Should Startups Extend the Window to Exercise Options?

Dave Gammell | 1/23/18

Pinterest did it. Square did it. And Coinbase did it, too. These unicorns have all given departing employees more than the standard 90 days to exercise their stock options. They've extended the window to exercise options for employees who have at least a minimum period of service.

The tech recruiting site Triplebyte urged an even more generous arrangement. In a blog post called "Fixing the Inequity of Startup Equity," it offered a raft of free documents companies can download to more easily implement a 10-year exercise window. "This is the future," Triplebyte predicted last spring, "and we're going to accelerate this trend to make it the industry standard."

The impetus for this new flexibility is soaring valuations and anxiety about talent retention in the highly competitive market for tech workers. Silicon Valley software engineers, architects and coders have become accustomed to pocketing generous six-figure salaries and being showered with meals, massages and beer tastings, and a raft of options (the promise that a windfall awaits employees whose hard work leads to a liquidity event). Companies are staying private longer, so more and more often employees change jobs before they can cash out and employees are forced to exercise their options within 90 days or lose those options. Because valuations (and option exercise prices) are so high even if they have enough ready money to exercise options, it is a big investment decision.

The jury's still out on whether Triplebyte's vision will become the norm. However, whether you're launching a startup, running one or funding one, you'll have to make some serious decisions about how and when you'll grant options. Let's consider a few factors:

Think creatively: Between the standard 90-day exercise period and the generous Triplebyte window, there's a huge amount of room for compromise and creativity. You could, for example, offer a three-year window to exercise options to employees who have spent at least two years at your company. You can expand the window to exercise to five years. Or seven.

There's no "right" way to incentivize employees, but there is a wrong way: Blindly follow the herd without considering your startup's unique product, timeline and employees.

What VCs think: It's no surprise that employees favor longer periods to exercise stock options. And it's no shocker that VCs aren't fans. The more time workers have to exercise those options, the greater the likelihood that they won't. Instead, they'll sit tight as they wait for a liquidity event. Or they'll forget about them for years and ultimately forfeit them. During that time, their options are gathering virtual dust when they could be returned to your company's option pool and used as a recruiting incentive for prospective workers.

Sure, you could issue more options to compensate for the ones out of circulation, but then you're diluting your share value and diminishing the value of the options already in the hands of your investors (and yourself and your co-founders). As long as options are outstanding they also continue to dilute the company's full-diluted capitalization – an effect that is amplified in a financing.

Backroom deals: Perhaps you have a few employees who are critical to your daily operations and essential to your long-term success. You want to incentivize this select handful with a custom vesting schedule, accelerators and an extended period to exercise options.

Proceed carefully. Even if these workers swear to keep their sweet deal under wraps, someone, somewhere will let something slip. There's no quicker way to kill morale and teamwork than by creating two classes of employees. The smarter choice is to be up front with your staff, addressing the issue proactively and concisely explaining your rationale. Even in this case, be prepared for pushback.

Prime time: The easiest time to create and implement your incentive stock option plan is when you're setting up your business. That way, all employees fall under the same policy and receive the same information. If you adopt a new policy a few years down the line, you will have more legal, tax, accounting, and practical hurdles to overcome.

As long as tech workers remain in demand—and I don't expect that to change any time soon—they'll be able to push on the terms governing the exercise of their incentive stock options. Founders and entrepreneurs who depend on the intellectual and creative skills of this workforce must balance the need to keep them happy with the bottom line of running a lean operation that will, almost always, struggle before it can succeed.

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