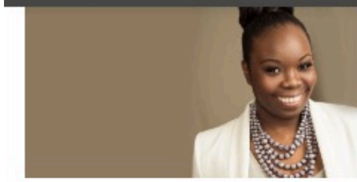

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Raising the stakes for job seekers: Company investment pros and cons

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Would working for a startup company sound more attractive to you, the job seeker, if you were able to have stake in the company? According to Fortune magazine, this may be the way to go. They believe an equity

Smart ways to spend money (Photo credit: Pixabay)

magazine, this may be the way to go. They believe an equity plan "produces more productive, passionate staff who truly feel like they're a part of something."

The best part about employee stock purchase plans (ESPPs) is the rate will usually be less than the fair market value. For entry-level employees who are already wondering how they'll get by on their current salary, this may feel a bit like investing in a 401(k) plan: Ignore now, pay later. But for entry-level employees who want to move up in a company (i.e., a career) versus those who have a job, investing in the early stages could be more lucrative. That's on top of saving for emergency funds, getting ahead on retirement savings and being more attentive about the company's earnings. Some companies are even using equity options as a negotiation tactic for executive-level talent.

Fidelity brings up a concern about stake investments, but in this case it was for well-known companies. Due to Enron's 1999 bankruptcy, over $1 billion in employee retirement savings disappeared. After bankruptcy, Lehman Brothers stock price nose-dived from $86.18 per share (2007) to

Lehman Brothers stock price nose-dived from $86.18 per share (2007) to $4.22 a year later, in addition to an 83,000 employee layoff.

But with a startup company, it would take far more time to have to deal with these kind of stock panic attacks. And for those with a glass-half-full perspective, some companies may never deal with these kinds of issues. For startup founders looking to offer equity options to employees, here are some things to consider.

Planning to invest? (Photo credit: Pixabay)

When will the equity option cliff and vest? A startup founder wants to incentivize employees by offering them an equity interest in the company. Naturally, a startup founder does not want an employee who only worked for the company for two weeks to retain an equity interest in company. This is where cliff and vesting comes into play.

Vesting means that instead of the employee being entitled to the full equity option immediately on day one, it is given to the employee in

Vesting means that instead of the employee being entitled to the full equity option immediately on day one, it is given to the employee in percentage increments over a period time. In the startup world, it is typical for equity options to fully vest after a period of four years.

For example, a startup employee received a 50 percent equity interest in the company. (This is highly unlikely, but using 50 percent helps to keep the math simple for illustration purposes). If the employee quits after six months, he or she would have earned 6.25 percent or (1/8th) of his or her total 50 percent equity interest. If the employee quits after three years, then he or she would get 37.5 percent or (3/4th) of the total 50 percent equity interest.

A **cliff** period allows a startup founder to hire an employee without making an immediate equity commitment. Let's say the employee's equity option contract contains a one-year cliff period. If the employee quits before completing the first year, that employee receives no

Use your time wisely when investing. (Photo credit: Pixabay)

cliff period. If the employee quits before completing the first year, that employee receives no equity. However, if the employee stays for one full year (the expiration date of the cliff period), then a full quarter of the employee's 50 percent equity option immediately vests. If the employee stays beyond the four-year vesting period, the employee is entitled to the full 50 percent equity option.

The balancing act between incentivizing an employee and protecting the equity interest in a startup is a complex one. It is advisable that startup founders consult with a business attorney.

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Have more questions about employee equity options, vesting and cliffs? Contact J. Paye & Associates today.

Shamontiel L. Vaughn contributed to this blog. Find out more about her at Shamontiel.com