



PRE-IPO/VENTURE-BACKED PAY PLANNING

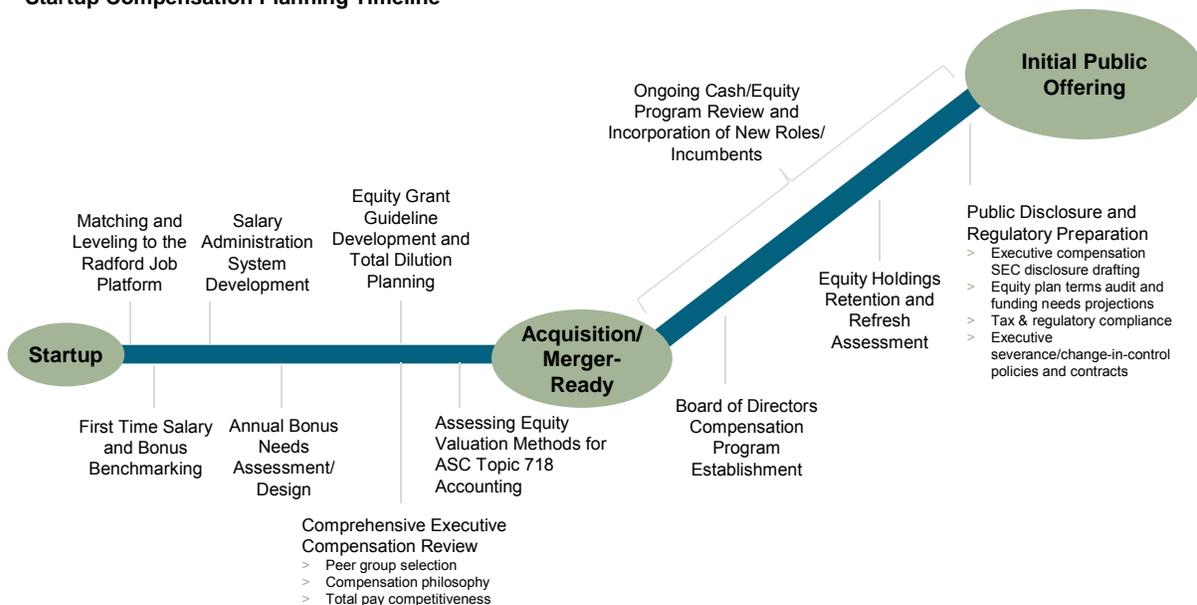
Getting Your Startup's Compensation House in Order

By Brett Harsen, Vice President

Working for a startup company can be an exciting jaunt through periods of growth and innovation spiked with both successes and set-backs. With such a frenetic pace it can be difficult for human resources professionals to establish compensation programs and policies. But without such systems in place there is risk in creating – and exacerbating – both internal pay inequities and competitive disconnects with the external labor market. For budget-constrained startup companies, wherein payroll is often the single largest expense line, it is imperative that limited resources like cash and company shares be managed effectively.

This Radford Review is meant to provide a compensation roadmap for private, venture-backed companies oriented toward a sale of the company or for an initial public offering (IPO), and is based on Radford's extensive consulting experience assisting clients as they navigate the startup path. Figure 1 provides a general overview of the process for putting your compensation house in order as a startup venture:

Figure 1 – Startup Compensation Planning Timeline



This article is first in a series and discusses the primary considerations for implementing:

- > Total cash benchmarking tools and processes; and,
- > Salary administration systems

Subsequent articles will focus on:

- > Annual broad-based bonus programs (non-sales);
- > Equity allocation strategies;
- > Executive and Board of Directors compensation programs; and
- > Preparations for compensation administration in a public company environment.

Total Cash Benchmarking

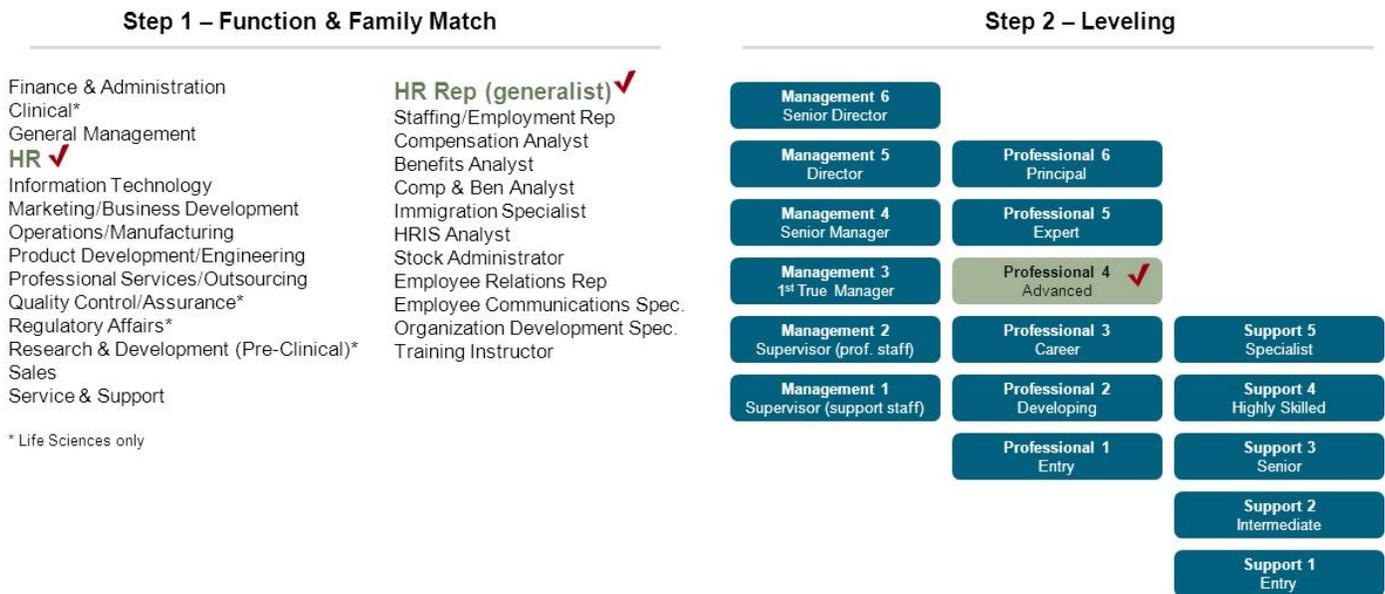
Phase 1: Job Matching

The very foundation of all compensation systems is compensation data. For startup ventures in the technology and life sciences industries, Radford provides an excellent primary source for comprehensive pay intelligence. The first phase in the benchmarking process is matching your organization’s roles to positions tracked in market surveys. Accurately matching your jobs is critical to the successful implementation of any compensation program as senior management must have confidence in the external comparisons being made. Radford’s global job platform has evolved over time to fit the needs of our clients and includes more than 450 job families and 2,200 different individual roles. Matching to the Radford platform is a two-step process:

- > **Job Family/Category Match** - Radford organizes all job families into Management, Professional Individual Contributor or Support Individual Contributor categories with descriptions of the primary responsibilities of each family (Executive level jobs are handled separately and will be discussed in a later chapter). The first step is to select the job family that best describes the role being analyzed. It is important to note that survey job matches are designed to be used by every company being studied and are not likely to precisely describe every aspect of a position at a particular organization. The goal is to find a match that describes at least 80% of the responsibilities of the job in question.
- > **Job Leveling** - Once the job family has been selected, the next step is leveling. Radford’s job platform defines up to six levels each for managers and professional individual contributors, and up to five levels of support employees. Each level is defined by the scope/complexity of the job, amount of discretion exercised in the role and minimum education/experience requirements.

Figure 2 provides an overview of the Radford leveling system as well as an example match for a Senior HR Representative. Note that the levels are designed with overlap between managers, professionals and support categories to reflect the progressions that exist in most organizations.

Figure 2 – Matching to the Radford Global Job Platform



Phase 2: Competitive Analysis

After matching and leveling is completed, the next phase is to compare current incumbent pay to market survey data. Before making such comparisons, we must first define the labor market. In other words, from whom do we recruit talent and to whom do we lose talent? The answer will depend on the type of jobs being analyzed, as illustrated in Figure 3.

Figure 3 - Parameter Importance for Defining Labor Market for Total Cash Benchmarking

Job Type	Industry or Sub-Sector	Public vs. Private	Organizational Size	Geographic Location (within the US)	Sample Data Cut Parameters for Total Cash Compensation Analysis
Executive	●	●	●	○	<ul style="list-style-type: none"> > Software companies only > Private companies only > Under 200 employees > National data (all US)
Non-Executive, Non-Sales	◐	○	○	●	<ul style="list-style-type: none"> > All high-technology related sectors > Public & private companies > All company sizes > San Francisco Bay Area employees only
Sales	●	○	○	○	<ul style="list-style-type: none"> > Software companies only > Public & private companies > All company sizes > National data (all US)

● Important parameter for defining labor market
 ◐ Somewhat important parameter for defining labor market
 ○ Not an important parameter for defining labor market

It is a common misconception that private startup companies should only compare themselves to other private startups when assessing the competitiveness of cash compensation. While this may be appropriate for executive positions – where the scope of the role is dependent on organizational size and maturity – it is not true for non-executive jobs where private companies may be competing with both public and private companies of all sizes for talent. Note, however, that equity compensation should only be compared to other private organizations, as discussed later in this Radford Review.

Once the parameters have been defined and the custom cuts of survey data obtained, the next step is to compare your current incumbent pay to market. Best practice is to compare against multiple survey percentiles to understand where current incumbent pay falls on the market continuum. The example analysis in Figure 4 demonstrates that while overall competitiveness is at market 50th percentile, the Sr. HR Representative is more closely aligned with the 25th percentile and the Software Engineering Manager is closer to the 75th percentile. In order to keep the illustration simple, only base salary results are displayed in Figure 4 on the following page. Typically this type of analysis would include bonus amounts and total cash (base plus bonus) as well.

Figure 4 - Sample Base Salary Competitive Analysis Results

Position	# of Emps	Avg. Current Base Salary	Market Base Salary			Avg. Current Base Salary as a Percent of Market		
			25 th Percentile	50 th Percentile	75 th Percentile	25 th Percentile	50 th Percentile	75 th Percentile
Sr. HR Representative	2	\$80,000	\$79,000	\$90,000	\$110,000	101%	89%	73%
Sr. Software Engineer	5	\$112,000	\$100,000	\$115,000	\$135,000	112%	97%	83%
Software Engineering Manager	2	\$140,000	\$110,000	\$120,000	\$145,000	127%	117%	97%
Overall:						113%	100%	84%

Salary Administration Systems

As a startup company grows, there comes a time to implement a salary administration system that will provide guidance to people managers making pay decisions for their direct reports. Such a system helps to ensure both external market competitiveness and internal consistency and fairness. There are two basic approaches to a salary administration system (though variations abound from company-to-company):

Figure 5 - Salary Administration Approaches

Approach	Description	Strengths	Weaknesses
Market Reference Guidelines (MRGs)	A system that assigns "mini ranges" for each individual job	<ul style="list-style-type: none"> > Arguably a more "precise" approach compared to grouping multiple jobs into broader grades > Provides more flexibility to react to changing market conditions (e.g., hot skills jobs that move at different rates year-over-year), incorporate new jobs or remove obsolete jobs 	<ul style="list-style-type: none"> > Requires substantially all jobs at the organization to be matched to surveys – creates significant challenges for non-benchmark positions when they cannot be slotted into a grade with other like-jobs > Greater burden for HR to administer and communicate
Traditional Salary Structure	A system that groups like-paid jobs into a limited number of broad pay ranges or "grades" (typically 10-15)	<ul style="list-style-type: none"> > Limited number of grades eases administration for HR and communication/training to people managers > Non-benchmark jobs (those positions for which there are no survey matches) can be "slotted" into grades based on best fit with those benchmark jobs already in the structure 	<ul style="list-style-type: none"> > Reduces job-by-job "precision" > Provides less flexibility to react to changing market conditions (e.g., hot skills jobs that move at different rates year-over-year)

Figure 6 on the next page provides a sample of job-by-job Market Reference Guidelines (MRGs) for four different job families, each containing Manager, Senior Professional and Professional level roles. These MRGs are effectively "mini-ranges" around each individual job. Note that these job-specific MRGs will commonly have narrower range spreads¹ than traditional salary structures, which are discussed later. This is because MRGs are built around a single job whereas traditional salary structures group multiple like-paid jobs together into the same range.

The end result of using MRGs for this sample set of jobs is 12 unique ranges that must be maintained and communicated to the organization on an ongoing basis. While this provides a certain level of “precision” to each job, it makes the administration of an MRG system more complex than a traditional salary structure that groups similarly paid jobs together into a smaller number of ranges. Figure 6 clearly demonstrates that some of these jobs are paid very similarly and begs the question of whether the increased “precision” of MRGs is worth the added administrative burden.

Figure 6 – Sample Job-Specific Market Reference Guidelines (MRGs)

Position	50 th Percentile Base Salary	Range Spread (max-min)/min	Min	Mid	Max
HR Family					
HR Manager	\$100,000	25%	\$89,000	\$100,000	\$111,000
Sr. HR Representative	\$90,000	25%	\$80,000	\$90,000	\$100,000
HR Representative	\$70,000	25%	\$62,000	70,000	\$78,000
Finance/Accounting Family					
Accounting Manager	\$120,000	25%	\$107,000	\$120,000	\$133,000
Sr. Accountant	\$85,000	25%	\$76,000	\$85,000	\$94,000
Payroll Analyst	\$68,000	25%	\$60,000	\$68,000	\$76,000
Information Technology Family					
Information Systems Manager	\$115,000	25%	\$102,000	\$115,000	\$128,000
Information Systems Architect	\$89,000	25%	\$79,000	\$89,000	\$99,000
Programmer/Analyst	\$73,000	25%	\$65,000	\$73,000	\$81,000
Hardware Engineering Family					
Hardware Engineering Manager	\$140,000	25%	\$124,000	\$140,000	\$156,000
Sr. Hardware Engineer	\$105,000	25%	\$93,000	\$105,000	\$117,000
Hardware Engineer	\$91,000	25%	\$81,000	\$91,000	\$101,000

Figure 7 on the next page demonstrates how a traditional salary structure would be designed to fit these same sample jobs into five ranges, or grades, instead of twelve as with the MRGs. In our simple examples, the benefit of consolidating twelve ranges to only five may not seem so compelling – but note that we are only illustrating four job families. The typical start-up company quickly grows to multiply the number of families and jobs we illustrate here, but even the largest organizations using a traditional salary structure housing hundreds of jobs will have less than 15 grades.

As discussed above, range spreads¹ for traditional salary structure grades are wider (50% in this example) than MRGs’ (25% in this example). This greater width is needed to accommodate multiple jobs in the same grade.

This example is a “market-based” structure, meaning a job’s assignment to a grade is based on what the market data tells us the job is worth. The result is that higher-paid functions tend to be in higher grades. Figure 7 illustrates this effect for the Hardware Engineering Family where: the Manager level is in Grade 5 whereas other families’ are in Grades 3 or 4, the Senior Professional level is in Grade 3 whereas other families’ are in Grade 2, and the Professional level is in Grade 2 whereas other families’ are in Grade 1.

One final note about traditional salary structures is that they are better systems for accommodating non-benchmark jobs. Typically, an organization is able to find benchmark matches for approximately 80% of the jobs – the remaining 20% being too unique to find comparable matches in salary surveys. MRGs are dependent on having job-by-job market data around which to build ranges. However, a traditional salary structure makes it easier to decide which group of jobs is most comparable based on how the organization values the positions internally, and “slot” that non-

¹ Range spread is a measurement of the width of salary range equal to the difference between the maximum of the range and the minimum of the range, stated as a percent of the minimum ((max/min)/min)

Conclusion

Establishing processes for benchmarking compensation to external survey data is the foundation for administering pay programs at any organization, big or small. For startups, the challenge is implementation when HR resources are limited – yet procrastination can lead to internal pay inequities and a lack of market competitiveness. This Radford Review has focused on the basics of survey matching, benchmarking and salary system design. These building blocks will continue to support more complex pay programs such as cash incentives, equity award strategies and executive compensation arrangements.

About the Author

Brett Harsen has more than 14 years of compensation consulting experience on a range of issues, including broad-based employee pay, short- and long-term incentive design, executive and Board of Directors compensation. He specializes in equity compensation design and delivery. Brett consults organizations in a variety of industries, with a focus on high technology and life sciences. In addition to his consulting, Brett provides strategic guidance to Radford Surveys in the development of new analytic reports and the Pre-IPO/Venture-Backed products. Brett is also a leader in Radford's underwater option practice and co-creator of Radford's web portal www.UnderwaterExchange.com. He is an active contributor to Radford's Relative Total Shareholder Return (TSR) performance equity practice and the corresponding web portal www.RelativeTSR.com. Prior to joining Radford, he held consulting positions at Buck Consulting, iQuantic and Deloitte. Brett earned a bachelor of science from University of Illinois and holds designations from WorldatWork as a Certified Compensation Professional (CCP), and the Society for HR Management as a Professional in Human Resources (PHR). He is a frequent writer and speaker on equity and long-term incentive topics and has been cited by The Wall Street Journal, Bloomberg, Financial Week, Agenda, The San Jose Mercury News, Corporate Board Member and others. He is based in San Jose.

About Radford

For more than 35 years, Radford has provided compensation market intelligence to the technology and life sciences industries. Global survey databases, which include more than 4 million incumbents, offer current, reliable data to nearly 2,000 clients. Leveraging Radford survey data, our thought-leading global Radford Consulting team creates tailored solutions for the toughest global business and compensation challenges facing companies at all stages of development. In addition to our consulting team, we also offer equity valuation assistance via Radford Valuation Services, and leading-edge market analyses and survey services with Radford Analytic Services. Radford's suite of surveys includes the Global Technology, Life Sciences, and Sales Surveys, as well as the US Benefits Survey. For more information on Radford, please visit <http://www.radford.com/>.

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