Insights for Early-Stage Companies

A Practitioner's Guide to Navigating the A.R.T. of Employment and Employee Benefits

By:Rebecca F. Alperin
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Early-stage companies must often rely on creative approaches to compensation and benefits to successfully navigate the challenges of Attracting, Retaining, and Transitioning employees necessary to win the war for talent. In the second article of our series – A Practitioner's Guide to Navigating the A.R.T. of Employment and Employee Benefits – we share with you five strategies proven to be successful for early-stage companies.

1. Be Employee Centric

Gone are the days where a one size fits most approach to hiring, firing and everything in between works in an employer's favor. Employers have distinct cultures, with employees that are increasingly strident in their desire for flexibility, transparency, respect, and recognition. Successful employers understand their demographics and appreciate the needs of different demographic groups within their population. They listen and react to their employees and perhaps more importantly, with those that have left or those that have declined an offer of employment. Successful employers are not afraid to ask difficult questions; employee centric questions that elicit responses to what they could have offered to better meet the employee's expectations and needs. And finally, successful employers learn from the responses and are dynamic in implementing change and flexible in the benefits they offer.

2. Encourage Employees to be Far-Sighted

It's one of the biggest conundrum's early-stage companies face – how to attract top talent with total compensation schemes that are less than market. At a time when the allocation of company resources must first be used to meet pressing business needs, deferred compensation arrangements offer a solution. Deferred compensation schemes preserve a company's cash in the short-term and may provide a lucrative payout for employees in the long-term.

Early-stage companies should ask questions such as how much cash is reasonable to lure a prospect away from his or her current position and does it make sense to grant equity interests. If yes, should the company use restricted stock, options, or a combination of the two.

Tools a company has at its disposal include:

Pay for performance. A less than competitive base salary may be more palatable to an employee when combined with a lucrative bonus structure, commission pay, or other performance incentives. A portion of the risk is shifted to the employee and the employee's pay is deferred until satisfaction of certain performance metrics designed to generate sufficient income to meet compensation demands. Performance based pay is not limited to sales, employees who traditionally receive commission-based pay. This model can be adopted for multiple professions so long as there are objective measurable criteria over which the employee has control.

Equity awards. When cash is in short supply, employers also may draw talent with the promise of a share in the company's growth by granting equity-based compensation. Examples include incentive stock options, restricted stock, and nonqualified options. These schemes transfer to employees a stake in the company's success by aligning the interests of employees with those of their employer. In addition to preserving cash flow and enhancing employee motivation, equity compensation awards minimize employee turnover by tying employees to the company. While equity-based compensation plans serve the purpose of attracting and incentivizing employees, they should be used in conjunction with other benefit strategies to attract and retain employees that are a good fit with the company's culture.

3. Take a Seat at the Big Kids Table

Although early-stage companies cannot compete with the panoply of benefits offered by their mature counterparts, early-stage companies have at their disposal qualified plans for small employers that mirror the qualified plans adopted by their large company counterparts. In this way, early-stage companies can adopt lower cost programs and still cover, or at least contribute to, employees' basic needs for health insurance and retirement security.

Individual Coverage or Qualified Small Employer Health Reimbursement Arrangements

The Individual Coverage Health Reimbursement Arrangement ("ICHRA") and Qualified Small Employer Health Reimbursement Arrangement ("QSEHRA") are employer-funded, tax-free health benefits used to reimburse employees for individual health insurance premiums (for example, purchased through the marketplace) and other medical expenses. These arrangements are not pre-funded; they are reimbursement accounts. Therefore, a company does not spend any money until a claim for reimbursement is made. Further, because reimbursements are pursuant to such an arrangement, they are tax-free to the employee and tax-deductible by the employer, in contrast to a company simply reimbursing employees for health insurance and expensing it which is a taxable event to both the employer and employee. The chart below highlights a few of the important differences between the ICHRA and QSEHRA.

	ICHRA	QSEHRA
Are there any size restrictions on who can sponsor an arrangement?	None.	Available to employers with less than 50 full-time equivalent employees.
Who is eligible?	Eligibility is determined by the employer and different classes of employees may have different eligibility criteria.	Full-time employees are automatically eligible; part-time employees are included at employer's discretion.
How much can an employer contribute?	There are no limits.	For 2022, the contribution limits are $5,450 per single employee and $11,050 per family.
Restrictions for employees with spousal or parental group coverage.	Employees with spousal or parental coverage cannot participate.	Employees with spousal or parental coverage can only be reimbursed for qualifying medical expenses, not premium payments.

Small Business Health Options Program

The Small Business Health Options Program ("SHOP") is a program for small employers (1 to 50 full-time equivalent employees) that provides affordable, flexible, quality, and convenient group health and/or dental insurance. SHOP plans are offered by private insurance companies. They cover essential health benefits and may not exclude coverage for treatments for pre-existing conditions. Small employers are not restricted to a limited open enrollment period for purchasing SHOP insurance; SHOP coverage may be offered and begin any time of the year.

Further, small businesses may qualify for the Small Business Health Care Tax Credit that could be worth up to 50% of the costs paid by the company for employee premiums.

SIMPLE 401(k) / SIMPLE IRA / SEP IRA

As their names suggest, these plans are cousins to the more well-known 401(k) and IRA. They provide early-stage companies a way to offer employees retirement savings without many of the administrative hassles and costs of a typical 401(k) plan. With each plan, the employer must make contributions on behalf of employees. Employees at all times are one hundred percent (100%) vested in contributions made on their behalf and employees enjoy tax-deferred growth until funds are withdrawn. The chart below highlights a few of the key differences among the three plans.

	SIMPLE 401(k)	SIMPLE IRA	SEP IRA
Who can set up this plan?	Employers with 100 or fewer employees. Self-employed individuals could set up a solo 401(k).	Employers (including the self-employed) with no more than 100 employees earning more than $5,000 in the preceding plan year.	Any employer (including the self-employed).
Who can contribute to this plan?	Employers must contribute to the plan. Employees may contribute to the plan.	Employers must contribute to the plan. Employees may contribute to the plan.	Only employer contributions are permitted.
How much must the employer contribute?	Dollar for dollar match up to 3% of pay or a 2% non-elective contribution for each eligible employee.	Dollar for dollar match up to 3% of pay or 2% of pay up to a maximum limit of $305,000 for 2022.	Employer may contribute up to 25% of pay, up to a maximum of $61,000 for 2022. Note, contributions are not required every year; if contributions are made, all employees must be treated equally.
How much may the employee contribute?	$14,000 in 2022. For employees age 50 and over an additional catch-up contribution of $3,000 in 2022 is permitted.	$14,000 in 2022. For employees age 50 and over an additional catch-up contribution of $3,000 in 2022 is permitted.	No employee contributions are permitted.

4. Harvest Low Hanging Fruit

There is no doubt that post-pandemic employee demands have changed and for employers to remain competitive in attracting and retaining top talent, employers must align benefits with the professional and personal goals of the post-pandemic work force. Fortunately for employers, many of these benefits can be offered with little or no additional cash expense, and many post-pandemic employees are willing to trade a portion of their salary for these benefits.

Flexibility

Currently, the name of the game is flexibility in both hours and work location, with employees prioritizing lifestyle and quality over quantity. Early-stage companies can promote balance and flexibility by, for example, adopting generous vacation and leave policies, granting additional leave to promote approved service projects, allowing flex time, remote days, or half-day Fridays in the summer. Additionally, the pandemic has made us all keenly aware of the importance of care benefits – childcare, elder care, and even pet care. Early-stage companies can ease the burden on employees by offering, for example, paid access to online platforms to find care.

Invest in Training and Professional Development

Reskilling and upskilling employees is a key retention technique and helps to ensure a company's longevity. Employers can demonstrate commitment to employees' professional growth by, for example, encouraging employees to take time during work to develop new skills or creating a formal mentorship program internally or by pairing senior executives with external advisers or investors.

Cover Expenses Before Taxes

Parking, mass transit, ride sharing, gym memberships, supplemental insurance coverages, daycare, summer camps, adult care, college debt repayment — over the course of a year, these costs add up for an employee. Choosing to pre-tax such benefits will give employees a tax break on their current taxes, which may be valuable depending on their financial situation.

Encourage Peer Recognition

Peer recognition programs are a corollary to the employer-employee bonus structure. Here, co-workers recognize, validate, and value the outstanding work of peers. When colleagues affirmatively notice another's efforts and contributions, key cultural drivers such as teamwork, trust, and collaboration are enhanced. There are many peer-to-peer recognition platforms available to early-stage companies. These range from creating a recognition feed for employees to post to, to providing employees with an allowance to be used to send co-workers gift cards redeemable for snacks, coffee, gas, etc.

Digital Currency Savings Plan

A Digital Currency Savings Plan provides early-stage companies with a tool to leverage the power of digital currency such as bitcoin to attract and retain employees and to differentiate themselves among competitors. Employees choose what percentage of their pay they would like to auto-convert to digital currency on an after-tax basis. Because these plans do not offer tax advantaged savings like a 401(k) plan, employees can sell their digital currency at any time and withdraw the proceeds. Employers wishing to adopt a Digital Currency Savings Plan should first consult with counsel to determine the income tax treatment of digital currency and ensure compliance the Fair Labor Standards Act which does not recognize payment in the form of digital currency in satisfaction of the overtime and minimum wage requirements.

5. When You're on the Way Out, Recognize Those with You on the Way Up

A corollary to encouraging employees to be far sighted, is promising specified employees a share in an anticipated or pending sale of the business. Transaction bonus plans are typically structured so that specified employees benefit from the increased value of the business upon a change in control. This may be accomplished through the issuance of performance-based awards that allow employees to share in the increasing value of the company without transferring voting power to them. Performance shares, stock appreciation rights, and phantom stock are examples of performance-based awards that compensate employees with an amount that reflects the appreciation in company stock. A carve out plan similarly rewards specified employees by setting aside (or carving out) a specified dollar amount or percentage of transaction proceeds for distribution upon a change in control. There are more similarities than differences among these alternatives and the right alternative may be more a function of optics than anything else.

Founders and c-suite professionals of early-stage companies constantly must act and react to changing business demands. By following these 5 strategies, early-stage companies can ease the burden of attracting and retaining qualified talent and become an employer of choice.

Contact Rebecca Alperin to discuss the applicability of any of these 5 strategies to your company.

Other articles in this series:

Why Do I Need an Employee Benefits Attorney?

Stay tuned for the next article in this series – LLC's have "*Options*" – Equity Incentives for Limited Liability Companies.