No matter which startup you interview with, at some point you’ll likely have a conversation about stock options.

We’ve put together a quick guide to help you understand what it is they’re actually offering and the questions you should ask to help compare offers from different companies.
WHAT ARE OPTIONS?

Options are a right to buy shares in a company at a set price (known as the “strike price”). That price doesn’t change, so if the value of a company goes up, you can buy shares at an extremely attractive price.

When you “exercise” an option you pay the “strike price” and get a share in the company in exchange. When the company gets acquired or goes public, employees can then typically sell these shares at market value.

This process allows startups to give employees the opportunity to benefit from the success of the startup in a similar way to the founders.

SO WHEN DO I GET THE OPTIONS?

Although you’ll often be given an allocation of options when you join a startup, you normally have to earn them over a period of time through a process called “vesting”. This is designed to reward employees for committing to the company for an extended period.

The standard practice is what’s known as “four year vesting with a one year cliff”, which means you’ll receive (vest) 25% of your options after one year at the company (if you leave inside the first year, you get nothing), and then after that your options vest over set time periods (usually monthly or quarterly) across the following three years. After four years, that initial allocation of options is all yours (you become “fully vested”).

WHY WOULD YOU NOT WANT TO EXERCISE YOUR OPTIONS?

Typically you either exercise your option at one of two points, either when the startup has a “liquidity event” (i.e. the company gets bought) in which case you generally exercise your options and sell your stock simultaneously, or when you leave the company.

In the second case if the strike price is high you may have to invest a significant amount of money in order to exercise the options and end up holding stock that you can’t sell until the company has a liquidity event. There’s also the risk that your stock ends up worth less than what you paid for it.

WHAT QUESTIONS SHOULD I ASK?

Comparing offers of options from different startups can be difficult but these are the questions you should be asking:

// How many options am I getting?

One option is equal to one share, so if you have 100 options you’ll be able to convert them to 100 shares.

// What strike price are the options at?

In order to exercise all your options you’ll pay Number of Options x Strike price, so you’ll care what value this is.

It’s fairly common practice for the strike price to be set at the current price based upon last valuation however this means it can be fairly expensive and high-risk to exercise the options.

The most employee-friendly practice (which MarketInvoice follows) is for the strike price to be at a significant discount to the current price, low enough that it’s comfortably affordable for employees to exercise them. It also means your options have meaningful value from day one.

// What was the valuation and price per share at the last funding round?

Number of Options x price per share will tell you roughly how much your options would be worth if you exercised them today (though note that you can’t exercise options unless you’re leaving or there’s a liquidity event).

Valuation is important because you want your options to increase in value by large multiples so the question you want to ask yourself is do you see the company’s valuation increasing by those large multiples within the next few years. A company worth £1bn today is way less likely to be worth £100bn in the future than a company worth £10m today to be eventually worth £1bn.

// Does vesting accelerate on a liquidity event (acquisition/IPO)?

Acceleration means that if the startup gets acquired and you haven’t vested all of your options (say you’ve only been at the company for one year) then all of your options get automatically vested, so you get your full allocation of options immediately.

If you think that the startup has a chance of being acquired or listing on a public stock exchange before you’ve come to the end of your vesting period, then you definitely want an acceleration clause on your options.

// What happens if you leave the company?

Generally you’ll have a time limit from your leaving date in which you have to exercise your vested options before they expire. It’s commonly 30 days but at some companies you’ll lose the options immediately which is something to watch out for.

More employee-friendly startups generally offer an extended time-limit (at MarketInvoice it’s 12 months!) ensuring you have a reasonable time period to consider if you want to exercise or not.

// Is the options scheme EMI approved?

Enterprise Management Incentive is an HMRC scheme which allows startups to grant options to employees in a way that means you end up paying significantly less tax (as low as 10%) on your gains if the company gets acquired or IPOs. Options packages that are EMI approved can be significantly more valuable.

// MarketInvoice

All employees at MarketInvoice get stock options and we have one of the most employee friendly option schemes on the market as we want to reward our employees fairly. Find out about the roles we’re hiring for at marketinvoice.com/careers