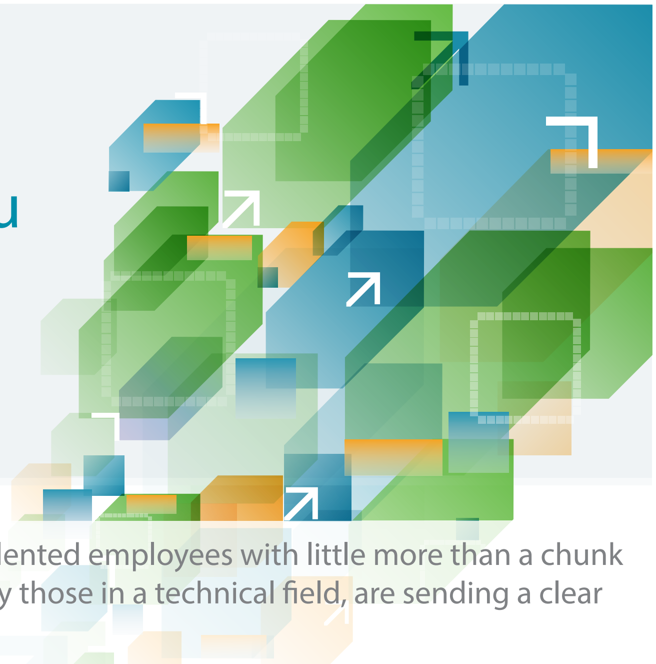
NASDAQ Private Market™

Cash vs. Equity: How Do You Strike the Right Balance?



Due to talent wars, startups today are offering bigger salaries

Years ago, it wasn't so hard for company founders to lure talented employees with little more than a chunk of equity and a dream. But today's job candidates, especially those in a technical field, are sending a clear message: Show us the money—and the equity, too.

While it's still common for founders and perhaps a few early hires to forgo most of their paycheck in favor of equity, companies that have completed their first round of venture capital financing are expected to pay a competitive salary, says Carine Schneider, President of Equity Management Solutions at Nasdaq Private Market. An early- or mid-stage private company might pay 10 to 20 percent below what a more mature company pays in exchange for more equity, Schneider estimates. In the 1990s, though, salary discounts of 50 to 80 percent were not uncommon.

Losing Its Luster

Why has equity lost some of its allure? Possibilities include:

- During the dot-com bust of the early 2000s, many founders' promises of big payouts evaporated along with their companies.
- The cost of living is soaring ever higher in tech hubs like Silicon Valley and New York's Silicon Alley, so employees require a decent salary just to pay the bills.
- The route to a public offering—and potentially a big equity payday—has lengthened, as more companies have chosen or needed to stay private for more years. "People were more willing to take a gamble when a company could go public in four years," says Dee DiPietro, founder of Advanced-HR, a compensation data provider focused on private tech and life sciences firms. "But in 2001, the public markets started needing to see a profit for a few years, and suddenly the path to an IPO was more like eight to 10 years. These companies need to retain their employees all the way to that exit, so their cash offers must be more competitive."
- Last—and perhaps most significant—there's the intense war for technical talent. These employees see no reason to accept below-market salary, says Tom LaWer, a partner at compensation consultancy Compensia. For them, equity has become more like a dessert than the main course. "People aren't going to pre-IPO companies for the salary; it's for the equity," LaWer says. "They see the potential for big gains."

NASDAQ Private Market

Investors like to see employees paid at least partly in equity because it shows that they have "skin in the game"—that is, they're personally invested in the company's success, Schneider says. And many new hires still expect an equity stake.

Executives are often expected to take more of their compensation in equity than line staff, says Tony Karrer, founder of the startups TechEmpower and Aggregage and a longtime mentor for founders in the Los Angeles area. "They're more directly responsible for fulfilling the company's potential, so they should be more willing to take some of their compensation in equity," Karrer says. Executives also tend to forgo salary first during lean times, Karrer says. Of course, with higher salaries to begin with, executives are often in a better position to sacrifice a portion of it. Non-technical employees also tend to be more willing to trade salary for equity, Karrer says.

Increasingly, tech sales staff—who typically rely on salary and commissions—are also receiving significant equity stakes because the competition for good salespeople is intensifying, says LaWer. "These companies are growing quickly, they have products to sell and now they need people to sell them," he says.

Equity Matters

Firms such as Advanced-HR publish surveys describing average salary and equity compensation for employees based on job role, management level and company growth stage. As a general rule, salaries increase and equity compensation tends to diminish as a company matures, DiPietro says. But even compensation experts such as DiPietro admit that there is a lot of subjectivity in how compensation is granted, especially for earlier-stage companies. That's because the potential upside of owning 1 percent of equity in a company varies hugely, depending on the valuation when a company goes public or gets acquired. In the case of many startups, nobody knows for several years whether that number will be $1 million or $1 billion.

"Companies look for answers in the data, but it's not just in the data," DiPietro says. "It's in the strategy and the unique story each company tells. It's the same story they tell their investors. If you believe the story, then the equity has value, and you may be willing to take that risk."

Lean-running startups are keenly interested in finding employees who are risk-loving true believers. "Some job candidates love the excitement of the early stage, the camaraderie and the ability to make a bigger impact than they could at a big company," Karrer says. "You may need to offer significantly more equity than Google can. You have to sell them on the upside, because that's how you beat Google for that employee."