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What are some wealth-management issues and strategies for executives at early-stage companies?

BY ELISABETH TALBOT, CFA®, CPA

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ILLUSTRATION BY KEVIN SPROULS

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Corporate executives employed by privately held start-up companies face complex wealth-management challenges. Like their peers employed by publicly traded companies, executives at early-stage companies typically receive compensation packages that include a mix of salary, bonus and equity-based compensation.

Yet, while salary and bonus levels at pre-IPO companies need to be competitive enough to attract talent, there is often less room to negotiate cash compensation. An executive should focus the negotiations, then, around matters such as the magnitude and types of stock option grants (e.g., incentive stock options versus non-qualified stock options).

Additional areas of focus should include whether the stock option grant offers the opportunity to exercise prior to vesting; the percentage of ownership of the company; dilution protection; change-of-control protections; and restrictive covenants.

Benefit packages at pre-IPO companies are often basic and generally include a 401(k) plan without a match and no defined-benefit pension plan. Health, life and disability insurance options may be limited.

Given these limitations in negotiating compensation and benefits, a financial advisor experienced in working with executives at early-stage companies will address key areas such as:

1. Cash-flow planning—helping an executive manage personal expenses, given his or her more modest base salary and bonus structure; and providing sufficient liquidity to cover unexpected cash shortfalls.

> “Partnering with an advisory team experienced in navigating challenges will help maximize the financial opportunities of working for a start-up.”

2. Stock option planning—evaluating whether stock options should be exercised prior to an IPO or liquidity event in order to qualify the shares for long-term capital gains, or to position the holdings to take advantage of the qualified small business stock exclusion of gain. Planning is also essential to determine capital requirements for the exercise of shares and the payment of any tax liability (regular tax or alternative minimum tax) at the time of exercise. Section 83(b) elections on unvested shares should also be considered.

3. Investment planning—advising the executive about the appropriate amount of investment risk to assume when investing personal capital to exercise stock options

4. Insurance planning—reducing the executive's dependence on group insurance benefits by assisting in the purchase of supplemental, portable life and disability insurance benefits. Given the inherent risks associated with early-stage companies, the executive should consider supplemental policies to enhance levels of insurance coverage offered by his or her employer. A portable benefit also serves as a safety net during any periods of unemployment when group insurance benefits may not be available.

5. Estate planning—determining how many shares of stock in a pre-IPO company could be gifted must be delicately balanced against the executive's long-term wealth accumulation targets for a secure retirement and other short-term goals, such as a new home purchase or the financing of tuition costs.

6. Retirement planning—maximizing tax-deferred retirement savings opportunities by ensuring full participation in the company's 401(k) plan, optimizing the plan's often limited investment options and ensuring that other tax-deferred vehicles are utilized. While, ultimately, the executive's ability to retire as planned may depend on a successful liquidity event, 401(k)s and IRAs are an important part of a contingency plan.

7. Post-liquidity planning—managing the volatility in the price of the executive's stock and options during the immediate period following an IPO is critical. Newly public company stock may be thinly traded and subject to lock-ups and restrictions. Senior executives may need guidance on how to structure a 10b5-1 trading plan within the context of their personal goals and risk tolerance.

Executives leading early-stage companies often find it challenging to manage their financial affairs while working in the fast-paced start-up business environment. Partnering with an advisory team experienced in anticipating and navigating these challenges will help maximize the financial opportunities of working for a start-up. ●

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