NASDAQ Private Market™

Winning the Talent Wars

How private companies can gain an edge over public companies to score great hires

Across the country, employers are seeking effective ways to sweeten the pot to attract and retain top talent. Caught in this hypercompetitive job market are late-stage, venture-backed private companies trying to compete with public companies for skilled workers.

Without the deep pockets and tangible value of publicly traded stock, private startups need to be more creative—and increasingly that means adding a slice of equity to everyone's benefits package. "In Silicon Valley, it's absolutely expected that employers will provide equity to every employee," says Carine Schneider, President of Equity Management Solutions for Nasdaq Private Market.

While this culture of communal ownership may have started among California's high-tech companies, it's spreading into other regions and industries, as younger workers demand a personal stake in the companies and careers they chose. This trend presents three key challenges for company founders: How much ownership do they need to give up in order to meet their recruiting goals? What's the best way to structure an equity participation plan to meet the company's needs and the expectations of new employees? And what liquidity options can they offer employees down the road to turn their equity into cash?

Weighing the Options

Owners who are willing to share the wealth but not the control can establish multiple classes of stock. For example, founders can receive stock that comes with 10 votes per share, while new hires can be granted stock that only carries one vote per share. But they all must have the same per-share dollar value, Schneider cautions.

After that, companies basically have three ways to structure an equity program:

- **Stock options**: These are by far the most popular form of equity because they give the employee the right, but not the obligation, to purchase stock at a preset price at some predetermined point in the future, such as after the employee has logged a certain amount of time or met certain performance goals. Option prices are usually very low, starting as low as a penny a share, in hopes that the value will rise significantly when—or if—the company takes off.
- **Restricted stock**: As their name implies, these shares come with strings attached, usually a waiting period before the shares are fully transferrable. The hitch is that, unlike options, the employee owns the stock as soon as it's issued, which could trigger an income-tax liability for the owner.

- **Restricted stock units (RSUs)**: These are an increasingly popular choice for companies because they combine the best features of options and restricted stock. The employee doesn't receive the stock immediately, so there is no tax hit, but the employee also doesn't have to go out of pocket to buy the shares when they do vest, as they would with an option.

Which to Choose?

Deciding among these three choices often comes down to where the company is in its life span, says Matthew Moisan of Moisan Legal P.C., a New York law firm specializing in small companies. Granting a big chunk of cheap options works well with employees who've been with the company since early on because they are taking a bigger risk coming into an unproven business, and the options basically cost the company nothing to issue. "A later-stage company, though, will theoretically be more stable and have a higher real value," he says.

That value would drive up the cost of options, making them less attractive to new employees coming in. That's where restricted stock or RSUs may make more sense—but which one? "The tax implications of each one of these alternatives are complex," Moisan says. "That's when you start going down the rabbit hole, so you need to speak with an attorney and an accountant to figure out which would be best for the company."

Another consideration: "RSUs can also be a higher risk to the company because they are more expensive to grant than options," Schneider says. "And employees have no skin in the game until they are fully vested and have some way to cash out."

Show Me the Money

At some point, though, options and restricted shares won't be enough to keep employees engaged. Investors need to see an endgame, and for years all sights were set on the initial public offering (IPO) market—the pot of gold at the end of the entrepreneurial rainbow. As the IPO market slows, though, companies need to find new ways to help their employees and other shareholders realize their paper gains.

Enter "structured liquidity programs," or SLPs. These allow a company to maintain control over its stock—including deciding who can sell, who can buy, when the trades can occur and what the price will be—while giving employees a specific timetable as to when they will be able to unlock some of the cash value of their shares. "It's a great way for employees to feel like the pressure valve has been opened just a little bit," Schneider says.

Taking Stock

No matter how generous your employee equity plan is, though, it's just one factor today's top talent will weigh when choosing among job offers, says Bertha Masuda, co-founder and partner of Vivient Consulting, a company based in El Segundo, California which specializes in compensation . Job satisfaction, career development and the ability to advance are just as important to today's employees, especially younger workers, she says.

"This generation also wants to have more fun at work," she adds. "They are looking for free lunches, company outings, vacations, and they have no problem jumping from place to place." They are also short-term oriented, more focused on broadening their experience and enjoying the people they work with than on building a career with one employer, she says. And having been weaned on stories about high-tech's IPO millionaires, "they want to get rich quick," she says.

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