Wealth creation for executives is bound to their company's stock price—and for good reason: making share price returns a critical driver of employee compensation is a way for corporate boards and shareholders to align management's focus with company performance.

Effective talent acquisition and retention may be one of the many tools that a company views as carving out a competitive advantage and driving their future growth. One strategy, among others, that companies can consider leveraging is granting equity compensation — a tool that can help to reward employees and promote a culture of ownership. Workers who participate in equity plans have the opportunity to build wealth and feel more engaged at work.

Startup Equity Basics

When your company is just starting out, cash can be limited. Granting equity compensation may supplement cash to attract and incentivize the talent you need to grow the business. Here are a few things that may be helpful to know as you administer an equity program:

1. An organized capitalization table ("cap table") to show equity transactions from investors, founders, and employee-shareholders.

2. An up to date 409A valuation, which ensures you're compliant with IRS regulations when offering equity compensation.

Companies design equity compensation plans to achieve goals, which are often informed by their stage of growth, size, and tenure in the market. Startup founders may view equity management as a necessary administrative task, rather than a mechanism for growth. Here are some primary business needs that equity compensation can help address:

Compensation
The value of stock options can play a significant role in a company's total compensation package. Offering equity to employees can be especially valuable for small companies and startups competing for talent with larger, more established companies that may be able to offer higher salaries.

Retention
Most stock options come with vesting requirements, which means employees must stay with a company to experience the full benefits of their equity awards. That is why companies may find equity compensation one of many useful tools for retaining valuable employees and motivating them to help the business grow.

Hiring
There is a lot of competition for top talent and offering equity awards may make a company more attractive to potential employees.

Typical Equity Type Offered

Startup equity plans are not a one-size-fits-all proposition. Companies can choose from several equity types based on their goals and objectives. Here are four of the most common awards:

- *Incentive Stock Options (ISO)*
  An ISO gives an employee the right to buy company shares at a pre-determined price with the potential for preferential tax treatment if the employee meets certain holding requirements. More complex than an NSO, ISO's generally have time-based holding requirements that must be satisfied to get preferential tax treatment.

- *Non-Qualified Stock Options (NSO)*
  NSOs are one of the most common types of stock options and they give employees the opportunity to buy shares of company stock within an established period of time. They do not receive preferential tax treatment and are taxed as ordinary income upon exercising the stock option.

- *Restricted Stock Awards (RSA)*
  These full value awards are issued and outstanding at grant. Employees own the shares from the moment they are issued. They become shareholders right away with voting and dividend rights. Generally, certain employee rights to their RSAs are subject to vesting requirements.

- *Restricted Stock Units (RSU)*
  These are similar to RSAs but are not outstanding at grant. Employees are not eligible to buy the stock until the RSUs convert to stock when vesting is complete.

What Are Your Company's Common Shares Worth?

Public companies are valued by the price their stock trades at in the market, but private companies do not have this luxury. When you start issuing equity in the form of stock options, a 409A valuation is often required.

Shareworks by Morgan Stanley offers a fast and transparent 409A service that is led by a team with 60+ years of combined experience in 409A valuations. Our valuations team can provide you with a professional and audit-ready valuation at every stage of growth.

Equity Management While You Grow

With financing secured and a rapidly growing headcount, your equity needs, and perspective can begin to change. New needs will arise, including added complexity to your equity administration and compensation strategy.

In the growth stage, a company has likely:

- added a more substantial employee base
- faced more compliance requirements like financial reporting

- gone through multiple funding rounds
- considered expansion

In terms of equity management at this stage, you might have a dedicated resource handling your cap table and compliance, whether that is a CFO or Stock Plan Administrator. You may also have a solid number of shareholders with vested stock options.

Those shareholders may be looking to see the value of their equity. It may be beneficial for them to have visibility not only for transparency, but also to help create a culture of ownership.

Another part of company growth is adjusting your compensation strategy. As you have moved through funding rounds, your cap table has potentially grown from a few founders, key team members and early-stage investors to a wider range of employee grants and investor holdings, which may have required heavy-duty cap table organization.

Late-Stage Equity Management

With these changes, you may not be granting equity to every new hire and with more cash at hand from those funding rounds, your compensation plans may have shifted to a custom mix of equity and cash.

Assuming your company does not go through an exit, you will soon evolve from a growing company to a mature company. And once again, your needs will change. Compliance might be an even bigger concern for you now, as is advising on liquidity events and a path to the public market.

Whether you are an emerging tech company with a handful of names on your cap table or a late-stage life sciences organization, your equity and compensation needs are sure to change over time. The Davis/Yost Group at Morgan Stanley can provide equity solutions for any stage of your company's journey.

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Logan Atkins is a Financial Advisor in the Dallas Texas office at Morgan Stanley Smith Barney LLC ("Morgan Stanley"). He can be reached by email at logan.atkins@morganstanleypwm.com or by telephone at (214) 720-5066.

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