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Planning for RSUs: Key Program Design Decisions



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Here we build on our previous article on the tax considerations when transitioning from stock options to RSUs.

In the life sciences sector, stock options have long been synonymous with precommercial public companies. A continuation of pre-IPO practice, they were viewed as sufficiently reflecting the risk profile of the industry. Stock options are highly leveraged, offering meaningful upside opportunity that has produced significant rewards for management teams and broader employee workforces upon successful exits.

By the late 2010s, however, a new trend emerged: a quickly growing number of precommercial companies were incorporating restricted stock units (RSUs) into the mix. That trend accelerated through COVID and the peak of competition for talent in the market while capital flowed rapidly into the sector.

There were three drivers of this trend:

1. Talent attraction. Growth-stage companies were competing for talent coming out of big biotech and big pharma, where a pivot to RSUs had already taken place. RSUs were understood and valued, and candidates were asking for them.
2. Retention. As valuations initially increased, there was recognition that the upside opportunity of options was decreasing; RSUs were a way to provide downside protection. Many executives were already sitting on equity holdings that had very high intrinsic values. Then when valuations turned, the “guaranteed” value of RSUs ensured that equity grants were providing some degree of retention value.
3. Dilution. RSUs are less dilutive at grant than stock options in the way they are allocated, so they reduce share burn rates and are less dilutive to overhang. A single RSU is always more valuable than a single stock option since the stock option must be purchased at the exercise price. The stock option only provides value when the stock price has risen whereas the RSU always has some value. Therefore, when a company makes a grant to an individual they may, for example, equate 3 stock options to 2 RSUs. This reduces dilution. As companies raced to grow, granting

RSUs was a way to offset the added share spend needed to cover larger employee bases.

Today, public biotech companies of all stages, sizes, and valuations use RSUs routinely. This doesn't mean they are right for everyone, but for companies that are implementing or using them already, there are key program design decisions to consider.

Award Sizing

As described above, a single RSU is more valuable than a single stock option. One of the first decision points is the appropriate conversion ratio to reflect this trade-off. For companies that use grant date fair value to size awards, this decision is covered by the Black-Scholes valuation.

For example, let's assume a company's stock price is $10 and the Black-Scholes percentage is 70 percent. The fair value of a stock option would therefore be $7 (reflecting the stock price x Black-Scholes percentage). Let's also assume that the grant date fair value of the award is $2,100 and the company will either grant the award entirely in stock options or entirely in RSUs.

- Stock options calculation: $2,100 / $7 = 300 stock options.
- RSU calculation: $2,100 / $10 = 210 RSUs.

The stock option award provides a greater number of units, but the holder of the stock option will have to pay the exercise price in order to acquire the shares if they elect to do so at some point in the future.

More commonly among precommercial companies we see awards denominated on a percent of company basis with the calculation producing a number of options. Companies then determine a conversion factor to use to denominate a single RSU as an "option equivalent." The two factors we see most frequently in the marketplace are 1.5x (i.e., 3 stock options = 2 RSUs) and 2.0x (i.e., 2 stock options = 1 RSU).

Mathematically, a 1.5x conversion factor is equivalent to a 66.67 percent Black-Scholes percentage while a 2.0x conversion factor is equivalent to 50 percent. The former is far closer to a cost-neutral approach, given Black-Scholes percentages in the sector. Very high market volatility produces Black-Scholes percentages that are nearly always above 60 percent and can routinely be 75 percent or more. But a 1.5x conversion factor is not as strong of a share preservation mechanism as 2.0x. Furthermore, a grant of 3 stock options only produces an economically better outcome for the holder than a grant of 2 RSUs once the stock has tripled. The RSU produces a better outcome until that point as well as in any negative stock price movement scenario.

The 2.0x approach saves more shares and produces a better outcome for stock options once the stock price has doubled. There is no one correct approach. Companies ought to

evaluate this decision from every angle. Questions to ask include:

- What is the message a company wants to send internally and externally by choosing one conversion factor vs. another?
- How strong of a share preservation tool do RSUs need to be?
- How important is it to equate the instruments from a value perspective?

Grant Dates and Vesting Dates

Because RSUs do not have a strike price, companies typically have more flexibility with RSU grant dates. The value of the award will correlate to the stock price whether the stock price immediately rises or sinks. This limits concerns and the risks of granting equity while in possession of any material nonpublic information (MNPI). Confirming this is that the latest SEC disclosure requirements concern only the granting of stock options in relation to the release of MNPI. Of course, companies granting RSUs in combination with stock options cannot avoid these risks.

Whereas stock options are taxable upon exercise but not when they vest, RSUs are taxable as compensation income upon vesting. This creates an added layer of administration. While many companies will vest options monthly or quarterly (sometimes after a one-year cliff), most choose to limit the number of RSU vesting events due to the taxation and extra administration. In fact, annual vesting is most common in the marketplace for RSU awards (e.g., 25 percent per year over 4 years).

In order to preserve company cash on balance sheets, most companies will require RSU holders to automatically sell shares as they vest to generate the cash to cover the tax withholding obligation. As long as the daily trading volume is sufficient, companies will choose to streamline to a single monthly or even quarterly RSU vesting date. This calendarizes and reduces the number of times the extra administrative lift is needed.

Where daily trading volume is not predictably sufficient and the sales needed to cover the tax withholding obligation could put undue pressure on the stock price, companies must be more planful. This can mean staggering future RSU vesting dates so that awards from different years may vest during different weeks in subsequent years. Note that these sell-to-cover transactions do trigger Form 4 filings for Section 16 Officers, so this staggered approach to vesting results in more frequent Form 4 filings.

Communication

Clear, proactive communication is critical when introducing RSUs or changing an existing equity mix. For many employees, RSUs will be a new vehicle, and initial reactions may focus on the number of units granted rather than the underlying value or risk profile. Because RSU awards are typically delivered in smaller unit counts than stock options, employees may perceive the change as a reduction in compensation unless the rationale is clearly explained.

Effective communication should focus on three core messages:

1. Value certainty vs. leverage: RSUs provide value across a much wider range of stock price outcomes, including flat or declining scenarios, while stock options only deliver value if the share price exceeds the exercise price.
2. Retention intent: RSUs are designed to preserve meaningful retention value over time, particularly in periods of valuation volatility.
3. Taxation and liquidity: Employees should understand when RSUs are taxed, how withholding will be handled, and whether shares will be automatically sold to cover tax obligations.

Successful implementations typically pair written materials with live education sessions that explain how RSUs work, how they compare to stock options, and how the company sizes individual awards. Equipping managers with clear talking points is equally important, as they are often the first point of contact for employee questions. When managers can confidently explain why employees may receive fewer units but more dependable value, concerns are reduced and alignment improves.

Thoughtful communication not only minimizes confusion but reinforces the company's broader compensation philosophy and long-term commitment to equitable, performance-aligned rewards.

Next Steps

Introducing RSUs or refining an existing RSU program are important decisions. Each design choice sends a signal about how a company balances upside opportunity, retention, dilution management, and shareholder alignment. Conversion ratios, vesting structures, administrative mechanics, and communication strategies should be evaluated holistically and in the context of the company's stage, culture, and talent priorities.

Companies considering RSUs should work through these decisions deliberately rather than simply defaulting to market convention. Likewise, organizations with RSUs already in place should regularly reassess whether their program continues to serve its intended purpose as business conditions evolve. We encourage compensation committees and management teams to revisit their equity strategy annually. Equity vehicles are tools, not permanent fixtures, and the most effective programs are those that evolve alongside the organization.

About the Author

Matt advises life sciences and technology companies on executive compensation, specializing in benchmarking, incentive design, pay-for-performance alignment, security arrangements, and CD&A disclosure.

About Pearl Meyer

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