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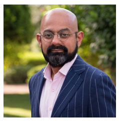
Pre-IPO Compensation: Managing Internal and External Parity and the Influence of Culture



Aalap Shah

MANAGING DIRECTOR

Transcript

From a pre-IPO perspective, whether a company is venture backed or non-venture backed, there are some special considerations that that need to be addressed. First and foremost is not only external pay equity, but also internal pay equity. You have a situation where depending on when certain executives or senior-level employees have entered into the organization, they may have different equity ownership levels. And in a pre-IPO situation, where cash can be constrained, equity is your true currency. So, one of the first things that we do is an assessment of what is the employee composition—executive as well as rank and file employees. How do they compare to one another to ensure that internal pay parity as well as from an external environment and how do they reflect against market?

And that particular exercise can be very eye-opening in the sense that there are individuals who have significant value to the organization because of the job that they do. And then there are other individuals who have value to the organization because of their tenure and the ability for them to be part of a growing organization and how to balance those two things because they don't always reside in the same individual. And so, oftentimes what we're doing with organizations is really doing a deep dive into the culture of the organization and trying to understand how to overlay the market data with the culture of the organization. And this can be a bit tricky because especially for a venture-backed company, and this is, I think, a big contrast to what you find in the public company environment, is that VC-backed companies, they tend to be in the trenches with the executives.

Unlike an established public company, a compensation committee, a board, the VCs are in the trenches with the employees. So they're both building value and contributing to significant value creation of the organization. So things tend to be very much more personal. And oftentimes what we hear is that compensation arrangements have historically been negotiated rather than objectively determined based on the strategy of the company as well as the cultural profile of the organization. So when going into these organizations and trying to understand how they operate, the number two thing that we try to tell organizations is that we need to come to this and why you hire us is that we'll provide an objective sounding board. And what we mean by objective sounding board, we're not there to dictate what actually happens and the decisions that are made.

But there are probably certain structures, loans, one-off loans that are provided, maybe certain benefits that are provided to individuals and not others, where having an objective party come in and say, "This is what is market standard. This is what potentially might be appropriate for your organization given where you're trying to go and the growth trajectory." It helps ease the conversations when what the VC is trying to do, or the non-VC directors are trying to do, is truly prepare that organization to be a fully functioning public company with all the appropriate governance requirements. That transition where you were not in the public space and so one-off compensation arrangements, certain benefits, certain perquisites may be acceptable—there's a good amount of cleanup that needs to occur when we cross that line into the public environment. So, those are, I think, two of the main things that we see are significant distinctions between a company that's preparing for a public offering versus a company that is already public.

About the Author

Aalap Shah is a managing director at Pearl Meyer. With more than 20 years of experience, Aalap advises public and privately held companies on executive compensation issues, with focus on pay governance, pay-for-performance alignment, and incentive plan design. Of particular interest is the intersection between business strategy, people strategy, and compensation strategy, believing alignment of all three is required to design effective programs.

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