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SMALL BUSINESS

For Entrepreneurs, Sharing Isn't Always Fun

Equity in Lieu of Pay Can Help Business Owners Lure Talent, but Many May Not Want to Part With Future Profits

BY SARAH E. NEEDLEMAN

Business owners with limited payroll budgets may be tempted to use equity as a substitute for a portion of salary when trying to attract top talent—but this means possibly parting with a piece of their business's future success.

Mary and Matt Paul say they're grateful that their employees turned down an offer of equity in lieu of more pay when they launched their transportation-services firm, **Crown Cars & Limousines** Inc., more than 15 years ago.

"They didn't trust that the company was going to be successful," says Ms. Paul of the recruits. "I'm happy it worked out that way because now I couldn't imagine sharing my profits." She says the company earned roughly $4 million in 2009.

Businesses have long used part-ownership in place of—or in addition to—bigger salaries. Some offer a piece of their firm's overall financial value as equity. Others dispense it in the form of stock options that only become valuable if their company goes public.

The latter may be a tougher sell these days since few companies have gone public in recent years: There were just 63 U.S. initial-public offerings last year and 43 in 2008, compared with 272 in 2007 and 221 in 2006, according to Renaissance Capital LLC, an independent research firm in Greenwich, Conn.

For a small business, where profits often aren't too big to begin with, this can mean dividing the pot even further. "In essence you are diluting your potential reward," says Michael Keeling, president of ESOP Association, a Washington trade group representing businesses with employee-stock-ownership plans.

Chris Carey, a small-business adviser in Brooklyn, N.Y., says owners thinking about offering new recruits equity-based pay should consider what would happen if they later decide that those workers aren't worth retaining.

"Companies sometimes outgrow the competence of the individuals they hire," says Mr. Carey. Other recruiting incentives, such as performance-based bonuses, may be more palatable for owners fearful of landing in that kind of situation, he says.

On the flip side, sharing a smaller percentage of something successful can be "better than 100% of your business closing down," says ESOP's Mr. Keeling.

Offering equity can be an especially useful tool in a downturn. Business owners should be able to more easily offset a below-market salary with equity-based pay when unemployment is high, theorizes Andrew Zacharakis, professor of entrepreneurship at Babson College in Wellesley, Mass. "A lot of people are trying to get something on their résumé, even though it may not pay as much as what they earn in a good economic climate," he says.

Equity can also sweeten a job offer for candidates who are always in high demand because they possess unique skills or knowledge. Bret Farrar proposed giving a financial stake in his small consulting firm to two prospective recruits last year in lieu of bigger salaries.

He says both candidates accepted the positions over other, higher-paying opportunities. "We wanted to attract better people and keep them for the long haul," says Mr. Farrar, founder of Sendero Business Services LP in Dallas.

Even in prosperous times, equity can be an effective recruiting tool for small firms, says David Wise, a senior consultant for Hay Group Inc., a management-consulting firm based in Philadelphia.

"There's a limited pool of equity available, and larger companies with more employees have to be that much more selective in allocating it," says Mr. Wise. "For a smaller company, providing an equity stake is one way to compete for talent with the big boys."

When Patrick Stakenas co-founded **ForceLogix Technologies** Inc. in Chicago in 2005, he says he and his business partner, Steve Potts, couldn't afford to pay recruits salaries on par with market rates. So they offered equity in their sales-technology firm to compensate for the difference.

"We looked for people who understood they'd have the opportunity to make a lot of money down the road," says Mr. Stakenas.

Over the next few years, ForceLogix employees also received pay raises mostly in the form of equity. "A couple of times in 2008 and 2009 cash was very tight, so tight that we weren't going to potentially make payroll," says Mr. Stakenas. "We promised employees that if they stay, there will be more equity for them, and all of them stayed."

This past December, ForceLogix went public on the Toronto stock exchange at 10 cents a share, making its 10 employees' stock options finally worth something. The price has been fluctuating between eight and 11 cents ever since.

"They can sit on it or sell it," says Mr. Stakenas, who declines to offer specifics on how much equity his staff has in his firm. "All of them are holding onto it because they want to see the company go further."

(Top to bottom) Crown Cars & Limousines; Studio West Photography

Crown Cars & Limousines' Mary Paul, above, says she's grateful her employees eschewed equity. Employees at ForceLogix, shown at right.