

## Twitter Thread by Gergely Orosz



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The 12 most important pieces of information and concepts I wish I knew about equity, as a software engineer.

A thread.

1. Equity is something Big Tech and high-growth companies award to software engineers at all levels. The more senior you are, the bigger the ratio can be:



2. Vesting, cliffs, refreshers, and sign-on clawbacks.

If you get awarded equity, you'll want to understand vesting and cliffs. A 1-year cliff is pretty common in most places that award equity.

Read more in this blog post I wrote: <https://t.co/WxQ9pQh2mY>

## 2. Vesting, Cliffs, Refreshers and Clawbacks

Any time you'll be awarded equity, you'll see a few common terms.

**Vesting** refers to in what installments you'll "get" the equity. Say you are awarded 48 shares – or options – over 4 years, and they vest quarterly. You would get 3 shares – or options – each quarter. If you stay for the full 48 months, all 48 of your shares/options vest.

**Cliffs** are a clause that requires you to stay at a company for a minimum amount of time before you get *any* equity. In the previous example, without a cliff, you could decide to quit after 3 months and still walk away with 3 shares/options. This might be in your interest, but the point of equity is to incentivize staying long-term.

A one-year cliff is typical with all equity settings and is usually not negotiable. Going back to the previous example: 48 shares over 4 years, vesting quarterly, with a 1-year cliff would mean this vesting:

- 3 months, 6 months, 9 months: no shares.
- 12 months: 12 shares
- 15 months: another 3 shares... and the same, every 3 months.

**Conversion from monetary value to shares** or options could happen at two timeframes:

- **Converting when awarding the grant.** This is the most common scenario. For example, if you join Microsoft and your contract states you are awarded \$244,000 in stock over 4 years, and Microsoft's stock price is \$244 at this time, then you'd get awarded 1,000 units of stock to vest over time. This approach ensures upside if the stock goes up – but also downside if it goes down.
- **Converting on vesting of each stock unit.** This is an approach Stripe, Lyft, and a few other companies are taking as of recently. Say you are awarded \$480,00 of Lyft stock to vest over 4 years, at a monthly cadence. After the cliff, you'd be allocated \$10,000 worth of shares every month, converted on the spot. This approach ensures you get \$10,000 worth of stock every month: but you get no upside from the stock going up or see a downside if it goes lower.

### 3. Stock options / ESOPs.

The most common form of equity compensation at early-stage startups that are high-growth.

And there are \*so\* many pitfalls you'll want to be aware of. You need to do your research on this: I can't do justice in a tweet.

<https://t.co/cudLn3ngqi>

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#### 4. RSUs (Restricted Stock Units)

A common form of equity compensation for publicly traded companies and Big Tech. One of the easier types of equity to understand: <https://t.co/a5xU1H9IHP>

5. Double-trigger RSUs. Typically RSUs for pre-IPO companies. I got these at Uber.



## 4. RSUs (Restricted Stock Units)

**Publicly traded companies** are on the stock market – like Microsoft, Google, Amazon. Anyone can buy and sell their stock after opening a stock account.

**RSUs** – Restricted Stock Units – are a form of stock compensation that publicly traded companies often offer to software engineers. You'd typically get awarded a specific *amount* of stock that *vests* over a *given time period*.

Depending on the terms of the stock, it could be awarded in various ways:

- **You get awarded a number of shares:** converted from the dollar amount from when your award is approved. Say you get awarded **\$120,500** in Microsoft stock that vests over 4 years. Let's assume your stocks get awarded when the Microsoft stock price is \$241. You would get awarded 500 units that vest over these 4 years: or **125 units per year**. If the price of Microsoft stock goes up or down, so does the value of this package. Once the stocks vests, you can decide to sell them or keep holding them.
- **You get awarded a dollar value of shares** that get converted to shares on vesting. Say you get awarded the same **\$120,500** in stocks to vest over 4 years. Regardless of the stock performance, you'd receive **\$30,125 per year** in stocks. Once you get these stocks, you can sell or keep holding them.

Companies have an RSU policy. However, most places would award a number of shares at the start of your vesting period, making you more of an "owner" and someone who can benefit more from the stock price going up.

Further reading:

- [Restricted stock](#) on Wikipedia
- [What is Restricted stock?](#) on Investopedia
- [Restricted Stock Unit](#) section in the [Holloway Guide to Equity Compensation](#)

6. ESPP: a (typically) amazing employee perk at publicly traded companies. There's always risk, but this plan can typically offer good upsides.

7. Phantom shares. An interesting setup similar to RSUs... but you don't own stocks. Not frequent, but e.g. Adyen goes with this plan.

## 6. ESPP (Employee Stock Purchase Plans)

Employee Stock Purchase Plans (ESPP) is a benefit offered mostly by publicly traded companies. It allows employees to buy stock 5-15% below the fair market value.

Details of ESPP can seem complex, but it's worth understanding, as you can benefit from participating.

- **Enrolment period** is the time you need to decide upfront how much of your salary you contribute.
- **ESPP lookback provision** is a key part of ESPPs. You will purchase stock at the lower of either the offering date or the purchase date share price. Basically, if the stock rises significantly during the period, you might be able to purchase the stock with far more than a 15% discount. See [an example here](#).
- **Contribution limits** curb how much of your salary you can contribute. ESPP is typically a solid deal, and the limits ensure you can't benefit too much from enrolling.

I benefitted quite a bit from ESPPs both at Microsoft and at Uber. Both companies had a generous program with offers to buy stock 15% below the fair market value and contribution limits of about \$20,000 per year.

Further reading:

7. SARs - similar to phantom stocks. A few EU tech startups I know of use them.

8. Growth shares. A more exotic equity type. Skyscanner awarded these kinds of shares.



## 8. SARs (Stock Appreciation Rights)

Stock Appreciation Rights (SAR) are an interesting middle-ground between stock options and RSUs and are probably the most similar to phantom stocks.

**Employees would gain the increase in the stock price of the company,** during a pre-defined period. They are almost always paid out in cash. They are sometimes issued parallel with options as tandem SARs, so the gain in SARs will help with buying the stock options.

SARs are not typical in Big Tech, but you might come across them with some startups preferring this setup in the EU. There are both advantages and disadvantages of SARs both from an employee, and a company perspective that you can read more of [here](#).

Further reading:

10. Dilution. What is almost certain to happen with options/shares with new fundraising rounds. Not much you can do: but be aware.

11. Taxes. The only certainty with equities is you needing to deal with this. Talk with an expert. This is important.

# 10. Dilution

You joined a startup when it was valued at \$100M and received options that you calculated to be worth \$100,000 over four years. Four years later, the company is worth 20x that, at \$2B. Is your equity also worth 20x that, or about \$2M?

Doubtful.

It's probably worth less than that. It could be worth 5x, 10x, or even 15x: all depending on dilution.

**Dilution occurs when a company raises new investment, and the new investors receive freshly issued stock** at the expense of existing stock holders – founders, earlier investors, and employee stock holders. For high-growth companies who raise several funding rounds, some level of dilution will be an ongoing characteristic.

Startups growing at a healthy pace will see stock holders own a smaller piece of a larger pie – but the pie growing typically offsets the shrinking in ownership.

At the same time, dilution is rarely the cause for employee stock options not being worth much. Not getting to a liquidity event or just stopping to grow are far more common cases. And remember: there is nothing you'll be able to do about dilution as an employee. However, you might be able to impact growth: and very high growth with high dilution almost always has better outcomes than slow growth with little dilution.

Further reading:

WeWork. Zenefits. Good Technologies. FanDuel. All cautionary examples.

Until you've cashed in your equity, it can evaporate. Keep this in mind.

Full article: <https://t.co/fuojT1jp4g>

And finally:

**Equity being worth nothing** is the most common outcome with startups. The company might never go public. It might be sold at a price where common stock – and options – are worth nothing [thanks to ratchet causes](#) protecting the early investors. The company might never have a financial event.

If you joined the "next and better Uber", you'd have gotten nothing. Sidecar was the first "true" ridesharing company, connecting riders with drivers who did not have to be black car drivers. Still, despite innovating ahead, the [company shut down](#) a few years later. Anyone with equity in the company was left with nothing.

As another story, one of my friends worked at five startups, over five years, exercising options in each. Only one of the startups ever had an exit: it got sold to another company. My friend had stock worth around \$50,000 on paper when he left. He received \$215 as proceeds from the sale.

Most companies do not equity for software engineers. Big Tech and high-growth tech startups are ones who typically do.

But how do you get into these places? I don't have the answers, but have a few thoughts I'll send out in email form

Subscribe here: <https://t.co/117RGTXS0u>