

ENTRY PHASE

Participant onboarding: what goes wrong, and how to prevent it

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Onboarding a manager into the plan looks like an administrative formality, a few signatures, a line added to the cap table. It is, in fact, the moment a participant's record is created. Get it right, and everything downstream is easy. Get it wrong, and every reconciliation for the next five years inherits the error.

The previous article in this series looked at the documents you need to set up a MIP correctly. This one is about what happens when you actually use them, when a specific person is brought into the plan, on specific terms, at a specific value, on a specific date. Onboarding is where the design meets reality, one participant at a time.

It is also where a surprising amount of trouble begins. Not because the steps are complicated, individually, they are not, but because they have to be done in the right order, recorded at the right value, and reflected consistently across several places at once: the award documentation, the shareholders' agreement, the company's share register, and the cap table that everyone subsequently relies on. Miss one of those, and you have created a participant whose paper position and whose recorded position no longer match.

This article walks through onboarding as it actually happens: the decision before the paperwork, the question of entry value and why it is tax-sensitive, the documents that make participation real, and the points where the record quietly drifts from the truth on the very first day.

Before the paperwork: what has to be decided first

Onboarding does not begin with a signature. It begins with a set of decisions that, in many programmes, are made informally and recorded late, which is precisely the wrong way round. Before anyone is offered a place in the plan, four things should already be settled.

- The allocation. How much of the pool this participant receives, and how that fits within what remains unallocated. A place cannot responsibly be offered until it is confirmed that the pool can actually accommodate it.
- The instrument. Whether the participant takes the full strip, ordinary equity alongside a proportionate share of the institutional instruments, or sweet equity only. The two have very different risk and return profiles, and the choice belongs at the start, not after the fact.
- The terms. Vesting schedule and commencement date, the leaver provisions that will apply, and the share class. These are the terms that govern the participant for the entire hold; they should be explicit before entry, not reconstructed at exit.
- The entry value. The price at which the participant acquires the instrument, which, as the next section explains, is not a free choice.

In a well-run programme, this is the part that takes the most thought and the least time, because the design work was done at setup. In a programme that drifts, this is where an offer gets made before anyone has confirmed there is room in the pool, and the administration spends the next year catching up to a promise.

A practical rule that prevents a great deal of later difficulty: never make a formal offer of participation before the allocation, instrument, terms, and entry value are confirmed and capable of being documented. The offer is the easy part. The structure behind it is what has to hold.

Entry value: why the price is not a free choice

The single most consequential number in onboarding is the price at which the participant acquires their instrument. It feels like an internal matter, the company and the participant agreeing a figure, but it is not, because the tax treatment of management equity turns on it.

The general principle, across most of the jurisdictions in which these plans operate, is that a participant should acquire their instrument at market value. The logic is straightforward: if a manager is allowed to buy equity for less than it is worth, the discount looks like a reward for employment, and tax authorities will tend to treat that discount as employment income, taxable at the moment of acquisition, before the participant has received a single euro of proceeds.

That is the scenario every onboarding should be designed to avoid: a dry tax charge. The participant acquires below market value, the discount is taxed as employment income, and a tax liability falls due on equity that cannot yet be sold. The instrument is supposed to be an incentive; handled carelessly at entry, it becomes a bill.

Acquiring at market value is what keeps the participant's subsequent gain in the capital domain rather than the employment-income domain, which is the entire point of structuring reward as equity in the first place. It is also why entry valuation is not something to be improvised: it needs a defensible basis, and it needs to be documented at the time, not asserted afterwards.

Market-value entry raises an obvious practical problem, though. If a manager has to pay full value for a meaningful stake, where does the money come from? This is where the financing structure that is common to these programmes comes in: the participant funds part of the acquisition themselves and the remainder is financed through a loan, frequently in the region of 65 to 75 per cent of the entry price. The participant has genuine capital at risk, which is what makes the instrument a real investment rather than a gift, without needing the full purchase price in cash on day one.

The mechanics of entry valuation, the loan structure, and their tax treatment vary by jurisdiction and by the specific facts of each plan, and they are squarely a matter for (external) legal and tax counsel. The point of this article is narrower: that the entry value is a decision with consequences, that it has to be right at the moment of onboarding, and that it has to be recorded, not that there is a single formula that fits every case.

The documents that make participation real

A decision to bring someone into the plan does not, by itself, make them a participant. Several documents have to come together, and, this is the part that is easy to underestimate, they have to be consistent with each other. The award has to match the terms; the terms have to match what is recorded in the register; the register has to match the cap table.

In broad terms, onboarding a participant involves:

- The award or subscription agreement, the document under which the participant acquires the instrument, at the agreed value, on the agreed vesting and leaver terms.
- Adherence to the shareholders' agreement, the step that actually binds the participant to the rules of the structure: transfer restrictions, leaver provisions, drag and tag, and everything else that governs the equity through to exit.
- The transfer or issuance of the instrument, typically a transfer out of the warehouse where the pool is held, at market value, into the participant's name.
- The corporate approvals, the board and, where required, shareholder approvals that authorise the transfer or issuance.
- The register update, recording the participant in the company's share register, which is the legal record of who holds what.

The warehouse mechanics matter here, and they connect directly to an earlier article in this series. The pool is generally held in a warehouse structure; onboarding moves an instrument out of that warehouse to the participant at market value. That transfer is a real event with a real value on a real date, and it has to be reflected on the cap table promptly, not at the next time someone happens to open the file. The cap table is only a single source of truth if every onboarding is recorded into it as it happens.

Where onboarding quietly goes wrong

None of the steps above is difficult on its own. The trouble is that they are done by different people, at slightly different times, and the record only stays accurate if each step is captured at the moment it happens. Here is where, in practice, the truth and the record begin to diverge on day one.

WHAT SLIPS	WHY IT MATTERS AT EXIT
Vesting commencement date left undefined	Every vested-balance calculation for that participant is built on an unstated assumption. The number can be defended only if the start date can be.
Transfer recorded at the wrong value, or late	The entry value underpins the tax position and the participant's cost base. A figure entered approximately, or weeks afterwards, is a figure that will be questioned in due diligence.
Award signed, but no adherence to the shareholders' agreement	The participant holds the economics but is not bound by the leaver and transfer rules, the gap surfaces precisely when those rules need to be enforced.
Warehouse transfer not reflected on the cap table	Two records now disagree about who holds the instrument. Reconciling them later means reconstructing a transaction nobody documented at the time.
Offer made before pool room was confirmed	The allocation has to be made to fit after the fact, sometimes by quietly adjusting someone else's. The pool stops adding up.

What these have in common is that each is almost free to prevent at the moment of onboarding and expensive to correct afterwards. The cost is not paid when the error is made, it is paid years later, when someone has to reconstruct what should simply have been recorded. That is the recurring theme of this whole series, and onboarding is where it starts.

Onboarding is not a day-one event

It is tempting to think of onboarding as something that happens once, at closing, when the initial management team is brought into the plan. In reality, participants join throughout the hold, and in an active buy-and-build, considerably more often than the day-one plan assumed. A senior external hire, a promoted internal candidate, a management team arriving with an add-on acquisition: each is an onboarding event, and each carries the same requirements as the first.

This is why onboarding has to be a repeatable process rather than a one-time project. The programmes that stay clean are the ones where the fifth participant is brought in with the same discipline as the first, same confirmation of pool room, same market-value transfer, same adherence, same prompt recording. The programmes that drift are the ones where onboarding was done carefully at closing and informally ever after.

The handling of participants arriving through add-on acquisitions, and the discipline of keeping a pool current across a long buy-and-build, are substantial enough to deserve their own treatment later in this series. For now, the point is simpler: every joiner is an onboarding, and the quality of the record depends on treating it as one.

An honest opinion: onboarding is where the truth is written

Onboarding tends to be treated as human-resources paperwork, a welcome step, handled alongside the employment contract, important to get signed but not thought of as financially consequential. That framing is the root of most of the difficulty.

Because onboarding is not paperwork. It is the moment the administrative truth for a participant is created: the entry value, the vesting start, the terms, the contractual binding, the register entry. Every later question about that participant, how much have they vested, what do they hold, on what terms do they leave, is answered by reference to what was recorded at onboarding. If that record is complete and accurate, the answers are trivial. If it is approximate, the answers have to be reconstructed, and reconstruction always happens at the worst possible time.

The most accurate way to think about onboarding is this: it is not the administration of a decision already made, it is the moment the record itself comes into existence. Everything downstream either inherits an accurate record or inherits an error. There is no third option, and the choice between them is made on the first day.

This is also why onboarding rewards a clear owner more than almost any other part of the lifecycle. The steps cross legal, finance, and HR; no single function naturally holds all of them; and the cost of a missed step is invisible until much later. Someone has to be responsible for the whole sequence being completed and recorded, not for doing every part personally, but for making sure none of it is left half-done.

What this means in practice

FOR FUND MANAGERS

Treat onboarding as a repeatable process, not a closing-day task. Participants will join throughout the hold, more often than the day-one plan suggests. The discipline applied to the fifth joiner should match the first.

Confirm the pool can accommodate the allocation before any offer is made. Offers made ahead of confirmed room are the quiet origin of a pool that no longer adds up.

Insist that entry value, vesting start, and adherence are documented at the time. These three are the items most often left approximate, and the three most expensive to reconstruct later.

FOR CFOS AND MANAGEMENT TEAMS

Get the entry value right, with counsel, and record it. Market-value entry is what keeps the participant's gain in the capital domain and avoids a dry tax charge, but only if it is defensible and documented at the moment of acquisition.

Do not let an award stand without adherence to the shareholders' agreement. Economically in but contractually out is a gap that surfaces precisely when the leaver or transfer provisions are needed.

Record every onboarding into the single source of truth as it happens. A warehouse transfer that is not reflected on the cap table promptly is two records waiting to disagree.

One last thought

The whole apparatus of a management incentive plan, the pool, the vesting, the warehouse, the waterfall, exists so that the right people share in the value they help create. But none of it works on a participant whose record was never quite right to begin with. Onboarding is the unglamorous step where that record is either built correctly or quietly compromised.

It takes a little more care at the moment of entry than most teams give it, and far less than the reconstruction that carelessness eventually requires. The participants who are effortless to account for at exit are the ones who were onboarded properly years before. That is not a coincidence. It is the work, and it is the work we do at MIP Desk.