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# Building the Equity Program for Life as a Public Company

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An IPO is a key inflection point for equity compensation, requiring companies to balance talent needs, shareholder alignment and public-company governance. Key decisions include sizing the share reserve, establishing sustainable grant practices and building enough flexibility for the program to evolve as the company matures.

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## Why an IPO Changes the Equity Equation

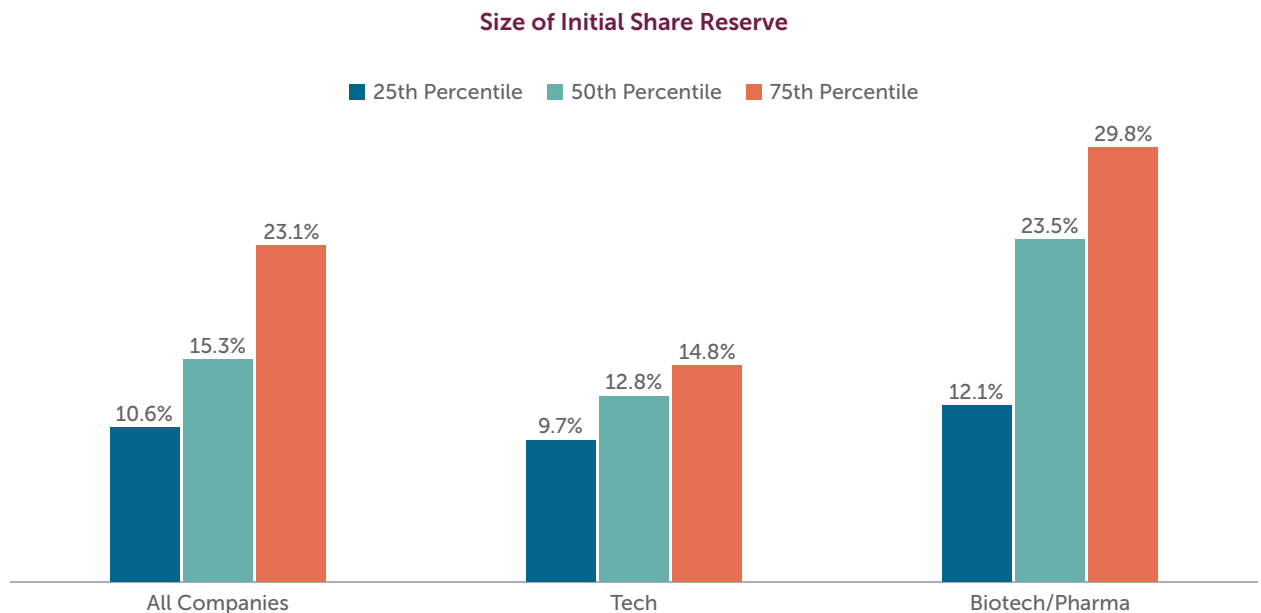
While many private companies use long-term incentives, whether in the form of equity or a phantom/cash-based program, equity compensation often takes on a different role after an IPO. Public company equity can be a more accessible compensation tool, but it also introduces greater complexity, including:

- Greater scrutiny of dilution and executive pay
- New shareholder and proxy advisor expectations, including emphasis on linking pay and performance
- A need to balance flexibility with good governance

Taking a holistic approach to equity program design during the IPO process can establish a framework that supports both the transaction and the company's first several years as a public company.

## How Large Should the Share Reserve Be?

Share reserves for newly public companies may look or feel different from the current share reserve (if a company already has one). When sizing the initial share reserve, companies should estimate the shares needed to support grants for at least three to five years post-IPO to avoid returning to shareholders for approval too quickly. Many new companies address this issue through an evergreen provision, which automatically increases the share reserve annually without additional shareholder approval. Approximately 90% of companies in CAP's sample have an evergreen provision at the time of IPO. The most common increase is 5% per year, reflecting 87% of companies. Because these provisions dilute shareholders without a separate approval mechanism, they are generally viewed less favorably from a governance perspective and are often removed when the company goes for shareholder approval on the equity plan.



Initial share reserves represent approximately 15% of shares outstanding at median, with meaningful variation by industry. Technology companies generally have a smaller share reserve than biotechnology/pharmaceutical companies. After IPO, investors increasingly focus on measures such as total potential dilution, ongoing burn rate, and the magnitude of executive awards.

There are three key questions to answer in determining the size of the initial share reserve:

| Question                                               | Considerations                                                                                                                                                                                                                                                                                                                                                          |
|--------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| What is the expected annual grant need?                | <ul style="list-style-type: none"><li>• How deep in the organization do you plan to grant equity? Do you anticipate growth in the eligible population in the next 3 – 5 years?</li><li>• How often will you make grants? Every year? Every other year?</li><li>• Will participants have targets or grant guidelines?</li><li>• What vehicles will be granted?</li></ul> |
| How will you determine the number of shares?           | <ul style="list-style-type: none"><li>• Fixed Value?</li><li>• Fixed Shares? Percent of Shares?</li><li>• Will a spot stock price be used? Average price?</li></ul>                                                                                                                                                                                                     |
| Is there a need for a carve out or special award pool? | <ul style="list-style-type: none"><li>• Do you plan on promotion awards?</li><li>• Should shares be available to recognize top performers?</li><li>• Do you plan on granting any other special awards in the first several years?</li></ul>                                                                                                                             |

Addressing these questions upfront helps companies model their share needs and maintain sufficient capacity to use equity effectively after the IPO.

## What Should the Go-Forward Equity Program Look Like?

Private company equity awards are often large, one-time grants expressed as a percentage of ownership. Following an IPO, companies typically transition to annual grants designed to maintain ongoing shareholder alignment. Awards are also more commonly denominated as a fixed dollar value (or percentage of base salary), with the number of underlying shares varying based on stock price at the time of grant.

Most companies in CAP's sample granted time-based awards in their first post-IPO grants (either restricted stock/units or stock options). Approximately 25% incorporated some performance-based equity. Over time, public company practices generally evolve toward a greater emphasis on performance-based awards, particularly for senior executives, with shareholder and proxy advisor expectations influencing that transition. For mature public companies, at least 50% of executive long-term incentive value is commonly delivered through performance-based vehicles; proxy advisors do not generally treat stock options as performance-based awards.

For time-based awards, we see most companies use either a 3- or 4-year vest, though how the shares vest during that time frame varies. While performance-based awards often cliff vest, time-based awards vest ratably (i.e., 25% per year over 4 years) or graded (i.e., unequal tranches). Executive awards typically have no vesting during the first year, preserving a meaningful retention period. Thereafter, vesting may occur annually, semi-annually, quarterly or monthly depending on company practice and philosophy. More frequent vesting is often used deeper in the organization to reduce concentrated retention risk around large vesting events.

While executives commonly transition to annual grants, awards deeper in the organization may follow a different cadence. Companies should thereafter establish clear refresh, new-hire and promotion grant practices, including:

- What levels are eligible for equity and annual equity awards?
- Should grant practices differ by employee level or function?
- Is equity only granted at set times throughout the year, or can an employee receive an award based on when they become eligible?
- For promotions, do you top them up to the new target at the time of promotion or do they need to wait until the next annual cycle to receive an award aligned with their new role?
- How should new-hire awards be determined, on a standard basis or on a case-by-case basis?

As companies adjust, simplicity is key. Programs that are overly complex can be administratively burdensome. The equity program should balance company strategy and market practice to be most effective.

## What Plan Provisions and Governance Features Matter Most?

Not every public company governance practice needs to be implemented at the IPO. Companies should prioritize the provisions that are required (e.g., a compliant clawback policy) or most consequential at listing, while allowing other practices to evolve as the compensation program matures. Other key provisions to consider when drafting the equity plan include:

- Share Repricing and Recycling: Will option repricing be permitted? Can shares withheld for taxes or used to exercise awards be returned to the share reserve?
- Minimum Vesting: Will awards be subject to a minimum vesting period? Will the requirement apply to all awards or only executive awards?
- Change-in-control: Will awards have single or double trigger treatment?
- Termination Treatment: How will awards be treated upon retirement or other termination? How long will vested options remain exercisable?

Other governance features that should be discussed are:

- Award Limits: Will annual award limits apply to executives and/or directors?
- Committee Authority: Will the Compensation Committee approve all grants or can authority for non-officer grants be delegated?

Following the IPO, companies should also establish stock ownership guidelines, hedging and pledging policies, and supporting grant administration policies. These features round out the broader equity governance framework but do not all need to be finalized at listing. Initial IPO plans may also include provisions that are less shareholder friendly such as share recycling (89% of companies in the sample permit), which can be revisited when the plan is subsequently submitted for shareholder approval.

## Design for Life After the IPO

The most effective IPO equity programs are not necessarily those that check every governance box on day one. Instead, they provide sufficient flexibility to execute the company's compensation strategy while establishing a foundation that can evolve with public company expectations. A well-designed initial program should:

- Support recruiting and retention
- Align pay with performance
- Manage dilution and annual share usage
- Provide sufficient flexibility for changing business and talent needs
- Satisfy shareholder expectations during the company's early years as a public company

As the company matures, the equity program can be refined to reflect evolving strategy, market practice, and shareholder expectations. The objective at IPO is to establish a foundation without unnecessarily constraining future design choices.



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