https://gist.github.com/yossorion/4965df74fd6da6cdc280ec57e83a202d#what-i-wish-id-known-about-equity-before-joining-a-unicorn

What I Wish I'd Known About Equity Before Joining A Unicorn

Disclaimer: This piece is written anonymously. The names of a few particular companies are mentioned, but as common examples only.

This is a short write-up on things that I wish I'd known and considered before joining a private company (aka startup, aka unicorn in some cases). I'm not trying to make the case that you should *never* join a private company, but the power imbalance between founder and employee is extreme, and that potential candidates would do well to consider alternatives.

None of this information is new or novel, but this document aims to put the basics in one place.

The Rub

Lock In

- After leaving a company, you generally have 90 days to exercise your options or they're gone. This seems to have originally developed around a historical rule from the IRS around the treatment of ISOs, but the exact reason doesn't really matter anymore. The only thing that does matter is that if you ever want to leave your company, all that equity that you spent years building could evaporate if you don't have the immediate cash reserves to buy into it.
- Worse yet, by exercising options you owe tax immediately on money that you never made. Your options have a *strike price* and private companies generally have a *409A valuation* to determine their fair market value. You owe tax on the difference between those two numbers multiplied by the number of options exercised, even if the illiquidity of the shares means that you never made a cent, and have no conceivable way of doing so for the forseeable future.
- Even if you have the money to buy your options and pay the taxman, that cash is now locked in and could see little return on investment for a long and uncertain amount of time. Consider the opportunity cost of what you could otherwise have done with that liquid capital.
- Due to tax law, there is a ten year limit on the exercise term of ISO options from the day they're granted. Even if the shares aren't liquid by then, you either lose them or exercise them, with exercising them coming with all the caveats around cost and taxation listed above.

  Does ten years sound like a long time? Consider the ages of these unicorns:

  - Palantir is now thirteen years old.

    - Dropbox will be ten years old this year (2017).
    - AirBnB, GitHub, and Uber are all within a year or two of their ten year birthdays.
- Some companies now offer 10-year exercise window (after you quit) whereby your ISOs are automatically converted to NSOs after 90 days. This is strictly better for the employee than a 90-day window, but as previously mentioned, ten years still might not be enough.
- Golden handcuffs kick in fast. The longer you stay with a company, the more equity you build, and a decision to leave becomes that much harder. This can culminate to the point where early employees have modest liquid assets but are "paper millionaires", and have to make the hard decision to throw all that away or stick around until their founders allow them some return.

Liquidity Events

- No time horizon for any kind of liquidation guaranteed. In fact, *no liquidation event* is ever guaranteed, even if the company is highly successful. One could be at 1 year out, 5 years, 10 years, or never. We've seen a lot of evidence in this day and age that companies are staying private for longer (see the list above).
- The incentive to IPO between employer and employee are not aligned. Employees want some kind of liquidation event so that they can extract some of the value they helped create, but employers know that allowing employees to extract that value might cost them some of their best people as they're finally allowed the opportunity to pursue other projects. One more reason to stay private for longer.
    - Although the above is one reason that founders don't want to IPO, it's not the *only* reason. Many of them do believe (rightly or wrongly) that there is another 10x/100x worth of growth left in the company, and that by pulling the trigger too early on an IPO all of that potential will be lost. For a normal founder, their company is their life's work, and they're willing to wait a few more years to see the canvas fully realized. This is a more noble reason not to liquidate, but from an employee's perspective, is still problematic.

Founder/Employee Power Imbalance

- Founders (and favored lieutenants) can arrange take money off the table while raising rounds and thus become independently wealthy even before they make true "fuck you" money from a large scale liquidation event. Employees cannot. The situation is totally asymmetric, and most of us are on the wrong end of that.
- Even if you came into a company with good understanding of its cap table, the ground can shift under your feet. New shares can be issued at any time to dilute your position. In fact, it's common for dilution to occur during any round of fundraising.

Private Markets

- Private markets do exist that trade private stock and even help with the associated tax liabilities. However, it's important to consider that this sort of assistance will come at a very high cost, and you'll almost certainly lose a big chunk of your upside. Also,

depending on the company you join, they may have restricted your ability to trade private shares without special approval from the board.

Valuations

- Especially in early stage companies, equity is offered on the basis of a highly theoretical future valuation number. Sam Altman recommends offering the first ten employees 10% (~1% each), which could be a big number if the company sells for $10B, but consider how few companies actually make it to that level.

  If the company sells for a more modest $250M, between taxes and the dilution that inevitably will have occurred, your 1% won't net you as much as you'd intuitively think. It will probably be on the same order as what you might have made from RSUs at a large public company, but with far far more risk involved. Don't take my word for it though; it's pretty simple math to run the numbers for a spread of sale prices and dilution factors for yourself before joining, so do so.

Tender Offers

- Some companies acknowledge the effect of drawn out phases of illiquidity on employees and engage in a tender offer to give employees some return (google around for some examples). I don't want to overstate this because receiving a tender offer is strictly better than the alternative, but keep in mind that one will probably be structured to minimize the amount of value you can extract. They're also very likely be infrequent events. Read the fine print, run the numbers, and consider how much your annual return *to date* will actually be (including all the time you've spent at the company, not just the year of the offer). It's probably less than what you could've gotten in RSU grants at a public company.

Working Environment

- This isn't equity related, but it's worth considering that the environment at a big unicorn isn't going to be measurably different from a big public company. You're going to have little impact per employee, the same draconian IT security policies, lots of meetings, and fixed PTO. In the worst cases, you might even have to use JIRA.

I'm Doing It Anyway!

So you decided to join a private company anyway. Here's a few questions that I'd recommend knowing the answer to before accepting any offer (you'd be amazed at how infrequently this information is volunteered):

- How long is my exercise window if I leave the company?
- How many outstanding shares are there? (This will allow you to calculate your ownership in the company.)

- Does the company's leaders want it to be sold or go public? If so, what is the rough time horizon for such an event? (Don't take "we don't know" for an answer.)
- Have there been any secondary sales for shares by employees or founders? (Try it route out whether founders are taking money off the table when they raise money, and whether there has been a tender offer for employees.)
- Assuming no liquidation, are my shares salable on a private market?
- Has the company taken on debt or investment with a liquidation preference of more than 1x? (Investors may have been issued > 1x liquidation preference, which means they get paid out at that multiple before anyone else gets anything.)
- Will you give me an extended exercise window? (After joining I realized that most people's window was the standard 90 days, but not *everyone's*. Unfortunately by then I'd lost my negotiating leverage to ask for an extended term.)

It's really tough to ask these without sounding obsessed with money, which feels unseemly, but you have to do it anyway. The "you" of today needs to protect the "you" of tomorrow.

Summary

Working at a startup can be fun, rewarding, interesting, and maybe even lucrative. The working conditions at Silicon Valley companies are often the best in the world; it's quite conceivable that you might want to stay there even if there was never a possibility of a payoff. But don't forget that as far as equity is concerned, every card in the deck is stacked against you.

The correct amount to value your options at is $0. Think of them more as a lottery ticket. If they pay off, great, but your employment deal should be good enough that you'd still join even if they weren't in your contract.

I don't say this just because of the possibility that your startup could fail, but also because even in the event of success, there are plenty of scenarios where getting a payout will be difficult. Say for example that five years in you want to try something new, or want to start a family and need a job that will pay you well enough to let you afford a starter home in the Bay Area (not easy). Your startup Monopoly money will put you in a precarious position.

If you're lucky enough to be in high enough demand that you can consider *either* a public company with good stock liquidity *or* a billion-dollar unicorn, give serious consideration to the former.