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# Equity Structure Problem and Optimization Strategy of Start-ups

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**Abstract:** Equity structure is the foundation of enterprise governance structure, which directly affects the decision-making process of the enterprise and has an important impact on the development of the enterprise. For the first time enterprise, the reasonable design of the ownership structure is directly related to the stability and sustainable development of the enterprise. This paper starts with the importance of the ownership structure design of the start-up, this paper analyzes the challenges in the ownership structure of the first established enterprise, and puts forward the corresponding coping strategies.

**Keywords:** Start-up; Ownership structure; Challenges; Coping strategy

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## 1. Foreword

For the first time enterprise, the ownership structure is the foundation of the enterprise governance structure, which is directly related to the stability and sustainable development of the enterprise. However, in practice, many start-ups have some problems in the design of equity structure, which leads to the development of enterprises. Therefore, it is of great theoretical and practical significance to study the challenges and countermeasures of the shareholding structure of the first established enterprise.

## 2. The importance of equity structure design of start-ups

The design of equity structure of start-up enterprises is related to enterprise development and market profit, and has an important influence on the development of enterprises.

### 2.1 Affect corporate governance and decision-making power

The ownership structure determines the power distribution and decision-making process within the enterprise, and affects the governance mechanism of the enterprise. A reasonable shareholding structure can ensure the rationality and fairness of enterprise management decisions, and avoid the power struggle and conflict between shareholders, which is conducive to the stable operation of enterprises.

### 2.2 Affect the financing ability of enterprises

Investors usually pay attention to the shareholding structure of enterprises. A healthy and sound shareholding structure can increase the trust of investors and improve the financing ability of enterprises in the financing market. Reasonable shareholding structure design can attract more strategic investors and venture capital, and provide sufficient financial support for the development of enterprises.

### 2.3 Inspire and retain core talents

Equity incentive is an effective means to attract and motivate core employees. Through equity incentive, employees can share the fruits of the growth of the enterprise, improve the loyalty and enthusiasm of employees, which is conducive to the long-term development of the enterprise.

### 2.4 Reduce potential risks

A reasonable shareholding structure can reduce the possible risks in the operation of enterprises, avoid the disputes and discord caused by the unfair distribution of rights and interests between shareholders, and ensure the stable development of the enterprise.

To sum up, start-ups should pay attention to the design of equity structure, reasonably plan and adjust the shareholding structure in order to achieve the strategic goals and sustainable development.

## 3. The ownership structure of start-ups

### 3.1 Single shareholding structure

Some studies have shown that the current situation of the ownership structure of start-ups is characterized by simplicity, kinship and

unclear definition of the original property owners (Julie, 2020). Most of the private enterprises in China are natural persons, which have gradually developed and grown with the support of their relatives and friends. However, this also leads to the single shareholding structure of start-up enterprises, with no more choices, and financing is not easy, which restricts the development scale of enterprises. Similarly, this will lead to the separation of the management and ownership of the enterprise, and "own people" control the core management of the enterprise and its internal important departments. Lead to the enterprise internal control is relatively weak, the enterprise management system is empty.

### **3.2 Unfair equity distribution**

Since start-ups are usually created by founders and early investors, the most common shareholding structure model in the early stages of a partnership is the average distribution of equity ratios. The mode of average distribution of equity among the main founding shareholders was initially based on mutual trust among shareholders, but the average distribution brought by many problems and hidden dangers (Li Guiping, 2019). The equity of start-up enterprises cannot be distributed equally, and the equity distribution should have obvious steps, and the responsibilities and rights of shareholders should be equal. Start-up team equity equal distribution, need to become the core behind the founder of the reasonable processing, the founder of more successful as haidilao zhang yong and ShiYongHong, enterprise start-up also accounted for 50% stake, when haidilao into development period, become the absolute core zhang from shi bought an 18% stake, become the absolute controlling shareholder (Julie, 2020).

### **3.3 Equity incentive mechanism is not sound**

Start-up enterprises need to establish an effective equity incentive mechanism to encourage employees to contribute to the development of the enterprise, but the reality often has the problem of imperfect equity incentive mechanism. On the one hand, start-ups often lack sufficient resources to provide competitive equity incentive plans; on the other hand, there are some difficulties and challenges in the design and implementation of equity incentive plans, such as how to determine the incentive object, incentive proportion and incentive mode.

### **3.4 Equity transfer is difficult**

The external equity conversion of shareholders is limited, and the effect of equity change is blurred, which leads to the difficulty of equity transfer<sup>[15]</sup>. (Li Likun, 2024)

Because the equity transfer market of start-ups is not mature enough, it is often difficult for investors to exit in time, which brings some trouble to the development and growth of start-ups. In addition, there are also certain legal and regulatory risks in the equity transfer of start-ups. How to carry out the equity transfer legally and legally is one of the important issues facing the equity structure of start-ups.

To sum up, the challenge of equity structure of start-up enterprises involves many aspects of unfair equity distribution, such as imperfect equity incentive mechanism and difficult equity transfer. In the face of these challenges, start-ups need to establish a sound equity structure, rationally allocate equity, establish a sound equity incentive mechanism, attract and retain excellent talents, and expand the channels of equity transfer, improve equity liquidity and marketization degree, to ensure the steady development and sustainable growth of enterprises.

## **4. Optimization strategy**

### **4.1 Formulate a clear equity distribution plan**

In the early stage, the founding team should develop a clear equity allocation plan to ensure fairness and rationality, and take into account the needs of future financing and incentive employees. The allocation of equity in a startup is a key decision-making process because it determines the ownership structure and future management rights.

The founder equity distribution should follow. First, the equity is allocated based on the founder's expected contribution to the startup and operation of the company. And appropriately increase the shareholding ratio of the main founders. Second, take the assumption of the risk allocation equity of the founder at the start of the company. Finally, encourage long-term participation and continuous contribution to the company, and allocate reasonable equity. Under this principle, the main founders are recommended between 30 and 40 percent, the co-founders between 10 and 20 percent, and the remaining early employees are recommended around 5 percent. This early stage for future financing and incentive needs.

### **4.2 Introduce the equity incentive mechanism**

Stock options, equity rewards and other ways to encourage employees to actively participate in the development of the enterprise, and balance the interest relationship between shareholders, management and employees. We introduce equity incentive mechanism, which usually includes two forms of stock option incentive and restricted stock incentive. Stock option incentive mechanism allows employees to buy company stock at a certain price in the future, while restricted stock incentive means that employees can obtain the company's stock after certain conditions are met. The equity incentive system should be actively used, and different incentive modes should be adopted for different employees to give full play to the incentive role. At the same time, the state should improve the market laws and regulations to provide a good

growth environment for the implementation of the incentive system(Gong Lei, 2023).

#### 4.3 Set the anti-dilution clause

No low-price issuance or capital increase provisions, and compensation provisions. We should pay attention to improving the equity distribution plan, equity incentive mechanism, protection of shareholders' rights and interests, and financing methods, which will help to optimize the equity structure of start-up enterprises, and improve the governance efficiency and market competitiveness of enterprises. The use of dual ownership(As shown in fig. 1) structure can reduce the risk of hostile acquisition. This is the enterprise to prevent malicious acquisition, promote the long-term development of the enterprise, to gain control benefits(Wu Zongming, 2018).

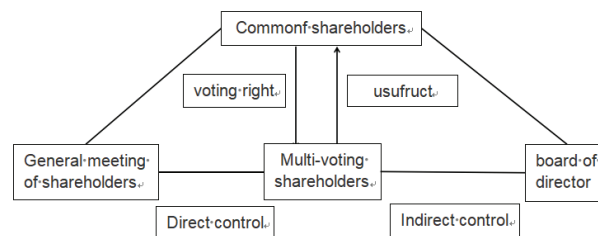


Figure 1: Dual ownership structure

## 5. Outlook

Looking into the future, we need to further strengthen international cooperation. At the international innovation forum, we can communicate with entrepreneurs and experts from all over the world, obtain valuable experience and suggestions, and provide strong support for the future development of enterprises. To jointly explore and solve the problems facing startups and promote the healthy development of the global innovation and entrepreneurship ecosystem. At the same time, we also look forward to the emergence of a new generation of entrepreneurs, who will work with innovative thinking and fighting spirit, to create a new situation, and make greater contributions to the progress and development of human society.

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