

A Piece of the Pie: *Equity Compensation For Emerging Technology Companies*

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■ Considerations in Determining Equity Compensation

- **Stage of development / round of financing**
- **Time horizon for an exit**
- **Industry (software versus medical devices)**
- **Tolerance of investors for overall equity pool**
- **Type of preferences in place for investors, if any**
- **Cash flow of the company**
- **Culture and philosophy of the company (hierarchical/egalitarian)**
- **Experience / background of management**
- **Type of equity instrument (s)**
- **Key is to view equity as a component of overall compensation package**

■ Old Paradigm Compensation / Exit

- **Exit value typically up to 6 times invested capital**
- **Time horizon for exit 3 to 5 years**
- **Compensation model designed to draw executives and employees to work in a high risk venture**
 - Executives and employees low to modest cash
 - No formal bonus plan to build cash flow
 - Significant equity opportunities throughout
 - Professional level non-exempt receive equity grants

■ What has changed?

- Exits are typically 3 - 4 times multiple of capital invested
- Taking longer to get to an exit. Time horizons are typically 6 – 10 years
- Executives being hired to start venture are well seasoned
- Expectations:
 - Large equity grants for not only Executives but entire employee population
 - Salaries competitive within the market. How much are they giving up to come work for the company? What is the risk, what is the downside?
 - The payouts are not as attractive as they were during the dot.com era or even in 2006-07

■ Addressing New Dynamics

- **Preserve employee equity allocation:**
 - Provide universal equity to all true start-up employees
 - Focus periodic allocations to top executives and key employees as company grows and time horizon lengthens (if the company is thinking it is time for annual grant guidelines, the company should be moving away from universal participation)
- **Design short-term incentive plan to provide incentive to other employees**
 - Drains cash but supports the notion that a more stable work force is needed leading up to an IPO
- **Drive appropriate behaviors using compensation elements**

New Pay Paradigm

Time Horizon to an Exit Event

Up to Three Years

Executives and Key Employees

- Hire seasoned executives
- Competitive base salaries
- Significant equity grants

Other Employees

- Modest to competitive base salaries
- Modest universal equity grants

Three to Five Years

Executives and Key Employees

- Competitive base salaries
- Formal short-term incentive plan
- At-Hire and annual equity grants

Other Employees

- Competitive base salaries
- Formal short-term incentive plan
- Limit equity grants

Five Plus Years

Executives and Key Employees

- Competitive base salaries
- Formal Short Term Incentive Plan
- At-Hire and annual equity grants
- May consider carve-out plan for top executives

Other Employees

- Competitive base salaries.
- Formal short-term incentive plan

Competitive Equity Holdings – General Guidelines

Level	Total Equity Participation at various Stages of Development (Fully Diluted)		
	Early Stage (Post First Round Financing) 25 th – 75 th percentiles	Mid-Stage (Post Second Round Financing) 25 th – 75 th percentiles	Later Stage 25 th – 75 th percentiles
Founders	2.00% - 10.50%	2.00% - 9.00%	1.75% - 8.50%
CEOs	4.00% - 7.00%	3.50% - 6.50%	2.00 – 5.00%
Executives	0.65% - 2.25%	0.50% - 1.10%	0.50% - 1.00%
Directors	0.20% - 0.50%	0.10% - 0.30%	0.10% - 0.30%
Managers	0.50% - 0.20%	0.05 – 0.10%	0.05 – 0.10%

Data from Dow Jones Compensation Pro