.

FDE
Fully diluted equity – the total number of issued shares, plus stock outstanding options, in your cap table.

Post-money valuation
Company's valuation after fundraising. Pre-money valuation + total amount of new funding raised.

Pre-money valuation
Valuation before fundraising – reflects what investors are willing to pay for shares in the company at that point in time.

RSUs
Restricted stock units are a promise to issue common stock at zero cost in the future to the holder. Whilst stock options are issued early in the life of a startup, RSUs tend to be used by public companies, or sometimes by late-stage private companies. Shares are delivered automatically on vesting. There is no exercise process.

Share capital
Total individual shares your company can issue.

Share price
The total valuation, divided by the total number of shares. The fully diluted share price is the valuation, divided by the sum of all shares and share options in the ESOP, whether or not they have been allocated yet.

Stock option
A right (but not an obligation) to purchase a given quantity of shares at a set price for a fixed period (usually 10 years).

Strike price
Fixed price for a given option grant – the amount an employee must pay to buy each share. It is also referred to as the exercise price or option price.

Vesting schedule
The timeline over which options become exercisable, or, the point at which they can actually buy shares. Unvested options are normally cancelled and returned to the unallocated ESOP pool when an employee leaves the company.

Company profiles

Carta
Carta is the first and only SEC-registered Transfer Agent for private companies. Their online platform allows companies — from seed stage to pre-IPO — to manage equity electronically with the participation of shareholders, employees, auditors, and legal counsel.

Farfetch
Farfetch is the global platform for luxury fashion, connecting customers in over 190 countries with an unparalleled offering from the world's best boutiques and brands from over 40 countries.

Just Eat
Just Eat has reinvented the takeaway. From keystroke to doorstep, the London-headquartered company has built a seamless multi-platform service, with more than 74,500 restaurant partners on its roster, covering 13 countries from Scandinavia to Latin America.

King
Creator of Candy Crush Saga, Farm Heroes Saga, Pet Rescue Saga and Bubble Witch Saga, King is the worldwide leader in casual games with more than 30 billion game rounds played per month globally, as of Q2 2017.

Mimecast
Mimecast is a category-defining SaaS company for unified email management, safeguarding email security, archiving and seamless continuity.

SwiftKey
SwiftKey's mission is to enhance the interaction between people and technology and we're committed to providing our users with the world's most intuitive and personalized keyboard. SwiftKey's technology is now found on more than 300m devices worldwide. In April 2016 SwiftKey became part of the Microsoft family, working together to empower every person and every organization on the planet to achieve more.

The Family
Moving at startup speed, The Family transforms portfolio startups, special projects and virtual infrastructures into a highly connected community of entrepreneurs, operators and fellow investors.

Wealthfront
Wealthfront fuses world-class financial expertise with next generation technology to provide access to the same high quality financial advice offered by major institutions and private wealth managers, without the high account minimums or costs.

Thank you

We would like to give special thanks to Advanced HR, Taylor Wessing and Seedcamp for providing expertise, content and data.

advanced hr

New ideas in compensation data and design for private, venture-backed companies. Advanced-HR provides compensation data to more than 2,300 private companies through Option Impact and partners with 115 leading venture firms to produce the VC Executive Compensation Survey. They also launched Option Driver – a revolutionary platform that enables startups to get and keep the right people.

TaylorWessing

Taylor Wessing is a full-service international law firm, working with clients in the world's most dynamic industries. We take a single minded approach to advising our clients, helping them succeed by thinking innovatively about their business issues.

Seedcamp

Seedcamp is Europe's seed fund, identifying and investing early in world-class founders attacking large, global markets and solving real problems using technology. Since launch a decade ago Seedcamp has invested in 250 startups including fintech unicorn TransferWise.

Abakar Saidov
Co-Founder & CEO, Beamery

Alex Gayer
CFO, Swiftkey (former)

Alex Wakeford
Finance Director, Secret Escapes

Anna Fredrixon
Head of HR, KRY

Andy Rachleff
President & CEO, Wealthfront

Ann Casey
Partner, Tax and Incentives
Taylor Wessing

Bart Hunnekens
Counsel, Taylor Wessing

Becki DeGraw
Associate,
Wilson Sonsini Goodrich & Rosati

Ben Medlock
Co-Founder & CTO, SwiftKey

Benjamin Smith
Finance Director, MOO

Benoit Grouchko
Co-Founder & CEO, Teemo

Bertrand Hermant
Counsel, Taylor Wessing

Bert Kimpel
Partner, Taylor Wessing

Brandon Gantus
Associate,
Wilson Sonsini Goodrich & Rosati

Carlos Eduardo Espinal
Managing Partner, Seedcamp

Chloe Palmer
HR Director, Secret Escapes

Christine Cordon
General Counsel, Secret Escapes (former)

Clare Johnston
Founder & CEO, The Up Group

Clint Smith
Experienced US Corporate Development
Executive and Startup Board Member

Conrad Lee
Head of Product & Sales, Advanced-HR

Corey Harrower
Chief People Officer, ROLI

David Booth
Product Lead – International, Carta

David Okuniev
Co-Founder & Co-CEO, Typeform

Dee DiPietro
CEO, Advanced-HR

Douglas Squirrel
Director, Squirrel Squared

Edouard Peers
General Counsel, onefinestay

Eric Klotz
Legal Counsel, CallidusCloud

Dr. Frank Freund
Co-Founder & CFO, Raisin

Ellen Tukk
Stock Options Manager, Transferwise

Fiona Russell
General Counsel, Betfair (former)

Hassan Sohbi
Partner, Taylor Wessing

Henry Ward
Founder & CEO, Carta

Huw Slater
CFO, Typeform

Ingo Uytdehaage
CFO, Adyen

Jean-Baptiste Rudelle
Co-Founder, Executive Chairman
Criteo

Jean-Daniel Guyot
Co-Founder & CEO,
Capitaine Train (former)

Jeff Eneberi
General Counsel, Just Eat (former)

Julian Fichter
Project Manager, People Analytics
SoundCloud

Juliet Russell
Head of HR, MyOptique

Josh Jian
Director, Corporate Development
Credit Benchmark

Kasper Heine
General Counsel, Trustpilot

Lee Greening
Finance Director, FaceIT

Lucy Vernall
General Counsel, Funding Circle

Marc Strigel
COO, SoundCloud (former)

Marianne Vikkula
CEO, Slush

Markus Haider
Finance Director, SoundCloud (former)

Mike Wroe
CFO, Just Eat (former)

Monica Sevilla González
Partner, Garrigues

Nicolai Orsted
Partner,
Plesner, Law Firm

Neil Miller
General Counsel, SoundCloud (former)

Olda Muller
CFO, Socialbakers (former)

Oskar Arndt
General Counsel, iZettle

Patrick Foster
COO, Drivy

Peter Campbell
CFO, Mimecast

Philipp Moehring
Europe, AngelList

Ray Raff
CEP - FP&A, Carta

Reshma Sohoni
Co-Founder & Managing Partner
Seedcamp

Rob Miller
General Counsel, King (former)

Sam Harper
General Counsel, Deliveroo

Sarah Anderson
Director, RM2

Shane Hogan
Partner, Matheson

Sian Keane
Executive Vice President, People
Farfetch

Simon Baldeyrou
CFO, Drivy

Dr. Stefan Hesse
CFO & UK Managing Director
Alkemics

Stephane Kurgan
COO, King

Tim Vandecasteele
Co-Founder, Silverfin

Tom Rippon
Developer, Freelance

Ulrik Laustsen
Partner, Bird and Bird

Index Ventures

3 Burlington Gardens
London W1S 3EP, UK
Telephone +44 20 7154 2020

139 Townsend Street, Suite 505
San Francisco, CA 94107, USA
Telephone +1 415 471 1700

Rue de Jargonnant 2
1207 Geneva Switzerland
Telephone +41 22 737 0000

indexventures.com

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Contributions and insights from the Index Ventures Investment Team and Legal Counsel.

Researched and written by
Dominic Jacquesson, Director of Talent
at Index Ventures.

The information provided in this handbook, in particular chapter 6, is a general guide and specific legal and tax advice should be sought when implementing option arrangements.

Download the full version in high-res, go to www.indexventures.com/rewardingtalent