Employee contract structures in startups can be determining factors of success

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Conventional wisdom in the startup community is that with the right incentives, the venture can meet and exceed expectations, and a major component of this is how you structure your contracts for founders and early employees.

New research has found that when it comes to those contracts, it may be less about incentive, and more about identifying the right people to incentivize.

New research in the upcoming INFORMS journal *Management Science* suggests that identifying personality types is as much if not more important than contract elements.The study, "Equity Contracts and Incentive Design in Startup Teams," was conducted by Evgeny Kagan of Johns Hopkins University, and Stephen Leider and William Lovejoy both of the University of Michigan, to examine the effects of different contracts based on effort and value in startups.

The most compelling finding of the research is that incentive clauses in contracts tend to work only when applied to individuals who would be high-performing team members regardless. Team members who may not be high-performers do not tend to perform any better when given incentives in an employment contract.

According to Kagan, this means that it could be best to focus on including certain performance-based clauses in contracts for people who seem more likely to respond in kind. At the same time, others who may not appear to be high performers at the outset may not warrant performance-based contracts.

"Equally-split contracts can encourage free-riding behavior. They are embraced by the least desirable collaborator types who protect themselves by not taking risks but still sharing equally in the proceeds," said Kagan, assistant professor at Johns Hopkins Carey Business School.

One of the suggestions given by the authors, because it is about [personality types](#) and not incentives that matters most is that founders may want to delay contracting. By doing so, they can learn about the personalities of the other team members and decide whether a strong incentive, or a simple, equal split contract is appropriate.

The findings of this research encourage investors to avoid startups with equal ownership splits between founders, especially when those contracts have been chosen early in the collaboration.

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