How to understand stock options in your job offer

What is equity? Are stock options valuable? Don’t sweat it—we’ve got you covered.

Vicki Salemi, Monster career expert

Salary. Bonus. Paid time off. What do all of these have in common? They’re things you should (http://www.monster.com/career-advice/article/6-things-negotiate-employer-wont-budge-pay-0223)negotiate in a job offer (https://www.monster.com/career-advice/article/6-things-negotiate-employer-wont-budge-pay-0223). According to the mogul Mark Cuban, however, there’s one additional important element you may be inadvertently overlooking. And that, my friend, is equity.

What is equity?

In essence, equity is an ownership share in a company in the form of stock options.

“It’s really just an ownership interest in the company,” explains attorney Paul Starkman of Clark Hill’s employment practice group in Chicago. “You share in the upside of profits to the extent there will be profits distributed, and you also share in the potential downside if that interest and/or the entire company decreases in value.”

Stock options may be offered both by private companies like startups (https://www.monster.com/career-advice/article/startup-jobs-0517), as well as publicly traded companies like Google and Walmart (https://www.monster.com/jobs/c-wal-mart.aspx). For private companies, equity is typically a percentage of ownership in a company when that company goes public.

When a private company “goes public,” it means the company starts selling stock to the public and goes from being privately owned to being publicly owned.

As for public companies, equity is typically the ability for employees to purchase stocks at a discount. Employees at the executive level may have more of a stake in the company than lower-level employees.

In an interview with *Money* (http://time.com/money/4886046/mark-cuban-job-offer/?xid=homepage), Cuban said one of the most significant ways you can increase your net worth involves earning equity.

But unfortunately, “an employee cannot really ask for stock options” when negotiating a job package, explains Albert Rizzo, a New York City–based attorney. “The company either grants stock options, or it doesn’t.”

Why do companies offer equity?

Michael Elkins, attorney with Bryant Miller Olive in Miami, says offering equity to employees is a savvy recruiting tool for startups and a way to compensate higher-level employees who earn salaries below industry standards. The idea is that if/when the company hits the big-time, the payoff can be massive. (And if it doesn’t catapult, well, you just won't earn as much.)

If the company is private and offers stock options, Elkins recommends negotiating because offers to candidates may differ significantly. There isn’t a standard amount of stock to negotiate, so if you can provide the company with a coveted skill set, you’ve got a leg up.

According to Elkins, “If you’re being recruited by a tech company because you have skills they need, you need to ask them, ‘Are you thinking about going public? Are you thinking about being sold? What’s the company’s exit strategy?’”

Even a 1% or 2% stake in the company could be significant. “If you’re with a company that really hits,” he adds, “it’s definitely an important component [to the job offer] (http://www.monster.com/career-advice/article/How-to-accept-job-offer-0830).”

Publicly traded companies are another situation, Elkins notes, because you can typically purchase stocks at a discounted rate directly through your paycheck at a standard price. “Even if you’re an executive, public companies are governed by the SEC and [a company] can’t be offering stocks to Person A cheaper than they’re offering stocks to Person B,” Elkins says.

But before you fist-bump your way to the bank, there are a few tips to keep in mind.

Buyer beware

“When companies cannot offer much by way of salary, they try to entice the employee with stock options” says Rizzo. “You need to be very careful in evaluating what the option offer is worth—if anything!”

If a prospective start-up employer does offer equity, the job offer should dictate how much the company can or will offer you. Once that’s been established, the offer’s terms need to be clearly outlined in the employment letter.

Considering the plan could be complicated, since it’s not as straightforward as being offered a higher salary. “Unless you are sophisticated in stock options,” says Rizzo, “you should have an offer letter reviewed by an attorney or someone knowledgeable, to really know what to negotiate.”

Elkins adds, “Offer letters should be very detailed. It’s not as simple as, ‘We’re giving you a 5% stake in the company.’”

Why the need for specifics? With private companies, there’s always the possibility of dilution. “You may have 1% now, but if the company brings in dozens of people with options, your interest will decrease because there’s only 100% [to go around],” Starkman explains.

He says your offer letter should have wording such as, “One percent won’t be subject to dilution.” This way, if stock is offered to countless other employees as well as investors, you’ll still end up owning 1%.

Rizzo says you should ensure that any offer you receive clearly states the number of shares to be received as well as the vesting schedule.

What does vesting mean?

Vesting is essentially a retention tool whereby you don’t have access to the full amount of stocks until a certain period of employment has elapsed Instead of trading the stock the moment you have the ability to purchase it, you typically need to show your loyalty to a company before you can reap the benefits of their stock options. This is part of the vesting process.

“Generally, a plan will provide for a certain vesting period, typically four years with a one-year ‘cliff,’” says Rizzo. In other words, if you bail on the company within the first year (that’s the first year of employment, not a calendar year), you won’t receive any stock options.

If you remain on board beyond that year, stock options begin to vest—or transfer ownership to you—over the remaining period of your employment on a monthly or annual basis. And if you remain an employee during the entire vesting period, let’s say four years, then at the end of the fourth year, you’ll have locked in all of the options the company agreed to give you. (If you part ways after the vesting period has been completed, then the shares are still yours. Cha-ching!)

Elkins points out it’s important to have vesting clearly outlined in your employment letter. (With privately held companies, you should negotiate vesting periods and percentages, too.)

Then what happens if you’re working for a company that goes public? The stocks still aren’t necessarily paid out. Instead, you’ll hold the options that are vested until you decide to exercise the options by either retaining or selling them.

“Once the vesting period has been met, employees hold the stock and can sell the shares on a publicly traded market,” says Rizzo. “Otherwise, the employee continues to own the stock, or an ownership interest in the company, until it goes public or is sold or acquired. The employee will continue to hold the options even if no longer employed, unless the stock option plan states otherwise.”

“Sometimes private companies don’t go public,” Elkins notes. “They just get bought and you get a piece of that sales price. A lot of times, you’re making money on a sale.”

Overall, whether you’re potentially working for a private or public company, ask about stock options, and be clear on exactly what you’re going to receive and when. Most importantly, get everything in writing.

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