Compensation matters: a practical guide for reviewing compensation in a venture-backed board

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Introduction

Most companies conduct an annual compensation review near the start of their fiscal year to update their compensation schemes and ensure they remain competitive. For venture-backed startups, significant changes to the compensation plan require approval by a Board Compensation Committee—in practice, this means a busy November-to-February period for both you and your Committee members.

At Scale, we've found that laying out the proposed changes in a clear, concise way goes a long way towards helping the Committee understand and approve compensation recommendations. To that end, we've tried to create a simple, approachable document to help you effectively make and communicate cash-, bonus-, and equity-related decisions to your Committee, both at year end (for the whole company) and throughout the year (as you grow the team).

COMP COMPONENTS & REQUIRED APPROVALS

The three core components of compensation are cash compensation, variable compensation (bonus and commission plans), and equity compensation. (We are excluding benefits like healthcare and 401(k) plans.) Typically, as part of the annual compensation review, your Committee will want to understand each component a) on a name-by-name basis for members of your ELT (executive leadership team) and b) in an aggregated format for the rest of your employee base.

COMP COMPONENT	ELEMENTS FOR COMMITTEE APPROVAL
1 **Cash** compensation	• Overall benchmarking methodology • Details of proposed changes for ELT members • Summary of recommended changes for non-ELT employees
2 **Bonus** plan	• Details of bonus plan for ELT members, including performance metrics and payout rates • Summary of bonus plan for non-ELT employees • Summary of company sales commission plan
3 **Equity** budget	• Forecast for future dilution from new-hire, refresh, and other equity grants • Breakdown of all grants to be made in the next period Note: Typically, all equity grants require Committee approval

This rest of this document features templates, advice, and best practices, honed over 20 years of doing this work with our portfolio, for designing and presenting each of the components above. The goal is to help you lay out your data and recommendations as clearly as possible to secure your Committee's approval.

Should you have any questions, please do not hesitate to email them to our dedicated compensation inbox (**comp@scalevp.com**).

Cash Compensation Review

OVERVIEW

When it comes to cash compensation reviews, your Committee will want to understand three things:

1. How you benchmark cash compensation
2. Your proposed changes to cash compensation for ELT members *on a name-by-name basis*
3. Your proposed changes to cash compensation for non-ELT employees *on an aggregate basis*

1. BENCHMARKING

The process for benchmarking your cash compensation packages against the market, and presenting those benchmarks to the Committee, is relatively straightforward.

Earlier-stage companies tend to do their benchmarking using third-party data sources like **Pave**, **Carta**, **CompUp**, or **Payscale**, while later-stage companies might also engage compensation consultants (e.g., **Compensia**). While these are all valuable tools, you should be sure to contextualize their data with your own hiring experience. Your own offer acceptance rate and regretted attrition rate are helpful data points for sanity-checking compensation changes.

Irrespective of the sources you use, if you are proposing substantial changes to your cash compensation, the Committee will want to understand what the benchmark data says.

*Note: Third-party data sources typically benchmark cash on a total target compensation ("TTC") basis (i.e., base plus bonus or other variable compensation). In that instance, you will have to allocate proposed changes in overall TTC between base and bonus—for a more detailed discussion of the latter, please see the **Bonus Plan** section below).*

2. PROPOSED CHANGES FOR ELT

Committees usually want to review and approve all changes to ELT compensation (base, bonus, and equity) on a name-by-name basis. The easiest way to facilitate that process is by assembling all of the relevant data, including bonus and equity data, in a single place: an ELT summary dashboard. This sounds very basic, but it is important. It is surprising how often Committees are asked to make ad hoc changes to one ELT member's compensation without seeing the whole picture and then, one quarter later, end up receiving a series of add-on requests for other team members (all of which were perfectly foreseeable had the Committee been presented with all the relevant information the first time.)

Below, you'll find an example of a simple dashboard. We have also provided a templated version in the accompanying ELT Summary Dashboard spreadsheet.

PERSONAL INFO		CURRENT CASH COMP ($K)			EQUITY GRANTS TO DATE			PROPOSED CHANGES TO CASH COMP ($K)		PROPOSED EQUITY GRANTS		TOTAL GRANTS	
Title	Hire date	Base salary	Target bonus	Total cash comp	Equity granted (K)	% owner-ship	% equity vested	Salary changes	Bonus changes	Equity grants (K)	% owner-ship	Total grants	% total owner-ship
CEO	8/24/13	$350	$140	$490	24,000	7.50%	71%	$0	$75	750	0.23%	24,750	7.73%
CFO	10/10/24	$300	$90	$390	3,250	1.02%	5%	$25	$0	0	0.00%	3,250	1.02%
CRO	7/3/24	$300	$90	$390	3,250	1.02%	6%	$0	$50	0	0.00%	3,250	1.02%
CMO	3/14/22	$250	$75	$325	1,500	0.47%	67%	$30	$50	250	0.08%	1,750	0.55%
Total		**$1,200**	**$395**	**$1,595**	**32,000**	**10.01%**		**$55**	**$175**	**1,000**	**0.31%**	**33,000**	**10.32%**

To create your own dashboard, start by gathering the relevant data on each ELT member's current compensation. (In the accompanying ELT Summary Dashboard spreadsheet, you can fill out this information in **COLUMNS B, C, D, E, G, I, AND K.** Note: please unhide any hidden columns for this process.)

Then, after reviewing the relevant market data, propose changes to salary compensation. (In the spreadsheet, these changes reside in **COLUMN L**). To provide context for these changes, you can add adjacent columns with benchmark data for each leadership role.

Finally, after designing your **bonus plan**, **equity budget,** and **equity refresh program**, you can propose changes to each ELT member's equity compensation (**COLUMNS M AND N** in the spreadsheet.)

When the data is laid out clearly in this fashion, it helps the Committee understand what your company is providing today, what the market suggests is reasonable, and what the recommended changes are.

3. PROPOSED CHANGES FOR NON-ELT

For non-ELT employees, the company usually just proposes an overall target percentage increase in salaries. Note that recommending an overall salary increase of 3% does not imply that every single employee will receive an extra 3%; managers are still expected to exercise judgement on a name-by-name level. Additionally, companies sometimes propose allocating a certain amount of cash to a separate pool for special adjustments and promotions throughout the year.

For larger companies, or for companies struggling to hire for certain positions, the Committee might go one level deeper and look at salary changes by functional role. For example, in the past, we have seen companies recommend significantly larger

raises for engineering roles than for other roles, given the competitiveness of hiring excellent engineers.

We would not expect the Committee to review cash compensation changes for non-ELT employees on a name-by-name basis.

Bonus Plan

IMPORTANCE

Most revenue-generating software companies operate a bonus plan for the ELT, and often for non-ELT employees as well. At Scale, we like to see revenue-generating companies adopt bonus plans. Bonus plans are useful for driving conversations about company goals and how to align employees to those goals. We also believe that bonus plans, like all compensation schemes, are best understood as an *incentive* not a *reward*. Bonus plans should be clearly understood and communicated in advance; otherwise, they are a complete waste of money.

OVERVIEW

To design a bonus plan, you have to answer the following five questions:

1. Who is eligible?
2. How much is the target bonus?
3. What are the plan metrics?
4. How is the payout calculated? (i.e., "how much for how much?")
5. How often do we pay? (i.e., quarterly or annually?)

Your Committee will want to understand your response to each.

1. ELIGIBILITY

Bonus plan eligibility can be restricted to just the ELT (or a portion thereof) or open to the wider company. In instances where the CRO or VP of Sales operates on a separate variable commission plan, you also must decide whether their compensation should include elements of the general bonus plan.

2. TARGET BONUS

The mental model for setting target bonuses, at any employee level, is usually as a percentage of base salary. For ELT members, individual target bonuses should be included in the ELT summary dashboard (discussed in the **Cash Compensation Review section**).

A review of 2022 VCECs (tech-company-specific) data found the following target bonuses at each percentile (all expressed as a percentage of base salary). For non-ELT employees, the target bonus is usually set at 10 to 20% of base salary.

ROLE	25TH PERCENTILE	50TH PERCENTILE	75TH PERCENTILE
CEO	28%	40%	51%
C-Suite	20%	30%	40%
VP	15%	20%	25%

Note: The C-Suite / VP-level data reflects non-sales, incentive-eligible roles and non-founder roles at Series A and above companies.

When you present your target bonus percentages to the Committee, please remember to also calculate the total sum of *bonus dollars payable* (assuming 100% target-bonus achievement across all plan participants). It is easy to lose track of this figure, but the dollars can mount up quickly—especially if non-ELT employees are included in the plan.

3. PLAN METRICS

You'll need to identify the performance metrics or KPIs that will determine the bonus payout criteria. We think of metrics in three categories—growth metrics, efficiency metrics, and non-financial KPIs:

- **Growth:** Startups, to quote Paul Graham, are companies designed to grow quickly. That is their number one purpose. As a result, any bonus plan should include one or more proxies for growth (e.g., revenue, revenue growth rate, ARR, gross new ARR). This is usually the most significant determinant of the bonus payout.
- **Efficiency:** Efficient growth also matters, so we recommend including a cost or burn metric to put some check on spending. Whether you choose to implement this metric as a payout modifier (see the example in the payout process section below) or as a pass/fail binary, in which case no bonus is paid if a certain cost or burn threshold is exceeded, is up to you.

  Note: Typically, profitability metrics are inclusive of bonus payouts. This means that the total bonus payout to be made is factored into the calculation of the company's in-period profitability.

- **Other KPIs:** Some bonus plans include non-financial metrics, which can either be quantitative (churn rate, employee attrition rate) or more qualitative (product launches or other MBO targets). They key is to avoid vague or ill-defined targets—again, the goal is to have bonuses that function as incentives rather than rewards.

Most often, the same bonus plan applies to all ELT members. However, sometimes, companies include non-financial KPIs specific to individual executives. The upside of individual, non-financial KPIs is that they allow you to reward, say, a strong VP of Engineering even if Sales misses its target; the downside is that they can be nebulous and hard to track. Ultimately, the decision to include or exclude an individual KPI rests on your "compensation philosophy"; Committee members will usually defer to you on this question, provided you have a logic behind your choice.

Our recommendations

- **Align with company objectives:** Whatever metrics you choose, the most important thing is that they align with your company's Board-approved goals. Start your conversation with the Committee by clearly articulating the overall company objectives for the year.
- **Align with existing metrics:** Bonus plan metrics should align with metrics your organization already tracks. Try to avoid creating new metrics that will only be tracked for the purpose of calculating bonus payouts.
- **Stick to 1–3 metrics:** Select no more than 3 metrics total. The efficacy of the bonus plan is directly tied to the ability of the participants to understand the plan and optimize their payout against it.
- **Weight metrics by importance:** Since you will likely have more than one metric in the plan, you need to determine the relative importance of each metric to the overall plan payout. The weight attached to a given metric should reflect the relative importance of that metric to the success of the business and the employee's performance. Your Committee will review these weights.

4. PAYOUT CALCULATION ("HOW MUCH FOR HOW MUCH")

The first principle of payout calculation is simple: **100% performance should always result in a 100% payout of the target bonus.** Sometimes, we see companies with very aggressive, aspirational growth plans proposing to pay out full bonuses at below-plan targets. In other instances, we see companies with conservative growth plans—often adopted for the purpose of containing spend—decide to pay out full bonuses only for above-plan achievement. We are not fans of either approach; boards should adopt the plans they want to pay for.

Beyond this principle, once you start thinking about over- or under-performance, payout calculations quickly become complex. As a result, we often see recommendations that appear sensible on their faces but, upon further examination, turn out to be nonsensical.

To guard against this, it helps to lay out, side by side, the performance criteria (KPIs) and the dollar amounts payable for each of the following points in the plan: the minimum non-zero payout (i.e., the point at which the first dollar becomes payable), the "base case" payout (the payout at 100% performance), and the maximum payout. We generally like to see this in some version of the table below (also reproduced in the accompanying Bonus Plan spreadsheet).

METRIC	CALC. WEIGHT	LAST YEAR	LOW CASE				BASE CASE				HIGH CASE			
		Value ($K)	Value ($K)	% of plan	Payout rate	Payout ($K)	Value ($K)	% of plan	Payout rate	Payout ($K)	Value ($K)	% of plan	Payout rate	Payout ($K)
ARR	60%	36,000	42,525	75%	50%	30	56,700	100%	100%	60	65,205	125%	150%	90
Operating Income	40%	(38,000)	(30,500)	75%	60%	24	(24,400)	100%	100%	40	(20,740)	125%	140%	56
					Total	**54**			**Total**	**100**			**Total**	**146**

Note: This table assumes the target bonus is $100K. The payout rates for metric-level performance below the "low case" thresholds are 0%, and there is no increase in payout for performance above the "high case".

The table should show the payout rates and dollar payouts for a) the metric-achievement thresholds below which bonuses aren't paid, b) the thresholds at which bonuses are paid out at 100%, and c) the thresholds at which bonuses are maximized. Note that, in the table above, the "Payout ($K)" columns assume a target bonus of $100K. As a result, the dollar payout for, say, low-case ARR performance would be $30K ($100K * 60% * 50%).

Note the difference between the metric-achievement percentages and the payout rates at those levels of achievement. These are often conflated and made identical, but they do not have to be. A plan could pay out nothing for performance below 75% of the ARR target but start paying out at a 50% rate once 75% performance is achieved. Put simply, you do not need to pair a 75% payout rate with 75% achievement.

Our recommendations

- **Use common sense:** We can't emphasize this enough. Before finalizing the threshold amounts and the payout rates, ask yourself: "how good would we feel paying out at this rate for this performance?" For example, looking at the table above, would paying out at a 50% rate for 75% ARR-target attainment feel fair to both sides? If the metric in question were gross new ARR (or net new ARR), 75% performance might still be a good result. Meanwhile, 75% performance on total ARR could actually be a decline from the prior year's ARR.

  That's why we believe it is helpful for the payout calculation to show last year's results alongside this year's thresholds: it helps you and your Committee contextualize the thresholds and exercise common sense about the payout rates.

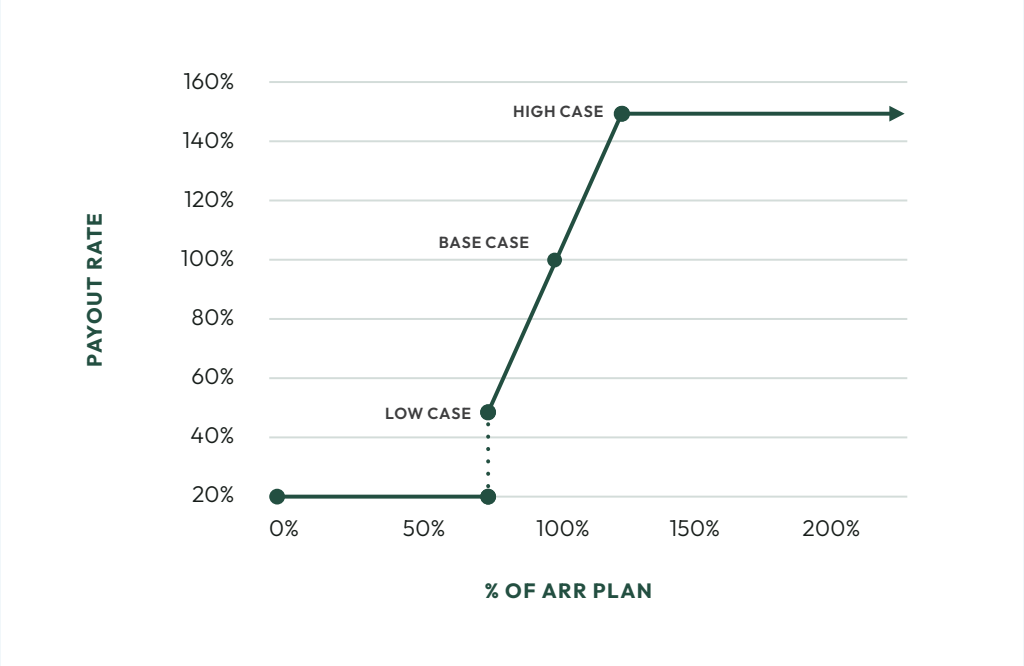
- **Beware of negative numbers:** If you are using operating income or free cash flow as a metric in your bonus plan, note that the target is often a negative number; this can lead to unintended mathematical consequences over time. For example, assume you define full plan attainment as ending a period with an operating income that is within 15% of the planned operating income. In that case, as your operating income nears zero over

several years, your +/- 15% margin will decrease in size (whether or not that is what you intended).

Note: Sometimes, to avoid this, companies will use a pass/fail cost or burn metric—in this case, if the company exceeds a certain expenditure or burn, no bonus is paid out.

- **Embrace linearity:** While some companies design complicated payout curves with various slopes and discontinuities, we believe the easiest curves are those that follow linear paths between thresholds. This is why the accompanying Bonus Plan spreadsheet enforces two types of symmetry: 1) symmetry in the distance the low and high thresholds each lie from the base threshold, and 2) symmetry in difference between the low and high cases' payout rates and the base case payout rate.

  The result of these symmetries is a payout curve like the one graphed below, which uses the information in the ARR row of the above table. As you can see, the curve follows straight lines between the low, base, and high thresholds. We have seen other methods work (e.g., a "percentage squared" metric to accentuate the accelerators), but, in general, simple linearity is preferred.



- **Sanity-check your payouts:** To test the "reasonableness" of your payout curve, use the attached Bonus Plan spreadsheet to sanity-check payouts for different levels of performance. Start by entering your performance metrics, calculation weights, achievement thresholds, and payout rates in the blue cells (COLUMNS B THROUGH D AND F THROUGH H) of the top table ("Determinative performance metrics & payout rates").

After you have done that, enter a target bonus for an example employee in CELL C23. Now, you can use the "Bonus simulator" table to test how different levels of company and individual performance (entered in CELLS D18 THROUGH D20) would impact that employee's bonus.

- **Decide on your cap philosophy:** Some companies cap the high-case payout rate to avoid excessive bonus payouts. Others believe uncapped upside is a useful incentive and want to leave it in place. If you are doing the latter, sanity-check your choice by simulating payouts at high levels of performance.

5. FREQUENCY OF PAYOUT

Bonus plans that pay out annually are a lot easier to manage than those that pay out quarterly, especially for early-stage companies; as a result, most startups start with annual bonuses. Some Committees loathe quarterly bonuses, but at Scale, we are supportive of quarterly payments provided the plan is well designed. In our minds, bonus plans are useful for facilitating conversations about performance, and having those conversations more often is a good thing.

If you decide to do quarterly payouts, you will have to answer two questions:

1. Do you evaluate performance in each quarter separately, or do you look at each quarter on a YTD basis?
2. Do you pay for over-attainment on a quarterly basis, or only at the end of the year?

We think the best approach is to treat each quarter separately and postpone accelerated payouts until the end of the year, effectively treating the fourth quarter as a "true up" quarter. Under this scheme, for the first three quarters in a year, the maximum payout rate an employee can achieve is 100%. Other approaches are also fine.

Please see a condensed list of pros and cons of quarterly and annual plans below:

CADENCE	ADVANTAGES	DISADVANTAGES
Quarterly	• Motivates more frequent performance conversations • Timing of rewards closely follows their corresponding performance events • If need be, allows for plan changes throughout the year	• More difficult to administer, especially if you make changes to the plan throughout the year • Bonus amounts can seem "small" relative to a participant's effort/impact
Annually	• Much easier to administer	• Timing of rewards doesn't closely follow their corresponding performance events

CONCLUSION

The content above might appear very detailed for what can be, at the ELT level, a relatively small portion of compensation relative to equity. However, we believe that time spent getting your bonus plan right is worth it. Crafting a bonus plan that does not correctly incentivize winning is not only unproductive, but wasteful.

POSTSCRIPT: SALES TEAM COMMISSION PLANS

An effective sales commission plan is crucial for a high-functioning GTM outfit. These plans are also generally significant in terms of the absolute dollars at stake. Consequently, Committees should apply at least the same level scrutiny to sales commission plans that they apply to general bonus plans. Oddly enough, though, we have observed that sales commission plans are often only subject to a cursory Committee review.

We plan on drafting and circulating an entire chapter on sales commission plan reviews in the next version of this document. In the meantime, as you use this document to create your general bonus plan, consider including company-wide elements of the general bonus plan in your senior sales leaders' bonus plans to drive better alignment between sales and the rest of the company. This is especially valuable when efficiency metrics are a part of the general plan but not senior sales leaders' plans—such a disconnect can motivate conflicting behaviors.

Note: Sales commission plans are often the most complex compensation schemes at any given company. If you would like more guidance on sales incentive plans, please email ***comp@scalevp.com*** *to be notified when we publish our chapter on sales compensation.*

Equity Budget

IMPORTANCE

The single most important compensation decision a startup makes is **how to allocate its equity.** If the company winds up being successful, the future value of its equity grants will completely dwarf anything offered to employees in the way of salary or bonus along the way.

For this reason, your Committee should spend a lot of time understanding how you plan to allocate your equity. The best way to systematically communicate your plan is via some form of annual equity budget. For smaller companies, the process of making one of these budgets is relatively straightforward. For larger companies, there is a lot more involved. This rest of this section (alongside the accompanying annexes) lays out all of the details.

EARLY-STAGE EQUITY TRACKER

For startups with less than ~$5M in revenue or fewer than ~50–100 employees, presenting the Committee with a simple rolling equity tracker is often sufficient. Below, you'll find an example of how this tracker is typically formatted (you can also find a templated version in the accompanying Simple Equity Tracker spreadsheet). At this stage, companies tend not to think about this activity in the context of annual budget reviews—to them, what's most important is tracking the option pool available until the next round.

TO DATE		
LINE ITEM	NUMBER OF SHARES	% OF OUTSTANDING SHARES
Initial pool shares	1,000,000	10.0%
Pool shares issued (net)	550,000	5.5%
Proposed issuance (this meeting)	100,000	1.0%
Remaining pool shares	350,000	3.5%
Total outstanding shares	10,000,000	
Price per preferred share	$3.10	
Price per common share (409a)	$0.40	

As shown above, the tracker displays the available option pool, the pool shares that have been issued to date, and the proposed issuance for Committee approval. To contextualize this pool appropriately, the tracker also includes the current 409a valuation, the last

preferred-round price, and the total shares outstanding (every Committee wants to see this supplementary information).

As you propose new issuance, you should be benchmarking your assumptions for the average grant per new hire, particularly for your first 10–20 employees, on well-established sources like **Carta**. Luckily, at this early stage, you typically have the advantage of simplicity. For starters, typically, all of your grants are options rather than RSUs. Furthermore, your benchmarking tends to be done on an ownership rather than dollar-value basis since the dollar value of shares at an early-stage company is entirely notional. (For a deeper discussion of this topic, see **Annex A**.)

LATER-STAGE EQUITY BUDGET

The equity budgeting process gets a lot more complex as companies grow in size. At this stage, you and your Committee should be thinking about your equity budget as a tool for intelligently managing annual gross and net equity burn rather than as a tool for simply navigating to the next financing.

The table below, which is also available in templated form in the Later-Stage Equity Budget spreadsheet, displays part of a typical budget at a later-stage private company. Depending on where you are in your journey as a company, you may not need to capture and exhibit all of this data today. Think of the path between the simple equity tracker above and the later-stage equity budget below as a continuum and identify the appropriate place for your company on it.

CATEGORY	LINE ITEM	FY23	FY24	FY25 BUDGET
New-hire grants	ELT grants	800,000	600,000	1,000,000
	Non-ELT grants	1,000,000	800,000	400,000
Refresh & other grants	ELT grants	1,000,000	750,000	600,000
	Non-ELT grants	660,000	550,000	500,000
	Other grants (board, consultants)	150,000	200,000	170,000
Gross grants & returns	**Gross grants**	**3,610,000**	**3,000,000**	**2,670,000**
	Total returns / forfeitures	600,000	200,000	200,000
Net grants	**Net grants**	**3,010,000**	**2,800,000**	**2,470,000**
KPIs	**Gross burn rate**	**4.2%**	**3.3%**	**3.0%**
	Net burn rate	**3.5%**	**3.1%**	**2.7%**
	Avg. grant per new hire (non-ELT)	**18,500**	**9,800**	**5,100**
	Total cost of refresh (ELT & non-ELT)	**2.1%**	**1.7%**	**1.4%**
Pool shares	Starting pool balance	1,000,000	7,990,000	5,190,000
	Pool shares issued (net)	3,010,000	2,800,000	2,470,000
	Pool shares created	10,000,000	0	1,000,000
	Closing pool balance	7,990,000	5,190,000	3,720,000

Regardless of how you structure your later-stage budget, to add context to your proposals, we recommend listing two years of historical data (columns “FY23” and “FY24” in the table above) alongside your budget for the upcoming year (the “FY25 budget” column in the table above). That way, you can track trends in equity issuance over time. As you move throughout the year, you can then add additional columns to the budget so that the Committee can track new grant proposals, the grants made YTD, and the remaining balance left in the budget.

Below, we describe each of the rows and columns of the above table in depth. To start, we’ll cover the five categories of equity grants (rows 6 through 13 of the Later-Stage Equity Budget spreadsheet): ELT new-hire grants, non-ELT new-hire grants, ELT refresh grants, non-ELT refresh grants, and other grants. Each of these categories needs to be understood differently, and listing them this way helps the Committee do that.

- **Grants for new ELT hires**

  ROW 6, COLUMNS D–F of the Later-Stage Equity Budget spreadsheet

  Since ELT offers are presented to and approved by the Committee before they are made, expected future grants for new ELT hires are typically already known to both you and the Committee. Of course, at the time they are being made, offers should be benchmarked against the market using a third-party data provider like **Pave** or **Carta**, a compensation consultancy like **Compensia**, or some other source. This category is usually large but uncontentious—the Committee has no wiggle room. If you want a new CFO, you have to pay for a new CFO!

- **Grants for new non-ELT hires**

  ROW 7, COLUMNS D–F

  For non-ELT hires, new grants are budgeted as a function of a) expected new hires (not just net headcount additions but also backfills) and b) the expected shares granted per new hire (tracked in the table above and in row 19 of the spreadsheet).

  A company of sufficient size and sophistication to complete a later-stage equity budget should already have defined target new-hire grant sizes (or ranges) for each division or level in the organization. Naturally, these should be designed using the same benchmarking process described in the cash compensation section above and should be reviewed annually by the Committee. Typically, as long as this figure is going down steadily over time, the company is making progress (see the KPI below on shares per new hire).

  *Note: As part of the process of defining those target grant sizes, the company will have decided whether to continue granting options or to start granting RSUs. Additionally, if the company is large enough to complete a later-stage budget, it will likely also have moved from sizing grants based on ownership to sizing grants based on the dollar value of the equity. These subjects are covered in more depth in **Annex A**.*

  If all the above work is laid out clearly, understanding the grants for new non-ELT hires is simply a matter of "math". That is, if company plans call for some number of new hires and if the target new-hire grants are well-defined and agreed upon, then the resulting figure is what it is.

- **Refresh grants for existing ELT employees**

  ROW 9, COLUMNS D–F

  To budget future refresh grants, start by defining the overall refresh program methodology (covered in detail in **Annex B**). The decisions made here have the biggest impact on burn over time; consequently, they are often the biggest topic of Committee discussion.

  Once the program has been designed, the resultant ELT refresh grants are just a function of the methodology and whatever performance adjustments are made. The Committee will want to review these grants on a name-by-name basis, so please ensure the ELT summary dashboard (discussed in the **Cash Compensation Review section**) displays any proposed refresh grants.

- **Refresh grants for existing non-ELT employee**

  ROW 10, COLUMNS D–F

  Once you have the methodology defined, this is just a lot of math.

- **Other grants**

  ROW 11, COLUMNS D–F

  This is a catchall for advisor grants, board grants, and other non-standard grants. It should not be a significant portion of your equity burn.

Once you have budgeted each of those five categories of equity grant for the upcoming year, you can proceed to fill out the other rows of the table as described below.

- **Total returns & forfeitures**

  ROW 14, COLUMNS D-F

  Summing the five equity-grant rows described above yields the total budgeted gross issuance. To estimate net issuance, you also have to also estimate future forfeitures as employees leave and return equity to the pool. We recommend looking at your historical data to make a simple assumption about the percentage of total grants that are returned or forfeited each year.

- **KPIs: gross and net burn rates, grants per hire, and refresh program cost**

  ROWS 17 THROUGH 20, COLUMNS D–F

  For later-stage companies, the key KPIs to focus on are the gross and net burn rates. It's easy to get lost in the specifics of an equity program and spend lots of time debating the minutiae of a new-hire or refresh plan, but what really matters to the Committee is that the overall budgeted burn is reasonable and trending down.

  What is "reasonable" is in large part defined by the growth rate (higher-growth companies can justify a higher burn since they are hiring more people) and equity vehicle (see the note below), but typically a burn rate of 3% to 5% *that is trending down* is acceptable if all grants are options.

  Note: The decision to use RSUs instead of options should reduce the burn rate significantly. If the Company is targeting a specific dollar value with its grants, achieving that target will require fewer RSUs than options; thus, using RSUs in place of options results in lower gross and net burn rates, even though the economic cost is identical.

  Sometimes, companies switching to RSUs will fail to reduce their grant sizes enough to compensate for the change. The consequence is that, though burn appears to have fallen, it has actually risen in real, economic terms. As a result, there is now a trend in public companies to measure stock-based compensation costs in dollars rather than dilution. That is overkill for private companies, but it highlights the issue at play.

  Two other KPIs to pay attention to are the cost per new hire and the total cost (gross burn) of the refresh program. The cost per new hire, in terms of the number of shares, should trend down over time as the equity becomes more valuable.

- **Pool issuance and depletion**

  ROWS 22-25, COLUMNS D–F

  The Committee will want to understand how the budgeted burn impacts the size of the remaining equity pool.

In the table above, we deliberately separate the pool rows from the prior rows because we want to dispel the notion that you should calibrate your budget based on "what is left in the pool". Don't fall into the trap of thinking about the pool as what you can or should budget in the upcoming year—instead, focus on what burn targets are reasonable given the inputs described above and add to the pool (or not) as required.

At this point, after filling out the rows and columns described above, you will have a complete annual equity budget for the Committee's review and approval.

Moving forward, you will be expected to provide updates to your Committee (and ask for their approval to issue new grants) at each board meeting throughout the year. As a result, we recommend adding three columns to this budget: one to keep track of your YTD grants, one to list your proposed grants for the present meeting (i.e., the grants the Committee is being asked to approve at that meeting), and one to display the remaining balance post-issuance. Please see the table below for a complete budget with the three added columns on the right.

CATEGORY	LINE ITEM	FY23	FY24	FY25 BUDGET	FY25 TO DATE	PROPOSED GRANTS TODAY	FY25 BUDGET REMAINING
New-hire grants	ELT grants	800,000	600,000	1,000,000	350,000	150,000	500,000
	Non-ELT grants	1,000,000	900,000	400,000	250,000	100,000	50,000
Refresh & other grants	ELT grants	1,000,000	750,000	600,000	400,000	100,000	100,000
	Non-ELT grants	660,000	550,000	500,000	300,000	100,000	100,000
	Other grants (board, consultants)	150,000	200,000	170,000	50,000	0	120,000
Gross grants & returns	**Gross grants**	**3,610,000**	**3,000,000**	**2,670,000**	**1,350,000**	**450,000**	**870,000**
	Total returns / forfeitures	600,000	200,000	200,000	150,000		50,000
Net grants	**Net grants**	**3,010,000**	**2,800,000**	**2,470,000**	**1,200,000**	**450,000**	**820,000**
KPIs	**Gross burn rate**	**4.2%**	**3.3%**	**3.0%**	**1.5%**	**0.5%**	**0.9%**
	Net burn rate	**3.5%**	**3.1%**	**2.7%**	**1.3%**	**0.5%**	**0.9%**
	Avg. grant per new hire (non-ELT)	**18,500**	**9,800**	**5,100**	**5,000**	**5,000**	**5,000**
	Total cost of refresh (ELT & non-ELT)	**2.1%**	**1.7%**	**1.4%**	**0.8%**	**0.2%**	**0.3%**
Pool shares	Starting pool balance	1,000,000	7,990,000	5,190,000	5,190,000	4,990,000	4,540,000
	Pool shares issued (net)	3,010,000	2,800,000	2,470,000	1,200,000	450,000	820,000
	Pool shares created	10,000,000	0	1,000,000	1,000,000	0	0
	Closing pool balance	7,990,000	5,190,000	3,720,000	4,990,000	4,540,000	3,720,000

This may feel like a lot of work, but remember what we said above: these decisions are very consequential. A company issuing 4% of its equity every year is, hopefully, handing out a minimum value of $40M (assuming a $1B outcome, which, in today's market, is very much at the low end of what an IPO can be). That is enough money make this exercise worthwhile.

This exercise also makes it much easier to secure your Committee's approval on equity proposals. Provided the overall trends are favorable—that is, gross and net burn are declining and within the normal range—your Committee will be much more inclined to go along with any specific grant, even if it feels slightly above-market. In the absence of this kind of context, every proposal becomes a separate discussion. As stated at the beginning, a well-run process with clear data is your friend.

Annex A:
Ownership vs. Dollar Value, Valuing RSUs & Options

OWNERSHIP VERSUS EQUITY DOLLAR VALUE

Early-stage companies have to think in terms of ownership, rather than dollar value, when they make equity grants. Consider a company whose most recent preferred round was done at post-money valuation of $50M. In that case, instead of characterizing an equity grant to a new VP of Engineering as being "worth $1M", they would almost surely characterize it as comprising 2% ownership in the company. The reason for this is simple: the distance between a Series A and a liquidity event is simply too great for there to be any useful discussion around the dollar value of any grants made.

As companies mature and get closer to a public offering, two changes often occur in tandem. First, companies start to think about their equity grants in terms of dollars rather than ownership percentages. Second, companies switch some or all of their grants to RSUs. The two trends are related, as explained below.

For later-stage companies, benchmarking grants in dollar terms makes sense for a variety of reasons. First, it better accords with how the world works. A CEO hired into a mid-stage company might get 5% equity, but a CEO hired into run Microsoft would not get 5% of $3T dollars. This example, while extreme, highlights the fact that ownership targets do not apply across companies of different sizes.

Second, it aligns with how employees and prospective hires think about equity grants, and how they compare different offers (especially when one of those offers comes in the form of public-company RSUs). Startups hate this fact, but we must compete in the market for talent as it is; individual employees, acting rationally, have to understand their upside relative to (likely) less lucrative, less risky alternatives. As a result, benchmarking providers tend to collect and present equity data in dollar terms, especially when they use public company information to calibrate grant sizes at private companies.

The tricky part of doing dollar-based grants at a private company is that you have to estimate the value of the company's equity. More than anyone, VCs should know how hard this is—this is our only job, and we get it wrong all the time. Nonetheless, we have to make the effort.

Typically, the move to dollar values also coincides with the transition to making some or all grants in the form of RSUs. There are many reasons for this, but one of the primary ones is that RSUs are much easier to value in dollar terms (see below).

VALUING RSUS & OPTIONS

Once you begin measuring grants on a dollar basis, you have to develop a consistent methodology for valuing the equity you're granting. This is not a trivial process.

For example, take a company that recently raised a recent Series C preferred round at $10 per share. Assume that the 409a valuation of its common stock is $4 per share and that it's trying to offer a new hire roughly $100K of equity value.

If the company is issuing RSUs, it could take one of two approaches. First, it could determine that each RSU is worth the 409a share value ($4), in which case the new hire would receive an offer of 25K RSUs. Alternatively, it could determine that each RSU is worth the last preferred-round price ($10), in which case the new hire would receive an offer of 10K RSUs.

Even though the 409a value is meant to represent the actual dollar value of a common share (and is thus, theoretically, the correct answer), it's our experience that, for fast-growing, successful companies, the 409 valuation undervalues the common share. Instead, companies often opt instead to use the last preferred-round price when valuing RSUs. This is a company-friendly assumption. In a successful outcome like an IPO, it seems like a reasonable approach; however, in a downside scenario, it can prove to have been overly optimistic. It reflects the investor logic of "we paid this price so we should value the shares as such," but it ignores the value of preference in the downside case.

If valuing an RSU is hard, valuing an option is even harder. In the U.S., options have to be granted with a strike price equal to the 409a price (in this case, $4). Using this strike price, the most recent preferred-round price, and a number of other variables, the "accounting value" of the option can be calculated via the Black-Scholes formula; when all the math is done, it will probably come out to around $2 per share. Again, this would be the correct approach in theory, and would imply that the new hire should receive 50K options.

In practice, however, this approach is far too theoretical and is almost never used as a basis for valuation. Instead, we often see rough math that values options as being equal to the difference between the 409a strike price ($4) and the last preferred-round price ($10). Under this logic, the "notional embedded value" is $6 per share and the new hire should get $100K divided by $6 = 16.6K options.

All of the above becomes even more complicated if the last preferred-round price is stale and the company is no longer realistically worth $10 per share. At that point, it makes sense to increase or decrease the $10 price by some amount and adjust the rest of the math accordingly.

It's worth pointing out that, even for public companies, the valuation of RSUs or options is only correct "on the day of issuance". What an executive ends up getting in terms of value can be very different from the notional value of the grant. In addition, there is, in theory, more upside (and more risk) in private-company grants, which is also hard to account for.

At Scale, we have internalized that there is no single "right" answer when it comes to valuing RSUs and options. What matters most is that the company has a coherent approach (e.g., valuing an RSU at the preferred-round price and an option at the difference between that price and the 409a value) that it can effectively and simply communicate to new and existing employees. Obviously, the company cannot and should

not make promises to employees about the future dollar values of grants made today. Employees are increasingly savvy about real value, and approaches that are overly company-friendly don't pass muster.

CHOOSING BETWEEN RSUS AND OPTIONS

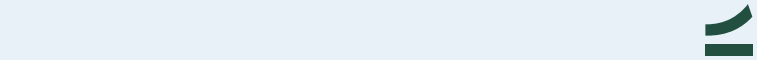
Ease of valuation is not the only reason to switch to RSUs, nor is it necessarily a sufficient one. The table below lists the key advantages and disadvantages of each type of grant.

GRANT TYPE	ADVANTAGES	DISADVANTAGE
Options	• May be tax-advantageous from the company's perspective • Allows employees to optimally time their tax obligation and potentially incur a lower tax rate • Aligns employee incentives with the goal of creating upside value	• More difficult to value than RSUs and harder for employees to understand • More dilutive than RSUs (even if the economics are the same) • Harder for the employee to exercise on departure given potential exercise price and AMT issues (especially if secondary sales are limited). While, in theory, this an advantage for the employer (less dilution), we strongly feel that this erodes employees' belief in the value of the option plan and is not a sustainable approach • Can require the provision of new grants if the company's valuation declines from one round to the next
RSUs	• Theoretically limits simple dilution since you can always offer the value of X options with fewer-than-X RSUs. However, the economic value is the same and often the switch to RSUs does not result in a significant reduction in grant sizes • Possess value regardless of whether a) they are exercised and b) the company's valuation increases or decreases from one round to the next. This provides more downside protection for employees • Dollar value is easier for employees to understand and believe in, which boosts the close rate on new offers	• Can create a substantial payroll tax penalty for the company upon the vesting of the second trigger • Deprives employees of control over the timing and rate of taxation on their grants • Limits retention value versus options if there is no "must-be-present-to-win" factor for employees. This is an advantage from the employee's perspective • Does not motivate upside value creation as strongly as options

We typically see startups use options for as long as possible. However, once their valuations reach the billions, many companies switch to issuing RSUs for the rank and file and a combination of RSUs and options for the ELT. In our experience, the two primary drivers for this switch are:

- Pushback from new employees who do not buy into the previous round's valuation. This is also the time when options become prohibitively expensive for departing employees to exercise. In those instances, options lose their attractiveness to new employees. (People really are smart.)
- A desire by the company to reduce headline dilution rates, even if the economic costs are the same.

We are not sure whether this is a good trade for either side, but this is the world in which we find ourselves.



Annex B: Equity Refresh Program

IMPORTANCE

The goal of equity grants is to attract and retain talent. As employees reach the end of vesting on their four-year new-hire grants, if you want them to stay, you have to offer them refresh grants that roughly correspond to what they could receive if they left for another company. If you do not, assuming your employees are rational actors, they will leave, and you will lose your most experienced employees.

Once you have at least ~10–15 employees requiring refresh grants each year, you almost certainly need a formal refresh program to administer the grants; your Committee will review this program annually as part of the equity budget review. This is probably the topic that attracts the most Committee discussion and scrutiny because a) over time, refresh grants can become expensive and b) there is a wide diversity of possible approaches.

OVERVIEW

The starting point for your equity refresh program should be your new-hire equity program. Philosophically, your refresh program should compensate existing employees at roughly the same rate you would compensate a new hire and, by extension, the same rate your employees would be compensated as new hires elsewhere.

Consequently, before you start the process of designing an equity refresh program, you should already have a) calculated your target grant per new hire at each level in the organization and b) decided if you are granting RSUs or options. **You should also be programmatically reducing the size of new-hire grants at least annually as the value of those grants rises (assuming the company is growing successfully).**

From there you'll make three decisions that can each merit substantial Committee discussion:

1. Who is eligible for refreshes?
2. What vesting approach do we use?
3. What discount do we apply to new-hire grants when sizing our refresh grants?

There is no one right answer to any of these questions, all of which are covered in detail below. The key is to exercise common sense to ensure the overall program, holistically, makes sense.

1. ELIGIBILITY

There are two key eligibility gates.

The first is tenure. As described in step 2 below, it is common for employees to become

eligible for refresh grants only after they have worked for the company for at least two to three years, though this can vary depending on your selected vesting approach (see below). If you are using boxcar grants, you can start grants earlier in an employee's tenure without creating additional costs for the company; if you are using a layered vesting approach, making grants earlier in an employee's tenure leads to more dilution.

Second, the company has to decide how to weigh individual performance in determining eligibility for refresh grants. The choice is whether to concentrate refresh grants on your winners instead of refreshing your entire (sufficiently tenured) team. Companies often default to the "refresh everybody" approach, but we believe that is a mistake. You should use this program, at least in part, as a mechanism to concentrate your retention efforts on your very best people.

2. VESTING APPROACH

Typically, for refresh grants, startups use one of the two vesting approaches described below. At Scale, we don't have a strong preference. Whether you choose one or the other is largely dependent on a) what you think you can most easily administer, b) how comfortable you are with the over-vesting (the concurrent vesting of both an employee's new-hire grant and their refresh grant) that is implicit in the layered approach, and c) how sensitive you are to negative employee perceptions of the boxcar approach's delayed vesting schedule. Anecdotally, even though the boxcar approach makes the most "sense", we know from survey data that less than 20% of companies with refresh programs use the boxcar approach.

- **Layered vesting:** Under a layered vesting scheme, annual refresh grants start vesting immediately and vest over four years (similar to a typical new-hire grant). Typically, these grants start once an employee reaches somewhere between the two- and three-year tenure mark and, as a result, tend to result in some degree of over-vesting early on. Later on, then, there is a period of under-vesting after the new-hire grant has fully vested (see the simplified table below), though this smooths out eventually.
- **Boxcar vesting:** Under a boxcar vesting scheme, annual refresh grants do not start vesting until the employee's new-hire grant has finished vesting. Subsequently, each refresh then vests over a single year.

In the table below, which lays out both a layered and a boxcar schedule, we make the extreme simplifying assumption—which is never true in real life—that the target new-hire grant does not change from year to year. (That is, we assume the market rate for a new-hire grant is held constant at 100K shares vested over four years, or 25K shares per year for as long as the employee is hired.)

NEW-HIRE GRANTS								
		Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Target new-hire grant (vested over 4 years)		100,000	100,000	100,000	100,000	100,000	100,000	100,000
Implied new-hire vesting per year		25,000	25,000	25,000	25,000	25,000	25,000	25,000

LAYERED VESTING SCHEDULE								
Grant	**Total grant amount**	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**
Vesting of initial grant (granted at start of tenure)	100,000	25,000	25,000	25,000	25,000	0	0	0
Vesting of 1st refresh (granted at 2.5-year mark)	25,000	0	0	3,125	6,250	6,250	6,250	3,125
Vesting of 2nd refresh (granted at 3.5-year mark)	25,000	0	0	0	3,125	6,250	6,250	6,250
Vesting of 3rd refresh (granted at 4.5-year mark)	25,000	0	0	0	0	3,125	6,250	6,250
Vesting of 4th refresh (granted at 5.5-year mark)	25,000	0	0	0	0	0	3,125	6,250
Vesting of 5th refresh (granted at 6.5-year mark)	25,000	0	0	0	0	0	0	3,125
Total vesting shares		**25,000**	**25,000**	**28,125**	**34,375**	**15,625**	**21,875**	**25,000**

BOXCAR VESTING SCHEDULE								
Grant	**Total grant amount**	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**
Vesting of initial grant (granted at start of tenure)	100,000	25,000	25,000	25,000	25,000	0	0	0
Vesting of 1st refresh (granted at 2.5-year mark)	25,000	0	0	0	0	25,000	0	0
Vesting of 2nd refresh (granted at 3.5-year mark)	25,000	0	0	0	0	0	25,000	0
Vesting of 3rd refresh (granted at 4.5-year mark)	25,000	0	0	0	0	0	0	25,000
Total vesting shares		**25,000**	**25,000**	**25,000**	**25,000**	**25,000**	**25,000**	**25,000**

As the table makes clear, though layered grants may be easier to explain, and though the two approaches net out at the roughly same result over time, boxcar grants solve the problem of over-vesting early on.

In the next section, we will look at how the picture changes when we relax the assumption that new-hire grant sizes remain constant over time.

3. DISCOUNTING NEW-HIRE GRANTS

In practice, almost no startups size their refresh grants to exactly match the annual vesting value of their new-hire grants. There are a few reasons for this:

- **Grant size decline:** Grant sizes for new hires should go down over time as a company grows. It takes many fewer shares to hire a VP at a Series C company than it does to hire one at Series A company. (For example, using the example above, though a new hire might be attained with an upfront grant of 100K shares today, due to share value growth, a new hire two years from now may only require 80K shares.) As a result, any refresh program, and especially a boxcar one, implicitly includes an estimate as to what a competitive new-hire grant might look like in two to three years' time.

  We have seen two approaches to estimating this discount. The first is to try and make a detailed estimate of what the forward value of the stock will be in two to three years' time using the current 409a and preferred-round prices and a projection of how the company's valuation will grow over that period. The other, simpler approach is to estimate using a single, high-level percentage. For example, if grant sizes have been declining by ~10% per year and refresh grants are made starting in year two or three, then a 20% discount rate is roughly what it takes to land in the right place at the right time—that is, a 20% discount will ensure existing employees are vesting their refresh shares at the approximate new-hire rate in year five and beyond (see the table below).

- **Existing equity inertia:** Switching jobs is a hassle and employees with existing options have an incentive to "let the options run." Consequently, it is not clear that your refreshes have to fully match what an employee would earn as a new-hire grant elsewhere, especially for your non-high-performing employees.

- **Public vs. private company refresh approaches:** This is a very "in-the-weeds" comment, and unless you are near going public and using public-company compensation consultants, you can skip it. However, if you are at that stage, you should know that public companies tend to offer smaller new-hire grants and larger refresh grants to their employees. Additionally, contrary to what we recommend, some compensation consultants benchmark refresh grants using public-company refresh data instead of new-hire grant data. In these instances, we sometimes see the private companies engaging these consultants adopt public-company-style (i.e., generous) refresh programs alongside private-company-style (i.e., also generous) new-hire programs. The result is excess dilution. If this is happening at your company, pause and recheck the basis of the scheme and/or consider applying a more substantial discount to your refreshes.

Taking these issues into account, we typically see companies discount their average new-hire grants by around 20% (at minimum) to 40% (at maximum) when doling out refreshes.

In the simple example below, the discount to the current new-hire grant is set at 20%. Refresh grants are then made starting in year 2.5, vesting immediately under the layered

scheme or in year 5 under the boxcar scheme. The key unknown variable at time of the grant (in year 2.5) is the rate at which new-hire grant sizes will decline going forward (based on the company's future performance). In the example, that rate turns out to be 10% per year.

In this instance, as shown in the "Difference relative to new-hire grant vesting" rows, the 20% discount winds up working pretty well—over time, an existing employee vests their refresh

NEW-HIRE GRANTS								
		Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Target new-hire grant (vested over 4 years)		100,000	90,000	81,000	72,900	65,610	59,049	53,144
Implied new-hire vesting per year		25,000	22,500	20,250	18,225	16,403	14,762	13,286
Discount to new-hire grant		80%	80%	80%	80%	80%	80%	80%
Annual refresh grant size (vested in 1 year)		20,000	18,000	16,200	14,580	13,122	11,810	10,629
LAYERED VESTING SCHEDULE								
Grant	**Total grant amount**	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**
Vesting of initial grant (granted at start of tenure)	100,000	25,000	25,000	25,000	25,000	0	0	0
Vesting of 1st refresh (granted at 2.5-year mark)	18,000	0	0	2,250	4,500	4,500	4,500	2,250
Vesting of 2nd refresh (granted at 3.5-year mark)	16,200	0	0	0	2,025	4,050	4,050	4,050
Vesting of 3rd refresh (granted at 4.5-year mark)	14,580	0	0	0	0	1,823	3,645	3,645
Vesting of 4th refresh (granted at 5.5-year mark)	13,122	0	0	0	0	0	1,640	3,281
Vesting of 5th refresh (granted at 6.5-year mark)	11,810	0	0	0	0	0	0	1,476
Total vesting shares		**25,000**	**25,000**	**27,250**	**31,525**	**10,373**	**13,835**	**14,702**
Difference relative to new-hire grant vesting			**2,500**	**7,000**	**13,300**	**-6,030**	**-927**	**1,416**
BOXCAR VESTING SCHEDULE								
Grant	**Total grant amount**	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**
Vesting of initial grant (granted at start of tenure)	100,000	25,000	25,000	25,000	25,000	0	0	0
Vesting of 1st refresh (granted at 2.5-year mark)	18,000	0	0	0	0	18,000	0	0
Vesting of 2nd refresh (granted at 3.5-year mark)	16,200	0	0	0	0	0	16,200	0
Vesting of 3rd refresh (granted at 4.5-year mark)	14,580	0	0	0	0	0	0	14,580
Total vesting shares		**25,000**	**25,000**	**25,000**	**25,000**	**18,000**	**16,200**	**14,580**
Difference relative to new-hire grant vesting		**0**	**2,500**	**4,750**	**6,775**	**1,598**	**1,438**	**1,294**

grants at roughly the same rate that new hires vest new-hire grants. Essentially, by the time their refresh grants start vesting, the target new-hire grant size has declined sufficiently to ensure the existing employee is vesting at roughly the new-hire rate.

In reality, the "correct" discount is only knowable in retrospect, and, for the very best companies, there will inevitably be a windfall gain at some point. If a company's value shoots up 50%+ in a one-year period, then prior refreshes that were granted assuming, say, a 10% annual reduction in new-hire grant sizes will turn out to have been extremely generous. Existing employees will find themselves with massive, embedded upside. Ultimately, this is a good problem to have.

Note: The guidance in the above section changes if you are using custom vesting schedules to allow for employee catch up, which some companies do upon implementing their first refresh program.

THINKING HOLISTICALLY

Stepping back, the key to arriving at a reasonable refresh program, for both the management team and the Committee, is to think *holistically.* For example, imagine an options-based refresh program with eligibility requirements that skew heavily toward high-performing employees. Because the grants will only be worth something if the team performs, and because they are being distributed among a smaller group of highly coveted employees, a lower discount may be appropriate. Conversely, an all-RSU, all-employee refresh program might merit a higher discount.

The table below provides a summary of the factors at play and how an employer-friendly approach to one can be appropriately counter-balanced with a more employee-friendly approach to another:

FACTOR	DESCRIPTION
Equity vehicle (RSUs or options)	• RSUs are often understood as being more employee-friendly, while options are generally construed as being more employer-friendly • **Example relation to other factors:** If your program is options-based, you may consider opting for an equity valuation method that privileges employees (i.e., conservatively rather than aggressively values the options), applying a lower discount, or starting grants earlier (widening eligibility) to allow employees to lock in lower strike prices
Equity valuation method	• Valuing grants conservatively tends to benefit employees (employees need to receive more RSUs or options to reach a given dollar-value-based grant size), while valuing grants aggressively tends to benefit employers • **Example relation to other factors:** If you believe you're using a conservative estimate of the dollar value of your RSUs or options (e.g., you're using a stale valuation despite recent company growth), you may consider applying a higher discount or implementing a boxcar vesting approach to avoid costly over-vesting

(CONTINUED ON NEXT PAGE)

FACTOR	DESCRIPTION
Eligibility requirements	• Policies restricting refreshes to longer-tenured and/or high-performing employees are considered employer-friendly, while policies granting refreshes earlier and more widely are considered employee-friendly • **Example relation to other factors:** If you gate eligibility by performance, you can afford to dole out larger, less-discounted refreshes. You may also want to do so, since the refreshes are focused on employees you really want to retain
Vesting approach	• Typically, layered vesting approaches are seen as more employee-friendly (since the vesting is front-loaded), while boxcar vesting approaches are seen as more employer-friendly • **Example relation to other factors:** If you pursue a layered scheme, you may consider applying higher discounts during periods of early over-vesting or valuing your equity grants more aggressively
Discount	• Lower discounts are more employee-friendly, while higher discounts are more employer-friendly • **Example relation to other factors:** If you use a higher discount (perhaps predicated on aggressive growth assumptions), you may consider a vesting approach that grants employees more equity early on (i.e., a layered scheme)
Company growth rate	• **Example relation to other factors:** If your company is growing more quickly, you may consider using a higher discount or valuing your equity grants more aggressively than you would if it were growing more slowly (since it's highly likely that, two to three years from now, those grants will be worth substantially more than they are worth today)

We think of the discount as the residual toggle that you can adjust to ensure your refresh program balances employee and employer interests. This is especially true if you have already made final decisions about the other, more foundational aspects of the refresh program (equity vehicle, equity valuation method, vesting approach, etc.). However, as you design or update your refresh program, we encourage you to revisit all of the choices discussed above to ensure they are sensible collectively.

Importantly, after you have made a set of choices, do the math to understand your expected total burn from refresh grants and add it to the Equity Budget (see section above). If the burn is reasonable and the general approach is sound, the Committee can avoid spending time debating all of the finer points of the program.

Postscript: Questions & Future Chapters

Though we recognize it remains incomplete, we hope you have found this guide useful. If you have any questions about the content above, if you require guidance as you design your own compensation schemes, or if you would simply like to suggest topics for future inclusion in this guide, please email our dedicated compensation inbox at comp@scalevp.com.

Below, you'll find an updated list of topics that we plan on adding to future editions of this guide:

- **Sales commission plans** *(preview)*
  The design of the sales commission plan demands at least as much Committee time and attention as the design of the broader bonus program. In the future, we will cover how to set and present commission plans (quotas, commission rates, accelerators, and other performance incentives), as well as how to treat windfalls, debookings, and other nuanced aspects of sales compensation.

- **Founder refresh grants** *(preview)*
  This is often the most difficult conversation of all. There are three approaches to founder refresh grants: 1) forgo founder refreshes entirely (given the founder's significant initial ownership); 2) dole out founder refresh grants using the same process that applies to the rest of the ELT (possibly with a higher discount due the founder's existing ownership); or 3) use multi-year super-deals (as was done for Musk at Tesla).

  We will cover the pros and cons of these approaches, and how to choose between them, in the next version of this document.