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articles

A Piece of Myself: Start-up Use of Equity in Payments for Critical Services

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Start-ups are often in need of external help to grow but do not have the cash to pay for critical services. A solution to this problem is to hire technology or strategy consultants and use equity as payment. With equity payments, the service provider also becomes an investor and a partner in the start-up. By interviewing consultants, investors, and start-up entrepreneurs, this study explores the challenges associated with equity payments, and it identifies situations when equity payments can be a viable solution. We propose that consultancies require a risk-seeking mindset and a business model that supports long-term investments in clients. Further, we propose that consultancies' inclination to accept equity payments increases when the entrepreneur has industry specific experience. The start-up entrepreneur's inclination to accept equity payments increases when they lack experience of running a start-up, and when the start-up has not yet shown a proof of concept. Even though the long-term viability of equity payments for critical services remains to be determined, it is an option worth taking into account by start-ups in need of assistance.

Introduction

Entrepreneurs sometimes need to give away equity in their start-ups to helpers that provide the critical resources needed to realize the vision of the start-up. Traditionally, these helpers have been individuals (Kotha & George, 2012) that have become co-owners and employees in the start-up. Alternatively, entrepreneurs have turned to venture capitalists who provide cash that, in turn, can be used to access other critical services.

During the dot-com boom in the end of the 1990s, an alternative business transaction appeared where consultancies and other critical service providers accepted equity as payment, when doing business with start-ups. This can be seen as a hybrid form of the individual helper and the venture capitalist. The consultancies are, at least for a limited time, responsible for critical decisions and activities in the start-up, while simultaneously becoming an investor. This innovative business transaction has the potential to solve a key challenge for start-ups: access to external resources when there is a lack of money to pay for the services.

The use of equity in payments for critical services quickly increased, following the high expectations on new tech firms that characterized the late 1990s. For example, McKinsey had Business Accelerators with stakes in more than 50 clients (Henderson et al., 2006). After the dot-com crash, the interest in the service-for-equity model rapidly fell. The innovative business transaction seemed to be reliant on inflated stock market prices and unrealistic expectations on start-ups. However, the same phenomenon has recently been observed in Stockholm's start-up scene, renewing the interest to further explore the use of equity in payments for critical services.

Purpose

Even though examples exist of start-ups paying consultancies with equity for critical services, it is still a rare phenomenon. When working with novel business models, an understanding of challenges facing the involved actors is needed (Kavadias et al., 2016). Therefore, the purpose of this study is to explore challenges in using equity as payment for critical services by start-ups. The paper will therefore investigate the nature of these challenges, and how they affect the inclination of the involved actors to use equity payments. For the purposes of this paper, a start-up is described as a small, newly established firm (Åstebro & Bernhardt, 2003) that intends to scale up its operations or has not yet realized its business model (Skala, 2019). Following the European Union's definition of a small enter-

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prise (European Commission, 2015), this study views start-ups as firms with less than 50 employees and less than EUR 10 million in turnover. Start-ups also resemble the aggressive growth venture (Morris et al., 2018), as they are often tech-based ventures trying to create new markets.

Start-ups Need External Resources but Lack Cash

A start-up rarely possesses the full range of knowledge and skills required for the development of its business (Kautonen et al., 2010). A lack of management skills, for example regarding marketing, finance, or business planning, is an important reason why more than half of all start-ups fail within three years of formation (Beresford & Saunders, 2005; Dyer & Ross, 2007). Lack of sufficient skill is a common cause for concern among smaller firms during periods of steep growth (Johnson et al., 2007; Mole et al., 2013).

The limited internal resources and business experience of many start-ups make them likely to benefit from external expertise (Łobacz et al., 2016), as external assistance can help overcome information and knowledge gaps (Campbell & Park, 2017; Kellermanns et al., 2016; Salazar, 2017). Dyer and Ross (2007, p. 130) also claim that there has been "substantial growth" in the number of business advisers who work with small business owners. Sectors experiencing technological and organizational change use more advice than traditional or mature sectors (Johnson et al., 2007; Łobacz et al., 2016; Mole et al., 2013). Therefore, start-ups experiencing high growth (Fraser et al., 2015) or technology-based entrepreneurs (Mosey & Wright, 2007) often seek external expertise to build relevant commercial skills.

Following the resource scarcity of many young businesses, liquidity or access to cash is a common problem. El Hanchi and Kerzazi (2020) describe innovation funding capability as an important building block in SME innovation capability. Under-capitalization and inability to access financing are the most common reasons for start-up failure (Dunne & McBrayer, 2019; Speights, 2017). According to Gifford (1997), a lack of liquidity during the nascent stages of a start-up not only threatens the survival of the firm, but it also precludes businesses from paying for external advice and knowledge acquisition. In essence, start-ups are often in need of external help to grow but do not have the cash to pay for critical services.

The Free Riding Problem

A well-managed pattern of investment funding can create a successful growth path and subsequent exit for entrepreneurs (Irwin et al., 2019). However, equity distribution inevitably creates a free-riding problem (Rathgeber, 2013). In a start-up, it is preferable that equity owners also contribute to the firm in a way that corresponds to their share. The first round of financing for start-ups, on average, entails giving away 30 to 40 percent of equity (Arthurs & Busenitz, 2003; Bruno & Tyebjee, 1985; Hand, 2007; Rathgeber, 2013). If this first round could be delayed or even avoided altogether with the help of consultants, there would be fewer free riders. While there is a risk that consultancies end up in the list of owners because of long-forgotten services, this risk is even more evident when equity comes from venture capitalists.

Challenges in Equity Payments for Critical Services

Research on equity distribution in SMEs has previously focused on either helpers, described as individuals in the focal entrepreneur's network (Kotha & George, 2012), or investors, in the form of venture capitalists and angel investors (Collewaert & Manigart, 2016; Hogan et al., 2017). Even though investors often add value post-investment (Bottazzi & Da Rin, 2002; Collewaert & Manigart, 2016; Colombo & Grilli, 2010), their main purpose remains to provide cash to firms. A consultancy that provides services for equity, therefore, should be described as a hybrid between the helper and the investor. They mainly provide help, but they are also firms trying to make a return on their investment rather than individuals in the entrepreneur's network.

The rationale for using equity payments to consultants can be sought in agency and stewardship theories (e.g. Davis et al., 1997; Eisenhardt, 1989). The incentives for consultants to work in the best interest of the start-up increase when they are given equity, as they become both principal and agent. To encourage a stewardship role among the managers in entrepreneurial firms, Kroll et al. (2007) also argue that outside owners should focus on advice and counsel rather than on control and monitoring. This is in line with what could be expected from a consultant that becomes an outside owner in a start-up.

Even though previous literature has not focused on equity payments in this specific setting before (Henderson et al., 2006 is an exception), there is plenty of research available that has dealt with adjacent issues. After receiving equity, a consultancy goes from being only a service provider to being an investor in the start-up. This transition of roles means that an investor perspective must be taken into consideration. Research on investments in start-ups and consulting business models, therefore, provides starting points for understanding equity payments for critical services. From this literature, three challenges associated with the use of equity in payments for critical services can be identified; these challenges will be further described below, and concern the topics (a) experience of entrepreneurs, (b) the phase of the start-up, and (c) the consulting income model.

Experience of Entrepreneurs

As venture capitalists often make investments in persons, rather that ideas (Pintado et al., 2007), the personal experience of an entrepreneur is a frequently used selection criteria when deciding about investments (Shepherd & Zacharakis, 2002). Experience in family business has been suggested to increase entrepreneurial spirit and innovativeness (Pitchayadol et al., 2018). The prominence of an entrepreneur's previous employments will likely affect whether a start-up will obtain external funding or not (Burton et al., 2002). Hellmann (2007) argues that, as an employee at an established company, entrepreneurs are likely to develop tacit knowledge about the industry and accumulate some relevant social capital that may prove useful in their venture later on. Ucbasaran et al. (2009) and Olivari (2016) also argue that entrepreneurs who previously attained relevant

working experience from the start-up world may have developed the expertise and tacit knowledge required to recognize good business opportunities.

From the entrepreneur perspective, equity is an essential part of the economic compensation received from their start-ups (Hall & Woodward, 2010). Therefore, the distribution of equity is both financially and emotionally important for them (Breugst et al., 2015). According to Kotha and George (2012), entrepreneurs with specific industry experience or who have previously worked with start-ups are able to retain more equity, as they can be more selective with the equity distribution to their helpers. More experienced entrepreneurs are also better at raising resources from partners or within their network (Kotha & George, 2012).

Henderson et al. (2006) mention conflicting goals in client relationships as a question to address in service-for-equity arrangements. Together, this constitutes a potential paradox related to when equity payments are feasible. Experienced entrepreneurs are not willing to give away equity, but less experienced entrepreneurs are less attractive in the eyes of consultants looking for equity reimbursement.

The Phase of the Start-up

Baum and Silverman (2004) argue that there exists considerable uncertainty for investors regarding the potential and value of early-stage start-ups since they face so many difficult problems, and because they only have short track records by which outsiders can evaluate their potential. There is a clear difference between early- and late-stage investors, with early-stage investors focusing more on high growth opportunities while late-stage investors in contrast seek demonstrated market acceptance (Elango et al., 1995). Because the management teams in early start-ups are seldom established, investors in this stage need to be more involved in the start-up's operations.

From a start-up perspective, the owner's expectations of future growth affect their willingness to sell all or parts of their business (Murphy et al., 2019). For established or profitable start-ups, growth expectations are likely higher. The age or phase of a start-up has previously been debated as a factor that influences the need for external assistance or funding. Life cycle theory suggests that firms' need to raise outside capital is the greatest in the early high growth stages of the firm (Mueller, 1972), before growth can be funded by profits. In a recent study, Hogan et al. (2017) also find weak support for the hypothesis that firm age is negatively correlated with the use of external equity in small high-tech ventures. External expertise is often used to allow the firm to enter the next stage of development in terms of organizing daily operations as well as configuring resources and market interactions.

Not all investors shy away from early-stage start-up investments, but there remains a potential challenge associated with the start-up phase, as the need for external assistance is greater in early stages when the difficulty of determining the value of a start-up is at its highest. From an agency theory perspective, consultants are reluctant to take on the role as principal when they do not possess sufficient understanding of the start-up's (i.e. agent's) operations and business potential.

The Consulting Income Model

Equity payments provide a variation on the traditional solution shop. The fundamental business model of consulting has not changed for more than 100 years. It is a project-based model where human capital is deployed, and clients receive recommended solutions for their most difficult problems (Christensen et al., 2013). Low assets enable a large extent of the cash flow to be directed towards employee expenses. With this business model, a dearth of income can rapidly make it challenging to cover operating expenses, as companies need cash to maintain operations (Adelman & Marks, 2002; Petty et al., 2015). Should a consultancy receive equity instead of cash as payment for services, their low-asset, high-cash flow business model must be transformed. Stakes in client firms need to be funded in order to cover labor costs. When a consultancy is no longer actively providing services, but still holds equity in the start-up, their role as agent ends and they become a passive principal. This is followed by the challenges of conflicting goals discussed in agency theory (Eisenhardt, 1989). Returns from the consultancy investments made in client firms can appear in the form of dividends or when an exit is made. Even though the number of shares received is fixed, the long-term profits of the consultancy are contingent on the development of the start-up. In this way, there is an apparent incentive for the consultancy to provide the best possible support to the start-up. However, these returns will take years before they start trickling in, if they ever do. An important challenge for incumbent consultancies is, therefore, to transform their income model and adapt to a fundamentally different way of earning money. In Henderson et al.'s (2006) investigation based on experiences during the dot-com boom, several firms recognized the increased risk in service-for-equity engagements and consequently limited the number of projects where they used this reimbursement model.

Methodology

This paper aims to generate insight into and a better understanding of the insufficiently researched phenomenon of equity payments for critical services. An exploratory approach is suitable when researching subjects on which little or no previous research has been done (e.g. Brown, 2006). The study has been conducted using a qualitative approach, as is suitable for exploratory studies. Data has been collected through semi-structured interviews with actors in the Stockholm start-up ecosystem that, together, provide different perspectives on equity payments. This context is characterized by a high technological and digital literacy (see Neumeyer et al., 2020), and the conclusions are therefore mainly relevant in similar developed economies. The actors, further described in Tables 1, 2, and 3, include entrepreneurs working in start-ups, different kinds of investors, and technology and strategy consultants with and without the experience of accepting equity as payment for their services. A semi-structured interview allows the researcher to adapt to the development of the interview and to emergent aspects of the topic (Jenner et al., 2004; Merriam & Tisdell, 2015). All interviews were performed in person, and two au-

Table 1. Start-up Interviews and Firms

Position of Interviewee	What the Firm Does	Start-up Phase	Background of Interviewee
CEO and Co-founder at Start-up1	App-based service	Has a start-up team and viable product, organizing next round of funding, about to scale up and gain more traction. Ten employees.	Made a successful exit from another firm he co-founded.
CEO and Co-founder at Start-up2	Digital marketplace	Product development. Looking for funding to finance the pivot for the product. Two employees but no core start-up team.	Former COO at established auction service. Thus, industry specific albeit with no entrepreneurial experience.
CEO and Co-founder at Start-up3	Digital service to property industry	Looking for the right product–market fit. Two full-time employees and one part-time employee. Open to taking in core competence of the start-up team.	Some tech-industry experience from internships but straight out of university. Developed the software himself and, thus, has the specific competence to lay the foundation for the service.
Co-founder at Start-up4	B2B digital marketplace	The firm has gone through several rounds of funding. A fully functioning product with two years of run time. Looking to grow supply and demand. A total of six employees, of which three are founders.	Dropped out of engineering and business studies to start the company together with the other founders.
Co-founder at Start-up5	Brand owner	The firm is in its third year of operation, looking to become cash flow neutral at €1.5M in revenue. Six employees, of which three are founders.	Former management consultant with experience from starting two other firms. Extensive network.
CEO and Founder at Start-up6	Niche betting service	Functioning product and revenue, looking to get more traction and grow. Looking for more funding due to high operating costs. Five co-founders.	Some previous work and education within the business, but inexperienced as an entrepreneur.
CEO and Founder at Start-up7	CRM system	Looking for more funding. Product in use with paying customers. Seven employees.	Extensive experience from sales, no other entrepreneurial background.
Co-founder at Start-up8	Digital marketplace	Has a working model but looking for more partners and investors. Four co-founders.	The start-up team is straight out of university.
Founder at Start-up9	Digital service	Cash flow positive with 250,000 unique users per month. Two employees. Arranging funding to scale up.	Software engineer at a Swedish unicorn, who decided to invest all of his time into his own business.
CEO and Co-founder at Start-up10	Consumer product	Has sold a beta batch of the product and is currently developing the product and the market offering. Has not talked to investors.	Product-focused engineering students.
CEO and Co-founder at Start-up11	Food	Early stage, without outside investors. Looking to prove existence of customer demand and viability of distribution channels and production.	Straight out of university, as an MSc in product development.
CEO and Co-founder at Start-up12	Website extension	Six years of operation, 3,000 customers in about 35 countries. Twelve employees. Entering a more mature start-up phase.	Experienced entrepreneur.
Co-founder of Start-up13	Retail management software	€600k of revenue last year. Six employees.	Former experience from evaluating start-up pitches and connecting entrepreneurs with angel investors.

thors were always present at the interviews.

Case Selection

To select suitable interviewees, we used a non-probabilistic sampling and endeavored to select respondents who were knowledgeable within their respective fields. Cases include start-ups, technology and strategy consultancy firms, and investor firms.

For the start-ups, respondents were CEOs and/or (co)founders in firms that suit our description of a start-up (i.e. newly established firms with less than 50 employees, less than EUR 10 million turnover, and that intends to scale up its operations or has not yet realized its business model, as explained in the introduction). We strived to include respondents both with and without experience from previous start-ups, and with varying degrees of formal education. The firms they represent are also in different start-up

Table 2. Consultancy Interviews and Firms

Position of interviewee	What the firm does	Experience in equity payment
CEO and Co-founder at Consultancy1	Newly established technology consultancy for either big firms or start-ups.	Has accepted equity as payment and incorporates equity payment in its business model.
Partner and Co-founder at Consultancy1	Same firm as above	Same firm as above
CEO at Consultancy2	A consultancy working toward both bigger firms as well as start-ups.	Has received equity as payment in a few instances, but this is not the norm.
Partner at Consultancy3	Technology consulting. 400 employees, €50M in revenue, €8M of invested assets.	Has a venture fund that invests a share of the firm profits.
Partner and Artistic Director at Consultancy4	IT and Management Consulting firm with over 900 employees. Geared toward large successful firms. Focuses on developing digital products and services at the forefront of technological development.	None.
Founder and Head of Sales at Consultancy5	Strategic management consulting, focusing on big names. 60 employees. Has an ambition to be entrepreneurial and different from other consultancies.	None.
Partner and CEO at Consultancy6	Management consulting toward both bigger and smaller brands, but with at least €100M in revenue.	Provides a results-based fee model.

Table 3. Investor Interviews and Firms

Position of interviewee	What the firm does	Focused development stage
Angel Investor, Investor1	Currently a private investor in ten early-stage start-ups.	Early-phase investments.
Head of Financing at Investor2	State-sponsored organization that provides loans to, and makes investments in, smaller firms that need cash to fuel their growth.	Early-phase investments.
Data Analyst at Investor3	The venture capital arm of a global private equity group with over €566M of investments.	Late stage investments.

phases, see Table 1. Some of the start-ups had direct or indirect experience of equity payments, while others did not. A diverse set of respondents and cases is suggested by Eisenhardt and Graebner (2007), as it increases generalizability.

The consultancies were chosen in order to provide different perspectives from technology and strategy consulting. In our view, technology and strategy consultancies have the capacity to provide the most business-critical services needed by start-ups. Most notably, we interviewed CEOs and partners at the firms that sparked the interest for this study, that is, firms that had experience in using equity payments or work as both consultants and investors. In addition, we searched for consultancies with relevant experiences for the purposes of this paper, such as equity ownership, start-up clients, or a general openness to novel solutions. The consultancies are presented in Table 2.

As three out of the six consultancies in this study lack direct experience of equity ownership, we found it necessary to complement the consultancy perspective with interviews of investors. With equity payments, consultants need to embrace an investor role, and we found it necessary to include investors in the data collection to provide an understanding of the challenges associated with investments in start-ups. Therefore, we interviewed three investor firms with an interest in, and connections to, the start-up scene, see Table 3.

All but two respondents are located in Sweden. Even though the specific cultural references as well as the current hype and influx of capital to the Stockholm start-up scene could limit the transferability of results, we have not encountered any specific reasons why these circumstances would affect our conclusions.

Data Analysis

All interviews were recorded as well as thoroughly discussed and analyzed immediately after they were conducted. The data collected centered on the three challenges

associated with equity payments for critical services. For the respective challenges, data was analyzed inductively (Hammond & Wellington, 2012), and thus compared to literature regarding investments in start-ups and consulting business models during the course of exploration. Two inductive methods were used.

First, we tried to identify patterns in the collected data for each case. Pattern matching is an inductive concept-building method (Merriam & Tisdell, 2015) and a relevant starting point for exploratory studies (Yin, 2009). Right after every interview, we summarized, organized, and categorized all gathered data and pieces of information that were deemed relevant into a simple coding template, that consisted of the three challenges identified in the frame of reference. By doing this, we consistently sorted all information from every interview, creating a credible data management system.

Second, we used cross-case analysis with the aim of achieving higher levels of abstraction and adding to the concept of inductive concept building. Using a cross-case analysis that compared incidents, patterns and sets, and that clustered and aggregated them into categories according to their properties, we aspired to compose conceptual links, as suggested by Merriam and Tisdell (2015) and Yin (2009). By cross-referencing all data and analyses pertaining to each factor, a more synthesized understanding of the challenges was achieved.

Perspectives on the Challenges of Equity Payments

The three challenges identified from previous literature were analyzed based on the interviews conducted with start-ups, investors, and consultancies. *Entrepreneur experience* and *start-up phase* were analyzed from a start-up and a consultancy perspective, as previous literature relates these aspects to both actors' inclination to use equity payments. *Consulting income models* were only analyzed from a consultancy point of view, as this is an internal challenge for consultancies. How consultancies maintain an acceptable cash flow with an income model based on equity payments is not a concern for their start-up clients. The results of this analysis are presented below.

Consultancy Perspective on Entrepreneur Experience

A strong common thread uniting how the investors evaluated the entrepreneur and the core team was their experience. All investors claimed that they evaluated entrepreneurs and the core team of start-ups based on their experience.

> *If they don't have the relevant industry experience, then it doesn't matter how great the idea might ever be. (CEO, Consultancy1)*

> *I mainly go to the team… A good balance between relevant capabilities and of course the product and the business is the most important thing to look for. (Angel Investor, Investor1)*

The evaluation of a start-up's promise made by an investor seems influenced more by gut feeling than by explicit factors.

> *To be honest, a lot of it is winging it. It is a gut feel from having worked through thousands of pitch decks and having met around a thousand teams for an hour of chatting around a table. Some fuzzy pattern matching starts to appear. Nothing that you could find in an industrial management textbook. (Partner, Consultancy3)*

Even though the investment decision is intuitive, relevant industry experience from the entrepreneurs appears to be important when the decision is made. This is also confirmed by Shepherd and Zacharakis (2002). Relevant working experience helps the development of abilities to recognize good business opportunities (Olivari, 2016; Ucbasaran et al., 2009). Therefore, we propose that relevant business experience from the entrepreneurs in a start-up increases a consultancy's inclination to accept equity payments from the start-up.

Start-up Perspective on Entrepreneur Experience

Some of the entrepreneurs without start-up experience explained that when they started out with full ownership of their companies, they did not hold on to their equity in the same way. One of these entrepreneurs explained that "…it seems like a couple of percentiles does not change much when you have it all" (CEO, Start-up11). Entrepreneurs who had previously worked with start-ups more often described themselves as reluctant to give away equity. It has also been shown that these experienced entrepreneurs are able to retain more equity and be more selective with equity distribution to their helpers (Kotha & George, 2012). It is possible that experience from previous start-ups has provided entrepreneurs with insights into the challenges associated with conflicting goals in principal agent relationships with external owners. This study also suggests that entrepreneurs with previous experience from the start-up world seem to know the value of their shares and be more reflective and hesitant regarding paying with equity for services, compared with first-time entrepreneurs. This follows naturally from Kotha and George's (2012) findings that experienced entrepreneurs hold on to equity to a further extent and are more selective when offering equity to individuals.

In contrast, one entrepreneur, who formerly had been part of a start-up team, said: "I do not see paying with equity as a future problem" (CEO, Start-up10). However, he only had a supportive role in the previous start-up team and did not own any equity. This would suggest that mainly substantial and relevant entrepreneurial experience creates a reluctance to offer equity as payment.

Kotha and George (2012) argue that more experienced entrepreneurs are able to raise more resources from within their network and partners. This can also explain how experienced entrepreneurs can achieve proofs of concept in their start-ups without offering as much equity to external resource providers, such as investors and consultancies. One experienced entrepreneur claimed to choose investors who trusted them to do their own thing businesswise, but still contributed more to the firm than mere money.

> *There are a lot of smart people around us that are always*

> *available. You just have to be persistent on the phone. Everything always works out. (Co-Founder, Start-up5)*

During the interviews with the entrepreneurs, it became clear that paying with equity is, in most cases, reserved for business-critical services. However, small businesses prefer developing in-house solutions to their problems if possible, as learning by doing is the most accepted method of knowledge creation (Dalley & Hamilton, 2000). Experienced entrepreneurs already have, in addition to their own knowledge of entrepreneurship, a network that enables better access to critical information as well as resources and capabilities. Furthermore, experienced entrepreneurs know the importance of having a competent and, with relevance to their business, complete team already from the start. Having more business-critical competence in-house decreases serial entrepreneurs' inclination to use equity payment solutions, as learning by doing is a viable option for the creation of business-critical services. Again, the biggest opportunities for equity payment come from new entrepreneurs who do not themselves possess all the resources and network ties needed to build a successful start-up. In addition, a less experienced entrepreneur often uses equity in lieu of cash to pay for tasks that are commoditized and easily available, such as accounting and the production of marketing material. Experienced entrepreneurs see equity mainly as a means of incentivizing people or partners to work with long-term shareholder value in mind. Therefore, we propose that lack of substantial start-up experience from the entrepreneur increases a start-up's inclination to offer equity as payment for critical services.

Consultancy Perspective on Start-up Phase

Interviewing an investor who focused on lending money to more traditional low-risk ventures, a fundamental risk concerning investing in start-ups became evident - the sheer amount of money needed to fuel the growth paired with difficulty in evaluating past performance. Other investors and consultancies geared towards larger established firms also emphasized the uncertainty associated with investments in start-ups. This is the same issue raised by Baum and Silverman (2004), who say that the short track records available to outsiders complicate evaluating the potential of a start-up.

> *The exit has to be really amazing to be worth the risk [investing in early-stage start-ups] - I would rather invest in ventures that are easier to evaluate due to past performance. (Head of Financing, Investor2)*

Other actors provided a contradicting view. During all interviews with investors and consultancies that held equity in start-ups, the absence of conventional risk management became apparent. A private venture capitalist argued that the outcome of start-up success was not distributed through normal distribution, but rather by a power law, which means that one big success could pay back all the numerous losses accrued up to a certain moment in time. A common sentiment is that by actively choosing to invest in start-ups, the concept of risk becomes redundant.

> *I think, by definition, by making early-stage investments in start-ups, we're already off the scale with risk. So typical financial behavior doesn't apply, and it's almost the reverse, because risk is so hard to quantify, and start-up success works rather in terms of exponential outcomes. (Partner, Consultancy3)*

> *Venture capitalists often don't even worry about risk. Instead, we want to maximize risk, since we want to maximize the upside... We only invest in moonshots, that each firm should have the potential to cover the entire fund. (Data analyst, Investor3)*

By maximizing your risk, you also maximize the expected payout, not worrying about the risks involved in single start-ups, since one big success can become worth more than all other investments combined. Therefore, we propose that the high risk associated with investing in an early-stage start-up encourages risk-seeking consultancies to accept equity payments for their services, while more risk-averse consultants are reluctant to accept equity payments from early-stage start-ups.

Start-up Perspective on Phase

When discussing the use of equity with the start-up entrepreneurs in this study, the answers from entrepreneurs with previous start-up experience highlighted that entrepreneurs were, in general, more willing to let go of equity during the earlier stages of the development of the firm. According to Henderson et al. (2006), entrepreneurs with less optimistic prospects tend to be more interested in service-for-equity arrangements. Consultancy1 experienced that clients who pay them in at least part equity are most often early-stage start-ups, and that their clients who pay them only in cash for more strategical services tend to be more mature. The interviewed start-ups expressed similar thoughts.

> *If I need help now [at this early stage], to pay with equity is the only available option for me. (CEO, Start-up11)*

> *In the beginning, you don't hold on to your equity in the same way... If we had more traction, I would be less likely to give away equity. (CEO, Start-up2)*

When start-ups have a proof of concept in the form of either a successful test or a beta-version, or as revenues from the product, they become less inclined to pay with equity. At this point, banks become more willing to provide loans and revenue streams from the business begin to provide liquidity to pay for the acquisition of new resources and capabilities. Thus, a proof of concept decreases the willingness of start-ups to offer equity as payment, as it creates alternative sources of cash flow to the firm. Łobacz et al. (2016) also claim that the use of external expertise is especially needed when new market offers are implemented, which is often when the firm enters the next stage of development. The CEO of Start-up3 described the reasoning behind a decision to pay a designer, which could be seen as a kind of consultant, in equity. The designer was perceived to be "great but expensive," and, thus, could not be compensated in cash.

> *You don't have that many chances; you've got to make it or break it. The timing can be decisive, so sometimes it is about prioritizing and doing the right things at the right*

Table 4. Inclination to Use Equity Payments

Challenge	Consultancy Inclination	Start-up Inclination
Experience of entrepreneurs	Entrepreneur's industry specific experience increases inclination	Entrepreneur's lack of experience of running start-ups increases inclination
Phase of start-up	Lack of proof of concept increases inclination of risk-seeking consultancies	Lack of proof of concept increases inclination
Consulting income model	Access to cash to finance investments increases inclinations	

> *time. (CEO, Start-up3)*

Another start-up described how a celebrity was paid in equity to become an ambassador for the firm and provide the recognition needed to create a critical user platform. Elango et al. (1995) also propose that a less developed early-stage venture requires investors to be more involved in the operations. Based on this, we propose that a lack of proof of concept increases a start-up's inclination to offer equity as payment for critical services.

Consultancy Perspective on Income Model

For the consultancies in this study that have received equity as compensation for their services, none of them have a business model that relies solely on equity payments. The need for liquidity requires these firms to take on regular projects that pay in cash as well. These findings are in line with, for example, Adelman and Marks (2002) and Petty et al. (2015). Access to cash therefore makes consultancies more likely to accept equity as payment.

> *Consultancies can go bankrupt in three months. Few consultancies have enough liquidity to last them for longer since the operating costs are so high… One could maybe accept equity at times as a part of a contract, but far from all projects can be carried out like that. (Partner and CEO, Consultancy6)*

The need for cash was reported to be even stronger within consultancies geared towards management than technology, due to a much heavier cost structure. Several of the consultancies discussed the issue with regards to the rate of consultant occupancy. If the consultant utilization rate is low, then one option might be to consider alternative business models. This creates a paradox - consultancies are more willing to accept new kinds of contracts when their cash flow is on the decline, but equity payments cannot solve the short-term need for cash and are, thus, an unlikely solution for incumbent consultancies.

> *Perhaps it could be an option [to use alternative payment models] in other circumstances…*
> *Our business model includes closing the book each year and working on a year-to-year basis. In order to take on equity, we would have to change our entire business model. (Partner and CEO, Consultancy6)*

For the consultancies with experience of equity payments, the need for cash, while present, never made the companies less likely to take on ownership in start-ups. Consultancy1 even wanted to be able to act as investor and provide funding for their clients if need be.

> *You do not want to miss out on an investment opportunity due to a lack of liquidity. (Partner & co-founder, Consultancy1)*

Consultancy3 is interested in equity payments, but due to an emphasis on liquidity, it lacks direct experience from it. The opportunity cost of not billing a customer and missing out on short term cash flow is always taken into consideration by the firm. Hence, the need for cash reduce the propensity to accept equity as payment. Consultancy3 only invests a part of its profits in start-ups, and if profits run dry, no investments are made. Therefore, we propose that access to cash to finance investments positively affects consultancy inclination to accept equity payments for services.

Conclusions and Implications

The analysis resulted in five findings that suggest when equity payments are feasible. The suggestions are related to the inclinations of both start-ups and consultancies to use equity payments.

Industry Experience, not Start-up Experience

Having an experienced entrepreneur running a start-up increases the likelihood of success. For this reason, consultants prefer a team of entrepreneurs with relevant experience when they consider accepting equity payments for their services. However, entrepreneurs with previous start-up experience, are often reluctant to give away equity for critical services. More experienced entrepreneurs believe more in the promise of a start-up, in effect valuing the equity higher. This belief can mean that experienced entrepreneurs will tend to invest more personal cash in a venture to support it instead of giving away equity to investors or consultancies. This might seem like a contradiction that would hinder equity payments between consultancies and start-ups completely, but while consultancies look for relevant business experience, whether from the start-up world or not, entrepreneurs hold on to their equity mostly when they have previous start-up experience and are confident in their own competence as an entrepreneur. The most favorable situation for equity payments would, therefore, be when the entrepreneur has lengthy industry experience but is new to the start-up world and lacks the skills necessary to build a firm on his or her own.

Consultancy Risk Appetite Instead of Start-up Proof of Concept

A proof of concept is expected to decrease the inclination of start-ups to pay with equity. Dunne and McBrayer (2019) argues that information asymmetries, and the difficulty to evaluate the potential of an entrepreneurial venture, often makes the cost of capital too high for start-ups. A proof of concept would likely make it easier for consultancies and investors to estimate a value of the venture. But even though a natural consequence of a proof of concept could also be a greater interest of consultancies in acquiring equity, this study has not found such a connection. The underlying reason for this nonexistent connection is that the value of equity tends to increase substantially after a proof of concept has been presented. As it is time-consuming to evaluate the potential of any start-up (Baum & Silverman, 2004), the larger share of ownership offered by unproven start-ups increases their attractiveness.

For all actors engaged in start-up investments, it was apparent that risks are substantial. Several of the interviewees even claimed that there was no real way to evaluate risks, but instead, the aim was to maximize risk exposure. It is likely that the same reasoning can apply to consultancies working for equity payments as well. Consequently, we argue that a consultancy's risk appetite is more important for its inclination to accept equity payments than the existence of a proof on concept of the start-up.

New Instead of Incumbent Consultancies

Accepting equity as payment would disrupt the traditional consulting business model. Internally, accepting equity payments implies a long-term commitment that affects the organizational structure and operational activities of a firm. Among other issues, consultancies need to decide how to compensate their employees for the equity brought to the firm when they leave, and they need a strategy for how to defend the equity from future dilution. If incumbents offer equity payments as part of their ordinary value proposition, they need to reconfigure their business model completely.

Consequently, a consultancy that creates a business model from scratch, which revolves around an equity payment model, might enjoy advantages over incumbent consultancies with traditional business models. Even though consultancies geared towards equity payments may not be able to deliver the entire value proposition of a traditional consulting firm, they can target a niche market of small, newly established firms, and provide critical services that enable these start-ups to scale up, or realize new business models. Christensen et al. (2013) argue that the traditional boundaries between professional services have blurred, and the new landscape will present opportunities for upcoming firms that offer novel solutions.

Managerial Implications

Consultancy firms that pursue an equity payment business model should search for potential clients among start-ups without a proof of concept, as these clients are more willing to offer equity. Suitable clients can also be found among entrepreneurs with relevant industry experience but who lack previous experience from the start-up world.

While the purpose of this paper is not to determine the general viability of equity payments for critical services, the insights generated here does provide some guidance. With a low task programmability, i.e. a complex task, outcome-based contracts (such as equity reimbursements), are more common (Eisenhardt, 1989). This speaks in favor of service-for-equity contracts. However, the connection between critical services and increased valuation of the firm is oftentimes weak, i.e. the outcome measurability is low. Low outcome measurability speaks against outcome-based contracts (Eisenhardt, 1989).

Many entrepreneurs in this study were tempted by the possibility of giving away equity to create engagement in the start-up of a partner or adviser with specific knowledge or resources. Kaplan and Strömberg (2004) have also stated that greater equity incentive is associated with increased value-added support. Equity can incentivize the receiver to go the extra mile, motivating a well-connected adviser to use his network and put in the hours to make things happen, or creating a sense of ownership for a developer who might have to work overtime to finish a prototype. For start-ups, equity payments could grant access to critical services that they otherwise would not be able to obtain during the early phases of business development. Equity should not be given away heedlessly, but when external assistance is required to survive, equity payments for critical services could be a viable option. Time will tell if the renewed managerial interest in equity payments for critical services, similarly to the 1990s, is caused by an inflated valuation of start-ups, or if the interest will endure.

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