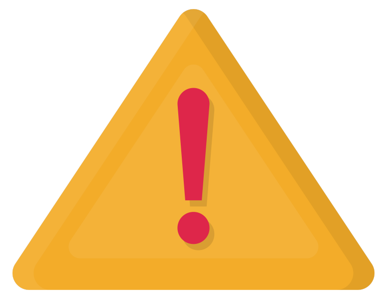
Startups

This lesson cautions the candidate to have his guard up when negotiating compensation with startups, as their equity, in most instances is hard to value unlike public companies.



Working at startups feels much like a rollercoaster ride with its own unique highs and lows. Startups are positioned as shiny, fancy, the-next-big-thing and sold as such by recruiters to the candidates. Kool-aid flows freely in startup offices and is religiously distributed among employees to drink up.

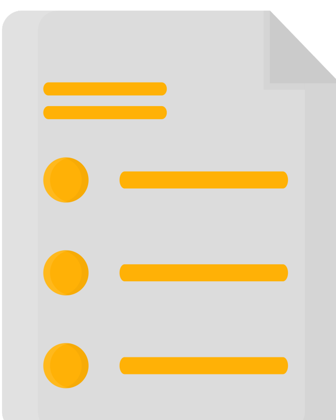
It can be very exciting and highly rewarding to work at one, but the adventure can also end up in tears and crushed dreams. In short, the phrase "high risk, high reward" is the most succinct description of employment at a startup.

The holy grail of negotiating with startups is to barter as much equity as possible in return for your toil and sweat. Because startups are usually constrained on cash, especially the early stage ones, they are unlikely to match the higher base salaries and cash bonuses that public companies with impressive bottom-lines may offer. However, this presents an opportunity for the candidate to negotiate hard for options or RSUs. If the startup indeed becomes successful, the equity will far outperform any salary bump you negotiate for at the start.

One recent anecdote is of a Blind user who asked for help on the forum when negotiating an offer from Snowflake. He was advised to negotiate for double the number of RSUs than what was initially offered. Fast forward, when Snowflake did go public, the user posted again on Blind, thanking the community since his equity stake in the company was worth $2 million dollars at the IPO share price with the negotiated offer instead of the $1 million it would have been without negotiating.

Evaluating a startup offer merits an entire book in its own right. The only caution we can extend to the reader is to thoroughly research and undertake ample due diligence before accepting a startup's offer. There are plenty of free online resources that talk at length about evaluating the potential monetary worth of a startup's offer. Unlike established public companies, it is not straightforward to value, say a 1000 RSUs or 1000 call options in a startup's offer. The vesting schedules and conditions may also differ. One notable example is of our friends working at Cloudera pre-IPO who learned their lesson the hard way. The vesting schedule required a liquidity event such as an internal tender offer or an IPO in addition to time-based vesting. This clause handcuffed several folks from leaving the company even though they had vested their RSUs based on the length of their employment. Leaving the company before the IPO meant leaving all your RSUs on the table. This kind of vesting restriction was uncommon in the valley at the time and caught many by surprise who had not pored over their offer letters of several pages with intricate details and fine print. Alas! The recruiter for these folks had conveniently skipped this detail.

Another important factor when considering startups is dealing with options if you decide to leave before the company IPOs or is acquired. Usually, startups have a cliff of one year, after which the options awarded for the first year as part of your compensation package would vest. Thereafter, the vesting turns to a monthly or a quarterly schedule. If 18 months into your job, you decide to leave, you will need to exercise your options within a limited time window, usually three months from the day of your departure. If the option strike price has been set at, say, $19 (which it was for folks joining Cloudera just before IPO), and you have accumulated, say, 1000 options, then you will be confronted with a bill of $19 x 1000 = $19000. Would you be willing to pay that sum for a company whose future may still be up in the air? Moreover, in the US, there are tax implications for early options exercise, and the Valley is replete with horror stories of folks who paid thousands of dollars to exercise their startup options when the company they worked for ended up going bust a few years later. Worse, we have known folks who took out six-figure bank loans to exercise options during the infamous 2001 dot-com bubble era. When the music stopped playing at the dot-com musical-chairs party, these folks were stuck with a hefty monthly bank payment and a couple hundred thousand worthless stock options.



To mitigate risk, some folks diversify their startup equity by working for a startup for two years and then moving onto another one. Thus, over a period of time, they build themselves a diversified portfolio of startup options and reduce the risk against startup failure. However, reducing risk also reduces reward, since one would not have worked long enough at the successful startup to accumulate a larger equity stake.

An acquaintance of one of the authors, had slaved away at a startup for eight years on a meager e base salary. After the long haul, the company was acquired by Facebook, but the acquaintance made zilch from options. The acquisition was an acqui-hire, i.e., the company was acquired primarily to recruit its employees and not to gain control of its products or services. A face-saving of sorts for a stagnant or failing startup.

We do not intend to discourage the reader from pursuing startup opportunities. Statically, for every nine sad endings, you will find one success that forever unchained its employees from the proverbial nine to five. The crux is whenever you come across startups, make sure your offer is commensurate with the risk you are taking, and in case the startup does succeed, your offer should be strong enough to vault you far ahead financially than if you were to join a stable public company.

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