DLA PIPER

ACCELERATE

# The option pool: wading or olympic sized?

For an early-stage company, the foundation for long-term success frequently depends on finding the right people. To hire and retain the right people, a key factor is providing them with the right equity incentives. Founders and investors alike are often happy to share in the upside with those who contribute to a startup's growth and success.

The number of shares set aside in the option pool is the amount available to grant as equity incentives to employees, directors, consultants and other service providers. The size of the option pool, of course, is a personal decision for each founder, with investors frequently providing input. Ultimately, the option pool's size falls within a range. This article explains some of the factors in deciding where your option pool should fall in that range.

Out of the gate, pre-funding, founders usually only have a handful of service providers who should receive equity incentives, so the size of the option pool need not be very large. Offer letters typically include an option grant stated in a number of shares.  However, the more sophisticated prospective employees will usually ask how much the option represents as a percentage of the company. That percentage is usually expressed on a "fully-diluted" basis (*ie*, a percentage of all the stock outstanding or planned for issuance  including the entire option pool, even if unallocated; for more about the difference between outstanding, issued and authorized stock, see our article). What this means is that founders may not want to get too carried away with a large option pool. That said, an unusually lean option plan reserve could result in founders running out of equity under the plan and having to incur additional costs and administrative headaches associated with increasing the option plan reserve just to make some basic early hires.

The real discussion about option pool size happens (and matters) when investors arrive. Investors tend to push for a healthy option pool to be established *before* they invest, since the price they pay for their shares will be lower and there will be plenty of equity incentives available for the hiring needs post-investment (without diluting the investor's ownership). The founder perspective is, of course, different, because the lower price for investors means heavier dilution for the founder at the time of the investment.

So the final balance of the option pool's size is usually struck between founders and investors based on the actual hiring needs of the startup. Founders and investors often agree to set aside only enough stock for the 12-18 months after a financing and deal collaboratively with any additional equity incentive needs after that. Depending on what the startup really needs, that usually translates into 10-20 percent of the company's outstanding stock for an option pool. If a startup needs superstar talent, a new, experienced CEO or several senior executives, then the option pool may need to be at the higher end of the range because hiring those executives may require granting them larger options. Early-stage companies that have already built out a solid team may not need those larger grants and, therefore, will not need the larger option pool.

Bottom line: like most decisions facing founders, digging a little deeper can ensure that you make the right decision for the business without wasting any equity.

---