Is the Startup Compensation Model Broken?

Chair: Rebecca Zarutskie, Assistant Director of Monetary Affairs, Federal Reserve Board of Governors

Panelists:

- *Amy Nelson, Venture for America*
- *DeLisa Alexander, EVP and Chief People Officer, Red Hat*
- *Sangeeta Badal, Principal Scientist, Entrepreneurship and Job Creation, Gallup, Inc.*
- *L.J. Brock, Coinbase*

Compared to more established firms, startups are more likely to compensate through equity rather than salary compensation. But is this model working, with companies staying private longer? Startups have to work harder to hire top talent. With unemployment at a record low, it's tough for businesses – especially young, small firms – to hire. What else besides equity is in the mix when recruiting talent? This session explored these questions.

DeLisa Alexander explained how Red Hat is growing fast, and so talent is top of mind. Red Hat competes with firms like Google and Apple for talent, but they also compete with younger organizations. When they were smaller (i.e., 500 people), they compensated much less through cash and much more through equity. Now, as a major company, they still give equity to about 50% of their employees, but at much smaller amounts, using salary as the main compensation. But Alexander said it's getting harder to hire and retain employees, because bigger players can take top talent from Red Hat and double their salary. Alexander said, though, that some employees lured away by other companies eventually "boomerang back" to Red Hat, because of its culture.

Sangeeta Badal has studied the psychology, or human side, of entrepreneurship. What can high-growth ventures do in an environment where the model that has been working is no longer working? She offered six tips:

1. Hiring and retaining talent is about more than compensation – it's about meeting psychological needs. The new workforce is less concerned with compensation, and more concerned about purpose. They want to derive meaning from work. When they do get meaning from work, they are more likely to stay in a job. Badal said that companies that have a more articulated purpose have stock prices 12 times those of comparable companies.
2. Companies should strive less for employee satisfaction and more for engagement. Engagement equates to psychological safety, with employees' welfare and opportunities to develop foremost.
3. Executives and managers should move from "boss" to "coach." Employees who receive daily feedback from their manager are three times more likely to be engaged, which then leads to better outcomes.
4. Companies need to find ways to move staff from an employee mentality to an ownership mentality. With an employee mentality, employees perform only the minimum requirements of their jobs. With ownership mentality, employees are empowered to make decisions. Transparency about current company health and future plans is also key.
5. Employees need to be encouraged to view their job as creating value. When employees don't see how their contributions contribute to bigger picture, they are not as productive, and don't grow

with the company. Founders can help their employees understand how their contributions affect the whole firm.

6. Weigh the pros and cons of work predictability versus flexibility in thinking. In bigger companies, there is a routinized work that is predictable. Employees know the expectations, goals, and daily tasks. This is efficient, but the standardization makes it less emotionally connecting to the individual. Here, young firms have an advantage, where something new might be thrown at employees every day, and they need to be ready to tackle any problem that comes their way.

L.J. Brock said that his company, Coinbase, an $8 billion private company, is in no hurry to go public. At Coinbase, there is a lot of dialogue around the missionary versus mercenary mentality in the company, since companies like Google are frequently poaching their employees. Brock said that culture and mission are thus very important, as is competitive compensation. All are critical to competing successfully with larger players in your industry.

Amy Nelson leads Venture for America, whose goal is to train the next wave of startup employees. Venture for America places fellows in mostly tech or tech-enabled startups in 14 cities throughout the U.S. They select companies with a strong leadership team that is able and willing to mentor the fellow and provide a growth trajectory. The 14 cities Venture for America works in are all emerging entrepreneurial ecosystems that typically struggle with hiring and retaining talent. Nelson said it's a win-win situation – the companies get good, trainable talent, and the fellows get an opportunity to gain experience and move up in the company more quickly than they might in a larger market.

The question-and-answer session prompted many ideas for further research on the topic. The questions participants raised included:

- What can companies offer to differentiate themselves from the competition?
- How do companies select talent? How do you select and evaluate candidates?
- How is it best to structure equity-based compensation given private companies are staying private longer?
- How do companies address the wealth gap?
- What effect has a more geographically mobile workforce have on companies' ability to hire and retain talent?
- Is it better to acquire talent or build it? And how do you build it?
- Do employees put too much pressure or expectations on companies for a mission or purpose?
- There is a scarcity of talent. What key things can the private and public sectors do to address that?