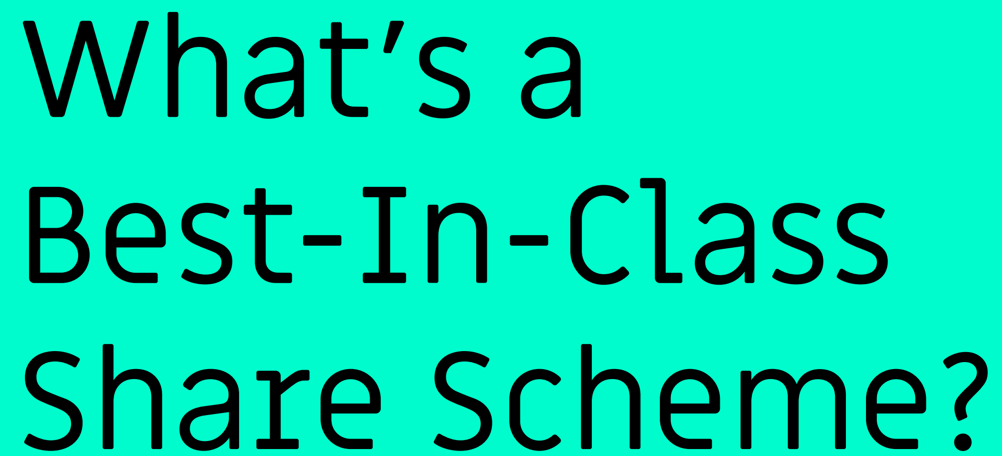

What's a Best-In-Class Share Scheme?

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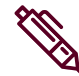
Introduction

Ifty Nasir
Co-founder and CEO at Vestd

One question we're asked a lot is, what makes a good share scheme? By good, they mean one that's fair, transparent and benefits both the business and the individual.

We've seen a lot of share schemes in our time, so we know what key ingredients the best of them contain. To set your scheme (and its beneficiaries) up for success, there are fundamental things that you should carefully consider, and you can find them all in this guide.

Once you've got a clearer picture of what you want your scheme to look like, tell us and we'll help you make it happen.



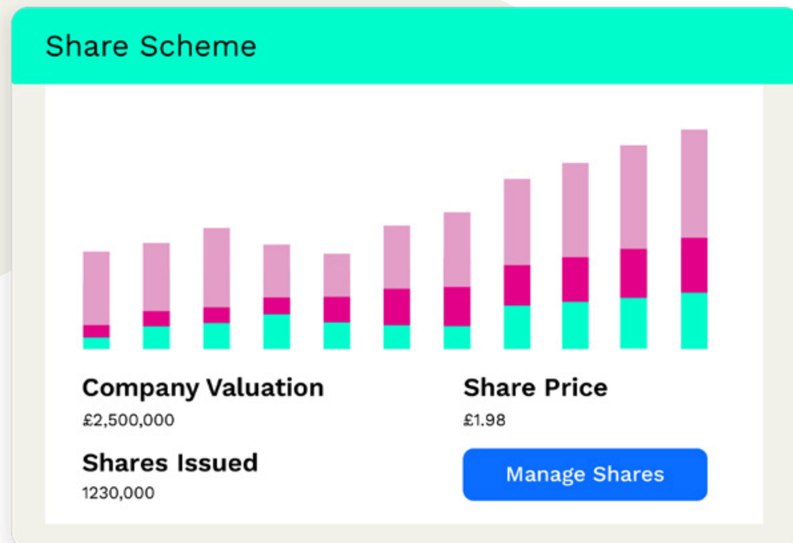
Note.

We'll talk about 'employees' a lot in this guide BUT you can also motivate non-employees with equity too, like an advisor, consultant or contractor. Essentially, you can reward anyone who helps your business grow with equity, even if they're not on the payroll (and even customers).

They don't necessarily have to be based in the UK either. It's possible to reward key people overseas, though this is very much dependent on the scheme you intend to set up, the tax implications and specific laws and regulations of the country they're in. We'd recommend seeking professional advice if this is something you're thinking of doing.

What's a share scheme?

There are **share** schemes and then there are share **option schemes**. They often get lumped together but technically, they're different.



Shares represent ownership in a company, while options give someone the right, but not the obligation, to purchase shares at a pre-agreed price.

Read our simple guide to shares and options.

Both share schemes and share option schemes can be conditional or unconditional.

- **Conditional:** equity is released subject to the recipient meeting specific conditions.
- **Unconditional:** equity is released without any strings attached.

We'll get into this in more detail later.

Why set up a company share scheme?

An employee share scheme can be a valuable tool for companies looking to attract, retain, and motivate employees, align interests and create a strong workplace culture.

Chris Hill
Equity Consultant

When talking to potential customers about share schemes, their top concerns are often recruitment and retention. For many, it's the main reason they reached out to us. A share scheme is an attractive incentive and a way for startups to stand out in today's competitive job market.

How can a share scheme attract talent?

Equity-based compensation is almost a given for job applicants in the US, especially in Silicon Valley. It's not as common in the UK and in Europe, which is ironic as the UK has one of the best regulatory environments for share schemes in the world.

But appetite is growing and the gap is closing.

Over 16,300 companies in the UK operated a tax-advantaged employee share scheme in the tax year ending 2021. That's an 88% increase from 2010.

A share scheme is **never** a substitute for a competitive salary but it's a fantastic addition to a comprehensive compensation package.

Employees want more, it's as simple as that.
Given the cost of living crisis in the UK and rising inflation, salary alone is not enough to lure applicants. Employee benefits like discounted memberships, services and private healthcare will attract their attention for sure.

Why set up a company share scheme?

But while those perks are attractive to applicants, they often come with a hefty price tag that not all businesses, especially small businesses, can afford.

A share scheme has the potential to be life-changing for your team. If things go the right way, it can help them build long-term wealth. Something most people's pensions are unlikely to provide.

How can a share scheme reduce employee turnover?

A share scheme triggers something known as 'The Ownership Effect'. Those with a slice of the pie are not only literally invested but emotionally invested in the company and its future success. Because ultimately, if their efforts pay off and the business grows in value, their shares become a lot more valuable.

That means employees are more likely to stick around for longer - aligned and motivated by a collective mission to drive the business forward.

In fact, we asked our customers what impact their EMI scheme had on their retention rates, and the results are staggering. EMI, by the way, stands for Enterprise Management Incentive, and it's the most tax-savvy share option scheme in the UK.

Download our free guide to learn more about EMIs.

95% of existing customers agree that EMI has helped with retention.

While it's a brilliant long-term incentive, it's important to design a share scheme carefully to ensure that it is **fair, effective, and beneficial for both the company and its employees.**

What makes a share scheme great?

We're going to get into the ins and outs, the nitty-gritty of what makes a share scheme great. But first, a quick overview. Here are the seven factors to take into account when designing a company share scheme:

01. Company goals.

The share scheme should align with the company's overall goals and objectives. For example, if you want to attract and retain top talent, the scheme should be designed to incentivise employees to stay with the company over the long term.

02. Employee needs.

The scheme should meet the needs and interests of the employees who participate in it. For example, employees may want to receive shares as a form of additional compensation or to have a stake in the company's success.

03. Equity distribution.

The scheme should ensure that equity is distributed fairly across different levels of the company and that it doesn't disproportionately benefit executives or senior management.

04. Vesting schedule.

The scheme should have a clear and reasonable vesting schedule that incentivises employees to stay with the company and rewards long-term commitment.

05. Tax implications.

The scheme should take into account the tax implications for both the company and the employees who participate in it. For example, some share schemes may be subject to tax at the time of grant or at the time of sale.

06. Legal and regulatory requirements.

The scheme should comply with all applicable legal and regulatory requirements, such as securities laws and corporate governance guidelines.

What makes a share scheme great?

07. Communication and education.

The scheme should be communicated clearly to employees and the company should provide adequate education and resources to ensure that employees truly understand the benefits and risks of participating in the scheme.

With Vestd, employees get access to their own online portal so they can visualise their stake and project its future value - in other words, how much they could potentially pocket one day.

Overall, a great company share scheme should:

- Align the interests of employees and the company
- Reward long-term commitment and performance
- Be fair and transparent in its distribution of equity
- Engage shareholders on an ongoing basis

The cornerstones of a winning share scheme.

A Michelin star meal is made with quality ingredients. The same can be said for a world-class share scheme. In this section, we'll cover the key components that we highly recommend embedding in your share scheme structure to give it that chef's kiss, star quality.

Conditionality.

With a conditional scheme, conditions must be met before the recipient's shares become unconditional. Until that point, they're limited as to what they can do with their allocated shares or options.

When they've become unconditional they'll have the opportunity to exercise their options (that is convert them into shares to buy or sell) or cash in their shares. And in some cases, they may at that point be eligible to receive dividends.

Exercise options = pay a pre-agreed price to turn vested share options into shares.

Many companies are founded with and issue only ordinary shares, which are issued with no strings attached. In other words, unconditional straight from the off.

And that's fine in certain situations but it's not always the safest or most effective option. Anyone with ordinary shares can walk away with a portion of your company's equity even if they didn't deliver what they promised.

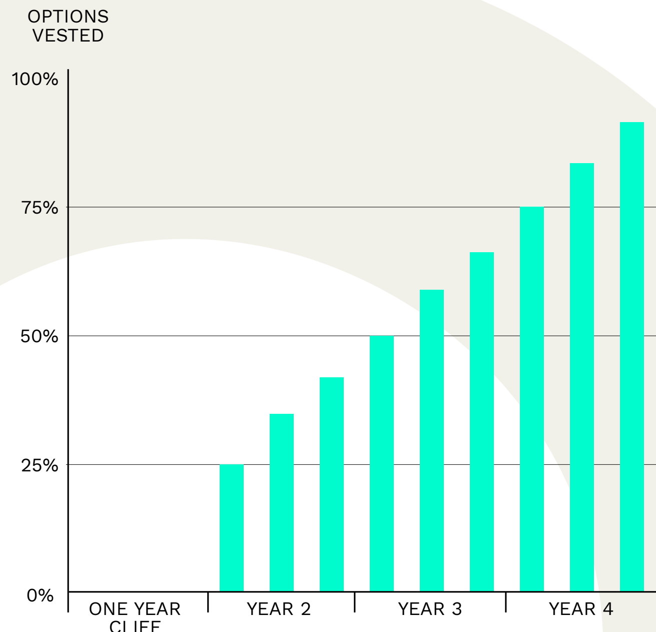
That's why we created **Agile Partnerships** - so you can lay out clear expectations and dish out equity rewards that are truly deserved.

Conditionality is a key ingredient in a best-in-class share scheme. You can set all kinds of conditions, which brings us nicely to our next cornerstone.

Vesting.

What is vesting?

Instead of immediately becoming a shareholder or having the opportunity to exercise their options right away, an employee can earn them over time and/or providing that they've met certain conditions. We call this vesting. You may hear of it described as a vesting period or vesting schedule.



Time-based vesting.

75% of Vestd customers include time-based vesting in their scheme design

Time-based vesting is a great way of rewarding those who stick around and prove their commitment. It's simple, straightforward and leaves very little (if any) room for ambiguity.

What's a typical vesting schedule?

The most popular vesting schedule is four years and a one-year cliff. It's pretty standard in the US and in the UK.

Though, depending on the nature of the business, it might make sense to have a longer vesting schedule, if your business has a long buyer cycle for instance.

What's a cliff?

Let's say you're setting up an employee share option scheme. If you include a one-year cliff, the employee must complete one year of employment before any of their options start to vest.

A one-year cliff allows you to allocate employees options as soon as they join (rather than promise them they'll get options later) incentivising them from the very beginning. But if they leave within a year, they leave with nothing.

Vesting.

Giving employees all of their options up front with no vesting and no cliff is an unnecessarily risky move and doesn't make business sense - not if your objective is to retain talent for longer!

> **58%** of Vestd customers that do add a cliff opt for a one-year cliff.

Unless you've already promised someone options and want to deliver on that promise immediately, in which case, those options can immediately vest. But you can still have the final say on whether the option holder can exercise right away or whether they need to wait for an exit.

We talk about exit-only vs exercisable schemes on p. 16.

Vesting frequency.

Within a vesting schedule, you can also decide how frequently an employee's shares or options vest; annually, monthly or quarterly.

In terms of retention, annual vesting sort of makes sense. But it may be less motivating to an employee, as they'll have to wait longer to reap their reward. There's also a risk of a mass exodus of employees leaving at the same time. Quarterly vesting is possible too but it's less common.

Monthly vesting is the happy medium. Shareholders with access to Vestd receive emails every month which serves as a nice little reminder that they've got skin in the game.

Back-weighted vesting.

Instead of evenly distributing equity over time, you can award employees with a greater percentage of their allocated options in the later years of their employment.

Why do this? Well, it's no secret that it can take some time for an employee to find their feet and make a meaningful contribution to the business. Let's say an employee reaches peak performance in their fourth year of employment. They're operating at a higher level and potentially working harder now than ever before.

Vesting.

But under a traditional vesting schedule, they'll get the same percentage of shares vesting in year four that they did in the previous year, and the year before that.

For some, that could be demotivating. But then again, the reverse is also true.

While back-weighted vesting isn't that common, large companies like Amazon are moving away from a traditional time-based vesting schedule, with the goal to retain employees for longer.

Performance-based vesting.

As well as time-based conditions, you can set performance-based conditions, similar to traditional sales targets or KPIs, that an employee has to meet before they get their just reward. For example:

- Generate £x in sales
- Deliver client work valued at £x or above
- Profit goal reached
- Secure £x of funding
- Deliver an agreed project

The problem with performance-based conditions.

We're of the view that tactical, role-based conditions are somewhat irrelevant. Employees fulfilling the duties outlined in their job description is a requirement rather than a goal.

Adding *too many* conditions to a share scheme can impact its effectiveness, making it:

A) Demotivating

B) Unnecessarily complex

C) Unrewarding

> You want your share scheme to be as easy to understand as possible, totally unambiguous and fundamentally, fair.

When it comes to conditions, it's best to keep things simple.

It's like with any goal, if you set too many the prospect of achieving them all can feel overwhelming rather than motivating. And too many conditions and clauses can cause confusion and misunderstandings.

Vesting.

What's more, if equity rewards are based solely on performance, an employee might do things that aren't in the best interests of the overall business just to try and hit their targets.

Performance-based conditions can encourage overly-competitive behaviours that may not align with (and could cripple) your company culture.

One way to circumvent this is to set collective goals for the team rather than individuals.

You can also design a scheme so that if an employee falls just short of their target, they will still receive a proportion of their total equity reward, just not all of it.

With all that in mind, you can see why time-based vesting is often the easier and fairer option! And if incentivising your sales team is a priority, there's nothing stopping you from implementing a bonus or commission scheme on top of a share scheme.

But if you are firmly set on performance-based conditions, make sure that those conditions are specific, measurable, tangible and clearly communicated.

Download our free conditional equity guide for examples.

Alan Clarke
Equity Consultant

Designing a vesting schedule with time-based conditions is one of the best ways to incentivise key people while protecting your business. But if you are firmly set on performance-based conditions, make sure that those conditions are specific, measurable, tangible and clearly communicated.

Inclusivity.

We say, equity for all! Or rather, equity for anyone willing to put in the work to make your business a success, and that includes people outside of the boardroom.

It's common for founders to only share equity with the C-suite and senior leadership. And for that to be weighted by the relative contribution of the individual to the business.

If you're that way inclined, that's fine, but as you're reading this guide, there's a high chance that you too believe that the whole team deserves a slice of the pie. After all, without your team, what have you got?

You can still retain a significant stake in the business and reward the rest of the team with equity. You don't have to give masses away, just small amounts will do the job.

If everybody in the company has that, then you can stand up in front of the entire organisation and say, "We're all in this together", and genuinely mean it. "If we succeed, if we reach X, Y, we will all benefit." **Now that is powerful**.

You'll do better in the business if everyone shares in it because you'll have a team of people committed to increasing its value. Better to have a smaller slice of a large tasty pie than a big slice of a puny pie.

Inclusivity.

But how much equity should I give?

The big question! We're of the view that the amount of equity you award someone should be:

A) Relative to their potential contribution to the business.
People who join the business earlier on, have taken a higher risk to join a less stable business. So it's common to give them a higher amount and then for it to reduce over time for later joiners. And then it's just a nice little thing that they receive in addition to other benefits.

B) Meaningful to them.
Let's say you want to get a business veteran out of retirement (and off the golf course) so they can help you get your business off the ground. What incentive would be meaningful to them?

C) Considered in the context of your overall equity plan and how much equity you're willing to share.

The average employee option pool size is somewhere between 5% and 20% of a company's total equity.

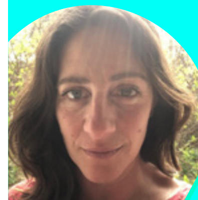
Let's say 20%. As a general guide, up to 10% could go to key hires and you could share the remaining 10% among the rest of the team, with a higher percentage earmarked for early employees and senior management.

We have tools to help you figure all this out at the very start of your journey.

Work out how many shares to give to your team (and investors) with our **equity sharing calculator**. Open the calculator along with **this blog** which explains how to use it.

Rachel Krish
Equity Consultant

Sure, you could just give shares to your leadership team. But without the rest of your team, where would you be? By giving everyone a piece of the pie, everybody is on the same page, the same journey, and truly invested.



Flexibility.

If you haven't come across the terms 'exit-only' and 'exercisable', here's a quick explanation. In the context of share option schemes:

- Exit-only options can only be exercised when the company is sold or goes public.
- Exercisable options, once vested, can be exercised regardless of whether the company has been sold or gone public. The option holder has the flexibility to exercise the option when it makes the most financial sense for them.

Examples of an exit event:

- The sale of your company to another
- A merger with another company
- A management buy-out
- A company buy-back
- A change in control
- An asset sale
- Partial or full floating on a public exchange

Exit-only v exercisable.

Which is better? Well, that depends on your goal.

Most businesses design exit-only schemes because their ultimate goal is to get to an exit with their amazing team who made it happen. And for them to still be there on that fateful day.

If you too are dead set on selling the company or taking it public, an exit-only scheme makes total sense.

It's a different kind of incentive to an exercisable scheme.

Flexibility.

An exercisable scheme is more flexible. Employees can choose if and when to exercise their vested options and become shareholders. And share in dividends later down the line.

You can see why many employees might prefer that, but then the risk for the business is that a couple of years in, they might exercise however many options have already vested and take off.

Exit-only with a twist.

Let's say you choose an exit-only scheme.

What if the unexpected happens? What if you decide that, actually, you've got more in the tank? Or the long-anticipated sale you were counting on falls through.

If employees are locked into an exit-only scheme, but there's no exit on the horizon, those options will lose their appeal. What's the point in having them if they can never exercise them?

What you could do is settle somewhere in the middle - design an exit-only scheme, but specify that those options *can be exercised* after seven, eight or nine years, in case an exit never happens.

In the case of EMI options within 10 years, otherwise, they'll lose their tax benefits.

> Ultimately, there's no right or wrong answer but you want to design a scheme that's flexible enough to be future-proof.

Fairness.

You'll notice that the word 'fair' has cropped up a few times now. It's the bedrock of a best-in-class share scheme. And in our eyes, a total non-negotiable.

Alas, not every employee will stay with your company from the very start to the very end. Nonetheless, they should get to share in the value they helped to create.

When they leave, let them keep that which is vested.

The choice of whether you want those options to be exercisable at that point or held until the original exercise condition is met (whatever or whenever that might be) remains yours.

Good leaver v bad leaver.

In the interests of fairness, a sensible share scheme agreement should include what's called **'good leaver' and 'bad leaver' clauses**.

Leaver clauses outline what happens to an employee's shares in the company if they leave and under what circumstances.

A good leaver can be defined as someone who has not left the company as a result of gross misconduct or breach of contract.

In this case, a good leaver gets to retain any vested shares or sell them back to the company at fair market value. But in the case of a bad leaver, the reverse is true.

In the event that someone has left the company on bad terms, bad leaver clauses greatly restrict or entirely prevent that person from walking away with a piece of the pie.

Fairness.

Good leaver and bad leaver clauses are a way of protecting the business while ensuring that those who rightly deserve a slice, get to have their cake and eat it too.

36% of companies on Vestd exercise discretion.

22% allow shareholders to keep all of their vestd shares.

17% allow it if shareholders exercise their shares within a specific timeframe.

So that's it - the five fundamentals, the pillars of excellence, the key principles that form the foundations of a best-in-class share scheme; Conditionality, Vesting, Inclusivity, Flexibility, and Fairness.

What does a bad share scheme look like?

Let's turn this on its head. We've covered the good stuff, but sometimes it's helpful to have something to compare to. So in this final section, let's quickly look at the signs that a share scheme might be in trouble.

Warning signs of a sub-par share scheme:

01. Overly complex.

The scheme may have a complex vesting schedule and conditions that are difficult to a) understand and b) achieve. If a scheme is too complicated and underpinned by unrealistic expectations, employees will simply disengage - they'll wonder, what's the point? Why should I bother?

02. Lack of transparency.

Share agreements need to be crystal clear. Employees need to fully understand how the scheme operates, what happens to their shares if they leave the business, what their rights are and so on.

Also, depending on the type of scheme, it may be wise to explain how you've calculated the value of their shares as that'll impact the financial gain they'll (hopefully) make later. For instance:

- In the case of EMI options, the exercise price - that's the price employees pay to purchase the shares - is determined by a company valuation submitted to HMRC.
- In the case of growth shares, the hurdle rate - the point at which the recipient can share in the capital growth of the business - should be based on the value of the company at the time.

What's a bad share scheme look like?

03. No liquidity opportunities.

Why design a share scheme that doesn't give someone the opportunity to cash in their shares? It's pointless - *unless* they get other benefits like dividends.

All share classes can receive dividends but only if your company's AoA and the particulars of your chosen share class allow it. In other words, each share class can have its own set of rules. And those rules will differ from one business to another.

For instance, someone with growth shares can receive dividends. But for that to happen, it has to explicitly state in the AoA that growth share classes have rights to dividends. **Learn more.**

But if you design a scheme without dividends AND without liquidity opportunities, then really, what's in it for them?

04. No alignment with company goals.

Let's say a company wants to improve retention by launching a share scheme. A scheme that gives equity to its employees right away (i.e. one with no vesting schedule or conditions) isn't necessarily going to incentivise people to stay.

Or let's say a company is not gearing up for an exit but their share scheme is exit-only, that doesn't make a lot of sense, does it?

What's a bad share scheme look like?

05. No digital records.

All too often share scheme agreements and other related documents are hidden away in a store cupboard never to be seen again - or misplaced entirely.

There are two reasons why this is a problem:

1. Employees could forget about their shares and options and never realise their benefits.
2. If you're unable to provide documentation you might fail due diligence checks ahead of an investment or a company audit.

Now, armed with all this knowledge, you might be thinking, OK I'm ready, let's do this! But how? How do I set my share scheme up? What's the process? How much will it cost? How will I manage it on top of the million other things on my to-do list?

That's where we come in.

Let’s recap

Here’s a quick recap of what a best-in-class share scheme looks so you can start thinking about yours.

Conditionality	Don’t just give equity away, design a conditional share scheme.
Vesting	Outline a clear vesting schedule with a cliff and time-based milestones.
Inclusivity	Equity for all. Align everybody’s ambitions with the company’s mission.
Flexibility	Exercisable schemes offer greater flexibility but you can create a flexible exit-only scheme too.
Fairness	Promise fair rewards to those who rightfully earn it.

Why use a share scheme platform?

Vestd is the UK's original share scheme and equity management platform for startups and SMEs. We've helped thousands of people like you set up and manage share schemes.

Customer testimonials:

"There were a few other platforms we were looking at but Vestd was so dramatically better. It was really a no-brainer choice for us."

Svetlana Tarnagurskaja, The Dot Collective.

"It was a combination of extremely knowledgeable support and really simple and intuitive technology. [Vestd] massively simplified the whole share scheme process for everyone involved."

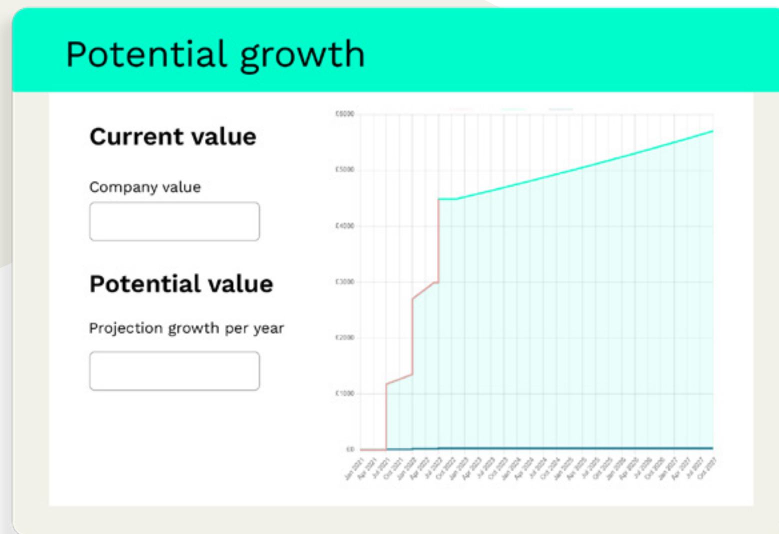
Jim Jensen, Propellernet.

"Vestd make it really safe, easy and most importantly for small businesses, they make it very affordable."

Suhail Rehman, Home Instead.

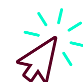
Why use a share scheme platform?

You could ask your lawyer or accountant to take care of it for you. But we know from experience that this can cost a fortune, a fortune that few founders have, especially in the early days.



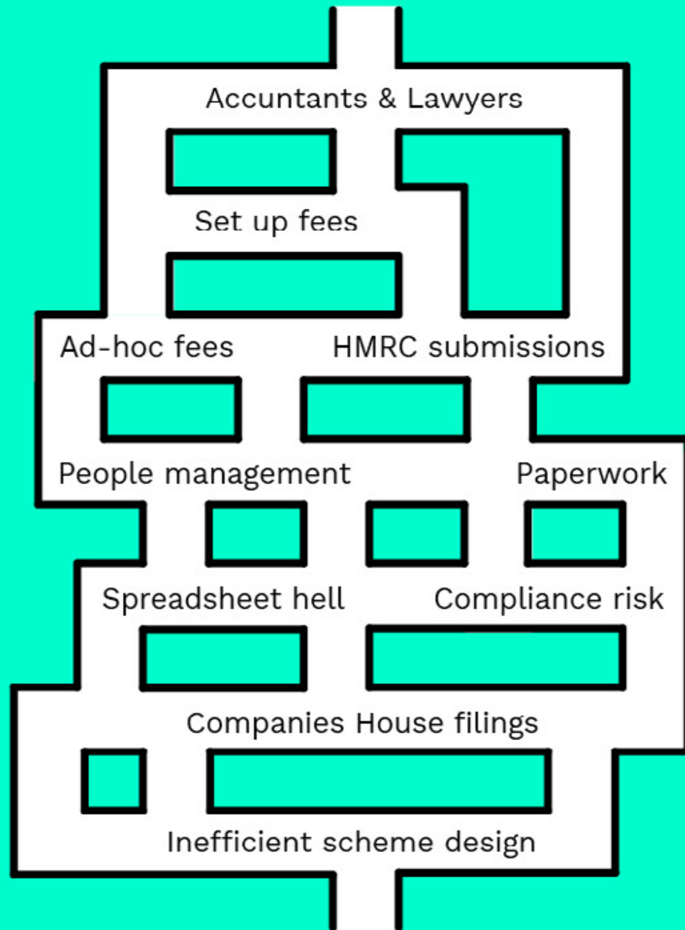
You could use a spreadsheet to manage your equity but believe us when we say, you really don't want to. Spreadsheets can become a sprawling mess and tricky to untangle, which could lead to complications and awkward conversations down the line.

It's also hard to truly engage folk with your share scheme if they can't see it. Too often we hear of share certificates stashed away in a drawer never to be seen again. It almost defeats the whole purpose of a share scheme - you want your team to feel motivated by it. That's why a digital portal is so powerful.



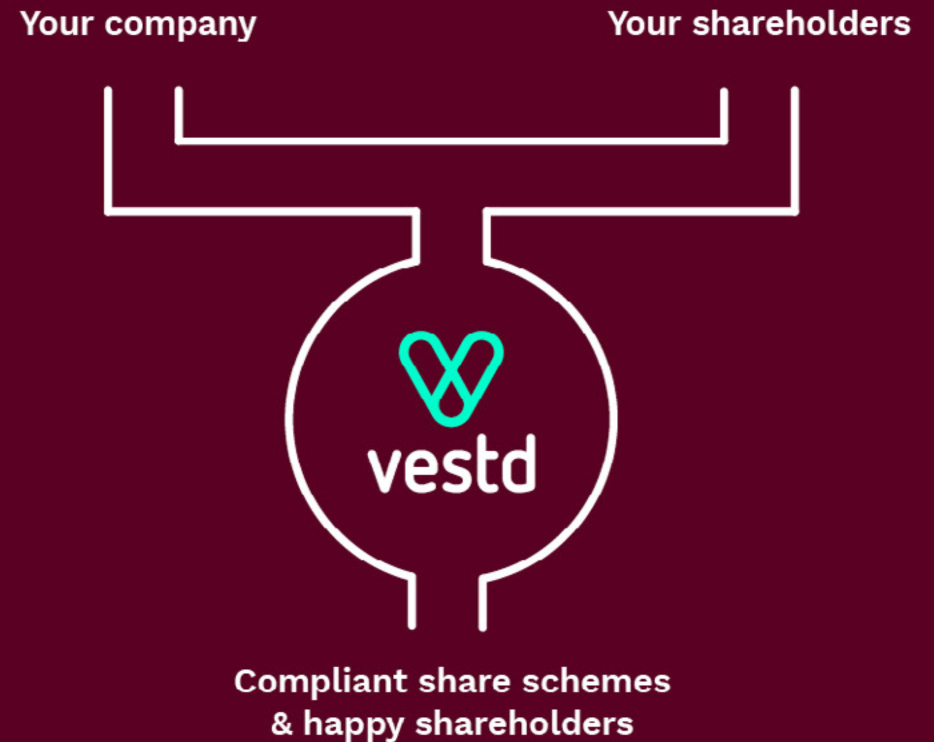
Save yourself the hassle and use a purpose-built platform. **Book a demo today** to see how seamless equity management can be.

The Old Way



Weeks of time and effort managing people and paperwork.
Tens of thousands of additional costs.

The Vestd Way



Tax efficient employee share schemes from £280/month.
Vestd is the all-in-one equity management platfrom.

Vestd: share scheme specialists

Vestd is the UK's first and only regulated share scheme platform for SMEs. Thousands of customers use Vestd to manage equity rewards, company admin and much more.

66 Customer Testimonial

Jim Jensen
Propellernet

"It was a combination of extremely knowledgeable support and really simple and intuitive technology. Vestd massively simplified the whole share scheme process for everyone involved."

Why Vestd?

- [x] Guided setup and five-star support
- [x] Two-way integration with Companies House
- [x] Issue shares and options in seconds
- [x] 100% accurate real-time cap table
- [x] Personal dashboards for all shareholders
- [x] Future scenario modelling
- [x] Intuitive scheme designer
- [x] CoSec tools

And much more!

Discover how you could unlock people-powered growth. Book a free, no-obligation consultation with a share scheme specialist.

Talk to the experts

Resources.

Did you find this helpful? There's more where that came from! Here are other guides, calculators, and resources you might find useful.