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Biopharma Fundraising and the Related Compensation Considerations

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For clinical stage biopharmas, raising money to advance pipelines and develop lead programs is a matter of life and death, and new rounds are something to celebrate given how tight capital markets have been over the last 18 months. From a compensation standpoint, a successful financing round can often represent an inflection point in the company's lifecycle. This has meaningful implications for pay levels and equity strategy, which may prompt a "leveling up" in the size and complexity of companies that are included in market benchmarking exercises.

While biopharma companies need to think through a variety of compensation-related issues, from founder compensation to the evolution of board pay, a successful fundraising leads to three specific compensation considerations that need to be addressed:

1. Sizing the new equity pool;
2. Implementing an employee equity refresh program; and
3. Updating the company's compensation structures.

1. Sizing the New Equity Pool

It's vital to consider the size of your employee equity pool post-financing. Fifteen percent of fully diluted shares in the form of employee equity is a longstanding rule of thumb, although these "top-down" levels of overhang fluctuate based on company size and stage. Therefore, we recommend a deeper investigation to determine what's really right for your organization as there are a variety of factors that can push your equity pool needs higher or lower as the company takes on new funding. These include headcount (e.g., the number and type of hires you need to make to support the next phase in your development), market positioning (e.g., whether you want your employees' total equity ownership to be at the market median or above it), and equity philosophy (e.g., the extent to which you believe dilution created by the financing should be offset with employee-refresh awards). Soliciting the input of your investors early in the fundraising process and working with your advisors to understand the implications of a variety of scenarios can help the company build a "bottom-up" perspective of equity needs that will better support the company's human capital strategy for the long term.

2. Implementing an Employee Equity "Refresh" Program

An equity "refresh" program is a key compensation element that is often rolled out shortly after financing at private emerging biotechs. Views around the appropriate size of refresh awards vary depending on who you ask, and not surprisingly, employees tend to favor generous top-up awards while investors favor a more conservative approach. Rather than relying on most current trends or one-size-fits-all approaches, we encourage companies to develop more tailored strategies by triangulating three key inputs:

- **Positional equity ownership benchmarks for the post-financing company size:** Use this information to determine how many shares are required to restore equity ownership to the targeted pay percentile across the workforce. In addition, use this assessment to develop a framework for handling outliers, such as those who would be above the targeted percentile even after accounting for dilution from the financing.
- **A dilution "make-whole" range which is often between 50% and 90%:** It's normal to offset dilution created by a financing round to some degree, but the question is how much? To be clear, an executive whose ownership is diluted from 0.5% to 0.3%, and who then receives a refresh award to increase their holdings to 0.4%, is receiving a 50% make-whole award. The right make-whole amount for your company depends on specific facts and circumstances, but it's not unusual to consider different make-whole amounts for different employee groups. Also note that while 100% make-wholes are not unheard of, they are not the norm.
- **The proportion of outstanding equity that is vested versus unvested:** As with most compensation decisions, refresh equity awards should also contemplate retention. We recommend using vested versus unvested equity balances to determine if you should differentially issue refresh awards to certain individuals to enhance retention strength. It's also appropriate to consider whether recent hires—who likely have no vested shares and may not have significantly contributed to the company's development to-date—should participate at all.

Of course, employee performance, potential, and impact are critical overlays to each of these inputs and can drive individual differences in refresh amounts. All else equal, high performers and "cannot lose" employees may receive larger refresh awards than others. While this more tailored approach to equity refreshes means more time is invested in the upfront design phase, we've found that it's worth it to ensure your best and brightest are properly retained and incentivized.

3. Updating the Company's Compensation Structures

Leveling-up the size and complexity of companies included in market benchmarks generally results in higher cash compensation benchmarks for your employees. At the same time, equity benchmarks as a percentage of fully diluted shares tend to lower. This well-established trend is indicative of the evolving business risk profile as the company has reached certain milestones in its development, was able to raise more capital, has increased its equity value, and has de-risked the business for investors and employees, at least in theory. In other words, the risk/reward balance between cash and equity compensation begins to level out, meaning employees will accept (and companies will provide) higher cash compensation in lieu of fewer, but more valuable, shares in the company.

Considering this trend, it's important for companies that have recently completed successful fundraising to update their total compensation structures in a way that strategically aligns to plans for the future organization. This includes salary structures as well as new hire equity ranges. Note that while it's reasonable to expect modest increases in your salary ranges after updating the structure, this does not mean automatic salary increases for employees. Rather, the revised structure becomes the new framework within which to administer compensation increases consistent with your annual planning cycle, and to size new hire pay as it comes up. Selecting the right companies to include in your peer comparison dataset is also an important consideration and should fairly reflect the company's current profile and trajectory.

In Conclusion

A financing round can trigger a variety of compensation-related discussions around both cash and equity compensation. Engaging with your investors and advisors early in the process will help your organization adjust its compensation philosophy to attract and retain top talent, and to move the company forward into the next stage of its development.

About the Author

Rob is a managing director with Pearl Meyer with over 12 years of experience in executive compensation and finance. He serves as a trusted advisor to boards and senior management at public and private firms across North America. He specializes in working with emerging and high growth companies that are pursuing or have recently completed a transaction, such as an IPO or deSPAC. He often works with clients to help them prepare for an IPO and in the design of equity programs across each stage in their lifecycle, including pre-and-post IPO. Rob works with companies in all industries, but he has in-depth knowledge and expertise in designing compensations strategies for organizations in technology, fintech, green tech, and life science/biotech.

About Pearl Meyer

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