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Building a Sustainable Rewards Program as Your Startup Matures: Lessons in Asia

This article first appeared in the Singapore Venture Capital Association's membership newsletter — the Singapore Venture Capital & Private Equity Guide 2019.

While Singapore doesn't (yet) have a high number of unicorns, it's quickly becoming a destination for startups — particularly in the fintech space. There were 264 financings during the first three quarters of 2018 totaling $4.42 billion U.S. dollars, according to CB Insights.

The government of Singapore has encouraged innovation through business-friendly practices such as eliminating overly complicated bureaucratic rules. Additionally, the culture of workplace flexibility in Singapore (particularly contrasted with other regions in Asia) has been effective in attracting startup talent. Location helps too: through Singapore, a company has access to a market size of more than 625 million people across Southeast Asia and a country that delivers steady GDP growth.

We recently held a conference in Singapore for some of our technology company clients across Asia. The excitement about the growth and opportunities for the technology market across Asia was palpable. Coming out of the discussion was a clear imperative that companies looking to grow and expand into new markets and locations need to engage in smart workforce planning (e.g., don't become too top heavy or hire for one job function while neglecting support for other functions such as HR or IT). Companies also need to understand the local labor market — which can vary widely across Asia — to determine the rewards and talent strategy that will support business goals.

While most startups in Singapore haven't publicly declared their expectations for listing, it's never too early to think about your workforce infrastructure and how it is expected to evolve as your organization matures. What's more, venture capitalists are increasingly playing a larger role in monitoring the human capital management function at their portfolio companies as they see the connection between well-managed HR systems to the success of a startup.

When designing a sustainable rewards program the following topics are key to consider. This article will delve into each one in greater detail.

- Pay mix
- Compensation Philosophy
- Equity Overhang
- Equity Design

- New Plan Adoptions
- Building and Compensating Your Board

Pay Mix

There is a natural evolution in pay mix once your startup matures. It's important to always maintain an eye toward the next stage of rewards design to see where your organization should be headed. Figure 1 provides a high-level overview of compensation design through three stages of a private company's growth. As your organization grows, you'll need to prepare your incumbent employees for greater differentiation in pay based on performance. Once a private company gets larger and more established, you'll need to think about setting up a formal annual incentive plan. According to the Radford US Pre-IPO/Venture-Backed Survey, most of the private technology companies in Silicon Valley have formal created bonus plans in recent years to compete with the larger, public companies and provide much-desired liquidity to employees. (We are actively recruiting global participation for this survey in Asia and invite interested parties to reach out to us.)

Figure 1

Compensation Evolution Snapshot

Early-Stage Private ▪ Low to medium cash/fixed pay ▪ Medium short-term incentive pay ▪ High long-term incentives (as a percentage of company)	**Positives:** ▪ Potential to wing big if successful ▪ Chance to be a part of something innovative	**Negatives:** ▪ Cash flow issues and lack of certainty ▪ More flexibility in negotiating pay ▪ With growth, informal salary increases; performance management systems can be less effective
Late-Stage Private ▪ Cash compensation rises ▪ Formal annual incentives arrive ▪ Significantly reduced long-term incentive awards	**Positives:** ▪ Last chance to "cash in" ▪ Legitimacy mentality; "we made it" attitude ▪ Resume enhancer	**Negatives:** ▪ Need to prepare for public and investor scrutiny ▪ Significant systems implementation ▪ Past inequities within the company will likely come to surface
Public ▪ More focus on cash and short-term incentives ▪ Long-term incentives focus on annual deliver in restricted stock	**Positives:** ▪ Financial stability ▪ Liquidity and annual equity value delivery ▪ Formalized career paths within firm	**Negatives:** ▪ More rigid/formulaic ▪ Lower levels not eligible for equity plan ▪ Executive pay-for-performance in the spotlight

Compensation Philosophy

Building a strong compensation philosophy is an important step in a company's startup phase, and it's never too early to work on it. Once you start hiring employees you'll need to think about your philosophy as it relates to your talent goals. We encourage our early-stage clients to follow these four rules when thinking through the kind of rewards culture they want to build:

1. Drop the boilerplate language; be creative and culturally aligned. Your compensation philosophy should be a reflection of your company's values, so put some thought into it and speak the language of your employees.

2. Be selective with your rewards; you can't be everything to everyone. Like most companies you probably need to be selective with the types of rewards you can afford to really benchmark above the market median. Choose wisely in determining what those rewards are by surveying your employees to understand the programs that resonate with them and reflect the type of workforce you're trying to build.

3. Know exactly where you want to be aggressive and target pay above the market. In Silicon Valley, for example, technical skills (e.g., data scientists, engineers, software programmers, etc.) command a general pay premium of around 30% on average compared to non-technical jobs in comparable levels. However, that's not the case in some markets in Asia. In Singapore, we find that product development jobs are actually at a 6% discount to the market while IT, HR, marketing, professional services and legal jobs all command a pay premium.

4. Make fairness and transparency a core value from day one. There is no question that the spread of pay equity laws are changing the dynamics of the employee and employer relationship around rewards. Companies need to stay proactive and ensure they are transparent with employees around how starting pay and promotions are determined.

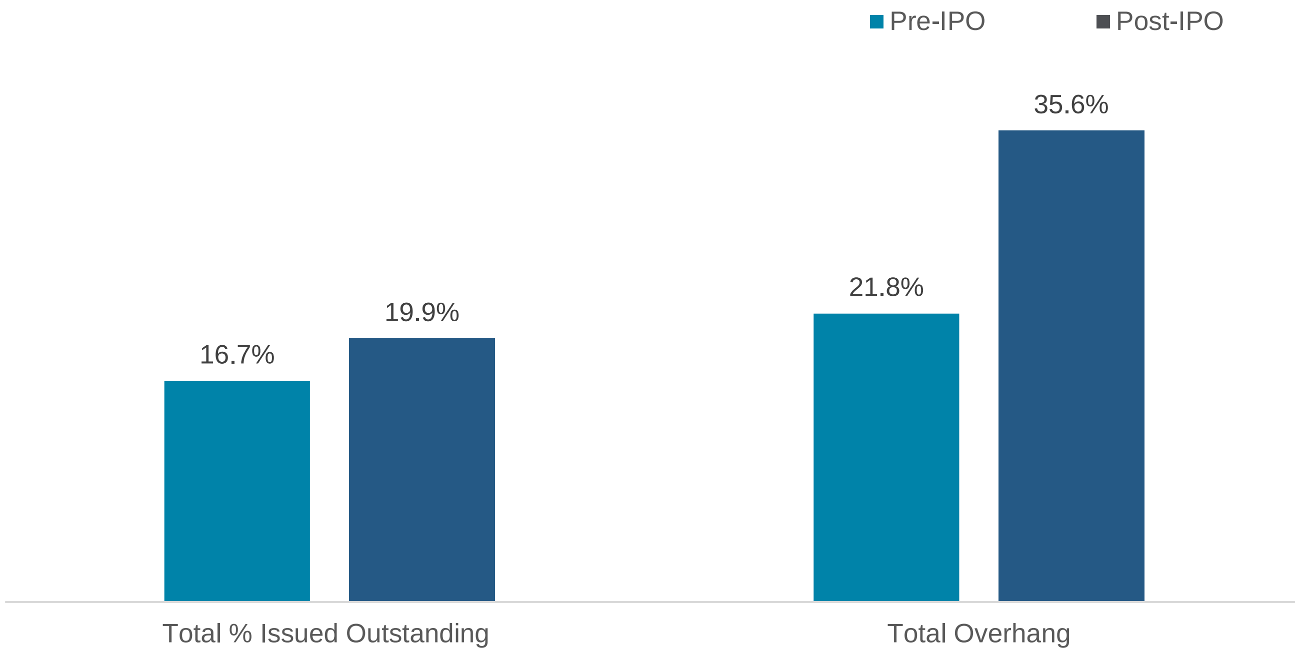
Equity Overhang

Overhang from outstanding equity awards (which is calculated by adding stock options granted and remaining options to be granted divided by the total shares outstanding) tends to increase over time as a company grows, but understanding just how much is important in preparing for an eventual IPO and the scrutiny from public investors that will follow.

Figure 2 reflects data from technology and life sciences companies that have gone public on a stock exchange in the U.S. in 2017.

Figure 2

Equity Overhang Pre- and Post-IPO



Source: Radford's proprietary prospectus database

Following an IPO, the larger available share reserve and evergreen funding boost total overhang, while issued overhang declines as options are exercised.

Equity Design

Just like pay mix, equity design will evolve as a private company matures and headcount grows. Among early-stage companies, equity will be in the form of stock options that carry significant upside but will be hard to quantify in terms of cash value. As a company gets closer to an IPO, equity will shift from being quantified as a percent of ownership of the company to a dollar value of the award. In some cases, highly-valued private companies will begin adding restricted stock to their vehicle mix. Furthermore, late-stage private companies will typically delay refresh grants until the IPO event (or two to three years after a new-hire grant is made).

Meanwhile, equity participation will eventually decrease once a company approaches an IPO. Typically, new hires will still receive an initial grant but refresh grants will be reserved for certain job levels and critical positions. Once a company goes public equity participation continues to become more selective.

New Equity Plan Adoption

Most private companies implement a new equity plan at the point of going public. Establishing new equity incentive plans provide flexibility to grant a variety of vehicles, including performance shares (i.e. an omnibus plan) and gives newly public firms the ability to adapt more readily to evolving market practices. It is also easier and less costly to implement a new equity plan while private when approval usually only requires the support of a closely held group of founders and venture capital investors. Once a company goes public, it quickly must seek support from a broader, more diverse set of shareholders who will likely impose stricter governance standards for equity compensation practices.

Preparing for adoption of a new plan will take months so it’s important to discuss early on what the equity plan should include.

Figure 3, which uses the same set of companies that went public on a U.S. exchange in 2017, shows the prevalence of certain equity practices at the point of public listing.

Figure 3

Percentage of Companies with the Following Equity Practices at IPO

New Equity Plan	83%
Prevalence of Evergreen Plans	83%
Median Post-IPO Annual Evergreen Funding	5%
Adoption of an Employee Stock Purchase Plan	63%
Total Equity Overhang	36%

Source: Radford’s proprietary prospectus database

Building and Compensating Your Board of Directors

Across the globe there has been a push from investors and regulatory agencies for companies to have a diverse and independent board of directors. The Singapore corporate governance code specifically states that boards “should comprise directors who as a group provide an appropriate balance and diversity of skills, experience, gender and knowledge of the company.” Three out of four companies have at least one female director, according to the search firm Spencer Stuart. That’s a steady increase from prior years, which is in line with global trends.

Around 18 months prior to an IPO we recommend companies form an audit committee, and within 12 months of an IPO we recommend forming a compensation committee. This is also a good time to hire external advisors that will assist with the IPO.

Companies should think about adding a formal director compensation plan (if they haven’t already) about 12 to 18 months before a planned public listing. That’s when boards will become more involved in their oversight role and their time commitment to board service will increase significantly.

What’s Next

There’s a lot of excitement within Singapore (and all of Asia) about the robust startup environment. The country was able to land on the IPO map in 2017 with the splashy debut of internet and gaming company Sea on the New

York Stock Exchange. But as the market has indicated, investors' expectations for IPOs are high. Planning early to go public, including putting in place the right compensation and governance systems with an eye toward how they may evolve, will go a long way toward setting the business up for success on the public stage.

For more information about creating a rewards program from the ground up, please see radford.aon.com/Comp101. To speak with a member of our compensation consulting group, please write to consulting@radford.com.

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