



MaRS | ENTREPRENEUR WORKBOOKS

Human Resources Management Series

Building Block 2 Compensation

HUMAN RESOURCES MANAGEMENT

Introduction: What to expect?

In his book *Outliers*, Canadian author Malcolm Gladwell looks at the relationship between statistical probabilities and the chance of success in your chosen field of work or sports. His essential claim is that you need around 10,000 hours of practice to become really good in a particular field.

This workbook will not take 10,000 hours to complete, so you should not expect that you will become an expert in human resources management by going through the activities outlined within. Rather, the purpose of the workbook is to help you understand and focus on the key issues in the field of human resources, and to introduce you to frameworks within which to think and discuss essential areas of your business. The process offered will provide sufficient grounding in the topic so that you will know what questions to ask advisors and consultants, and, in the case of consultants, how to evaluate their work.

Additionally, this workbook provides a launch point for a number of vital business decisions you will have to make to develop your start-up. As a best practice, it is critical to return to these workbooks and revisit facts and assumptions on a continuous basis. This will ensure not only that you build on your learning experience but that you adjust your assumptions to maintain the right course for your business.

Building Block 2: Compensation

This workbook is part one of a three-part workbook series on human resources management. It is designed specifically for entrepreneurs in the high-tech space. Human resources (HR) management consists of three major parts, or “Building Blocks,” each adding to the foundation of the previous one.

Building Block 1: Building an A-Team

Building Block 2: Compensation

Building Block 3: HR at Work

Each of these building blocks addresses an essential aspect of human resources management for the entrepreneur. Once you have completed all three workbooks, you will have a comprehensive HR management plan.

With this plan in hand, you will be equipped to begin building and managing a high-performance team of employees to drive your company’s growth.

How to use these workbooks

1. Take time to think it through.

These workbooks present a framework for formulating a comprehensive HR management plan. To make the most of them, it's best that you take time to think through your entries. Talk to advisors and fellow entrepreneurs, refer to your business plan and make sure that your HR decisions align with your financial forecasts and overall company objectives.

2. Revisit your assumptions.

The job of HR management is never done. Once you have completed the workbooks and begun to implement the resulting HR management plan, revisit these workbooks regularly to update their contents according to new information you've acquired over the course of running your business. Keeping your HR management plan up to date will make your job much easier when it comes time to bring new staff on board, discuss your HR policies with a potential investor, or make strategic decisions about the direction and capabilities of your company and your people.

3. Use the icons for help.

The workbooks are structured under the assumption that this is the first time you, the reader, has undertaken an HR management planning exercise. To clarify some of the ideas, we have defined key terms and offered real-world examples. In addition, we have provided links to online articles, templates and videos. For this reason, you may find it easiest to use these workbooks on a computer with an internet connection.

Look for these icons:



denotes a key HR term that will recur in these workbooks



indicates an example drawn from a real-world business in order to illustrate an important idea



denotes a link to a more in-depth online article, video or template



appears wherever you are asked to record something in the accompanying planning document while completing the exercises

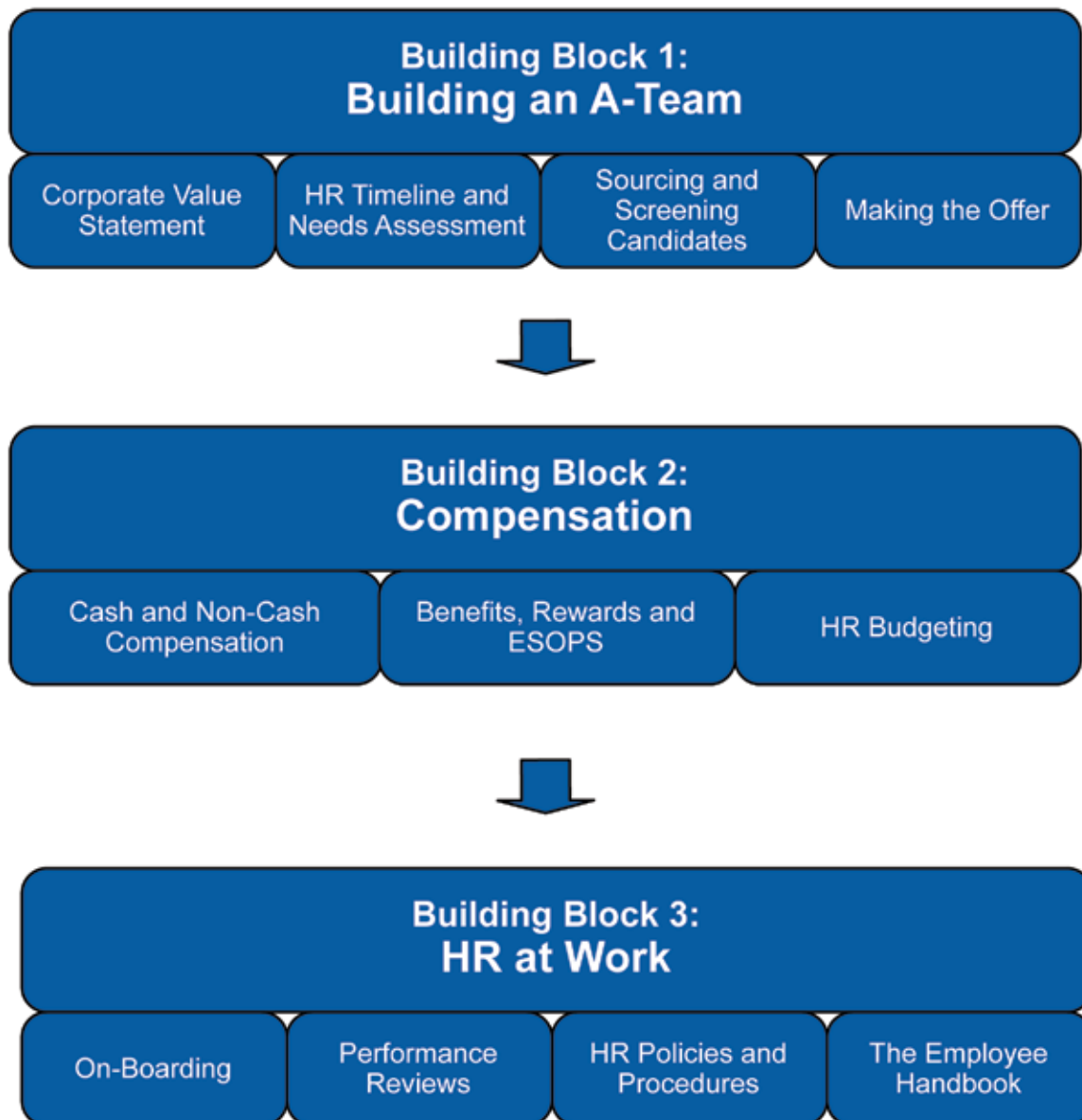


indicates key information for your business plan, pitch deck or other documents you might be preparing for potential external investors

Before you start

These workbooks are designed to assist entrepreneurs and their leadership teams in early-stage technology and life-sciences companies, and are based on tried-and-tested HR management practices relevant for start-ups in a wide range of industries. The following chart outlines for you the curriculum and the progression of each Building Block.

Building Blocks of HR Management Strategy Development



BUILDING BLOCK 2: Compensation—Getting The Most From Your Employees on a Budget

This section will help you to build on the backbone of your HR management plan developed in Building Block 1. Building Block 2 will guide you in designing an effective compensation strategy to attract, retain and motivate winning staff, and to budget effectively for HR expenses. It will address the following questions:

- What forms of compensation are most effective for a technology start-up?
- How do I structure my employee stock option plan?
- What benefits am I legally required to provide and how much will they cost?
- How do I build a realistic and comprehensive HR budget?

1. Compensation

a. Pay and behaviour



Read this article for an overview of the basics of [compensation](#).

Your firm's compensation strategy is intended to drive the value-creating behaviour of your employees. In order to attract, motivate and retain the employees that create high value, you need to develop a compensation strategy that rewards the right activities at your company while also staying within your HR budget. Most technology start-ups employ some combination of base salary, rewards and performance pay to get the best out of their key executive, sales and operations staff. Performance pay may be based on indicators such as sales, the number of customers served, the number of units produced, or overall company profits.



This article provides details on [performance-based pay](#).

b. Industry standards

Conduct some market research to determine common salary and performance-based compensation levels for each of the job areas at your firm. Speak to HR professionals, other entrepreneurs, and your contacts at similar companies to get a sense of the fair market rates.



In the corresponding section of the Compensation planning document, summarize your findings about common pay rates and compensation structures for key position areas at your firm.



Do these rates match up with your budget allocations for HR expenses? If not, what else can you offer to attract top employees?

c. Non-cash perquisites and rewards

Perquisites

Flexible work hours, telecommuting, enjoyable work environment and exciting career development opportunities all provide ways to attract and retain stellar employees without breaking the bank.



In the corresponding section of the Compensation planning document, outline some non-salary perks you can offer to attract valuable employees.

Non-cash rewards

Many companies employ a rewards system to encourage productive work and new ideas about how to create value. To get a sense of how to set up a winning non-cash reward strategy for your company, consider the following example.



Rewards at *Freshbooks*

Freshbooks is a Toronto-based provider of online software-as-a-service applications that streamline invoicing and other bookkeeping functions. At Freshbooks, every other Friday is known as “hack-off day.” The entire day is dedicated to employee projects that may have nothing to do with their primary function at the company, but are of interest to the staff. The projects must consist of something that can be completed by the end of the day, and around 4:30pm, the entire staff does a beer-in-hand walk-around to see what has taken place. Winning projects are judged by a company cheer index, and the winners often receive Raptors tickets, gift certificates or other treats.

Another common model involves employees nominating one another for reward points when they are caught doing something extraordinary to help the company. When this happens, the nominator notifies the employee as well as HR by filling out a standard form. Once a year, each employee has the opportunity to redeem his or her reward points for various trophies, or to enter a draw to win a grand prize. This scheme encourages employee interaction as well as a high work ethic.



In the corresponding section of the Compensation planning document, take a moment to draft a potential non-cash reward plan for key functions at your company. Be creative and remember that in the right setting, even a box of Smarties or a pizza can encourage your staff to continue delivering great results. Keep in mind that non-cash rewards are especially helpful for building morale, and for motivating value-based behaviours such as teamwork and new ideas.

d. Benefits

Legislated benefits

Ontario employers are legally required to administer the following benefits on behalf of their employees:

Benefit	Conditions	Percent of Salary
Canada Pension Plan (CPP)	Up to a maximum premium of Cdn\$2,049.30/year (2008)	4.95%
Employment Insurance Commission	Up to a maximum premium of Cdn\$994.62/year (2008) unless a reduced premium rate applies	2.42%
Workplace Safety and Insurance Board	Varies (depending on the industry and number of employees)	Varies
Employer's Health Tax (EHT)	Applied to eligible payroll over Cdn\$400,000	1.95%
Paid vacation	2 weeks	4.00%
Paid public holidays	8 days	3.20%
TOTAL		16.52%

It is important to include these expenses when formulating your HR budget.

Employer-sponsored benefits

The following are some common non-legislated benefits used by employers to attract and retain valuable employees.

- health insurance (e.g., prescription drugs, paramedical coverage, out-of-province emergency expenses)
- vision care
- dental insurance
- life insurance
- paid sick days
- short-term disability insurance
- long-term disability insurance

- retirement/pension plans (separate from Canada Pension Plan)
- educational assistance
- wellness programs
- employee assistance programs

By and large, the cost of employer-sponsored benefits is estimated to add at least 15% to a company's total compensation costs.



Read this article for pointers on how to set up an effective [employer-sponsored benefit package](#) and how to contain costs while doing so.

e. Employee stock option plans (ESOP)

As a general rule, if you provide key employees with an ownership stake in the company, it tends to increase overall value creation. Many technology start-ups make use of employee stock ownership options as a means to compensate key employees for a low monthly salary and the risk associated with working at an early-stage company. Nevertheless, remember that ESOP plans require careful structuring to ensure that they leave room for future equity investments.



ESOP: An employee receives the option to buy company shares, usually at a low price. These shares increase in value as the company grows, and eventually may be sold if the company goes public.

General guidelines for structuring ESOP plans:

- **Founders' stock:** Issue founder's stock at the lowest possible value (e.g., \$0.001/share). Many companies issue it in exchange for intellectual property rights, labour or equipment.
- **Future employees:** At an early stage, set aside 15 percent of the company's stock for future employees.
- **Vesting:** Founders decide on the right vesting schedule. The general rule of thumb is three or four years for employees and consultants, but start-ups should feel free to tailor these requirements in order to get the most from their participants. By and large, stock grants for board members and advisors are less likely to be subject to long-term vesting criteria, and very early-stage companies often adopt shorter or milestone-based vesting schedules in order to incent their teams to hit short-term objectives.



Vesting: Stock option vesting provides an incentive for valuable employees to remain with the company. Companies granting stock options with a vesting period give employees the right to buy stock in the amount of the options, but employees must adhere to a set schedule rather than receiving the stock all at once. Special rules in Ontario govern vesting rights if an employee leaves the company. When establishing an ESOP plan, discuss this with your lawyer.

- **Competitive levels of stock option ownership:** Establish equity incentives for key staff. The following table provides an overview for post-series-A

technology start-ups.



Example: Venture Capital General Rule for Common Stock Option Ownership Levels

	Competitive Stock Option Ownership % Post-Series A
CEO	~5%
Executive Team	~5%
Other Employees, Directors and Advisors	~5%



Read more about [ESOPs](#).



Find out more about [working with a board of directors](#).



Capitalization (cap) table: A cap table is a document that shows who owns the company and what they paid to obtain that ownership share. It typically includes the amount of capital (money) obtained from each investor, the number of securities distributed, and the implied ownership share in the company.



Learn more about [cap tables](#).

The stock option matrix

Board members and investors will often ask the company founders for a copy of their stock option matrix. This document outlines the company's proposed stock option plan for various employee pools and shows the maximum-share ownership level for each pool. This matrix will impact your company's capitalization table.



Example: A basic stock option matrix

	Level	Low	Mid-range	High
Engineering	Director	50,000	60,000	70,000
	Principal Engineer	45,000	50,000	55,000
	Staff Engineer	25,000	35,000	45,000
	Engineer	5,000	10,000	15,000
	Technician	750	1,500	2,250
Marketing	Director	50,000	65,000	80,000
	Manager	12,500	25,000	30,000
	Engineer	5,000	10,000	15,000
	Staff	2,500	3,750	5,000
Sales	Director	25,000	37,500	50,000
	Manager	15,000	20,000	25,000
	Engineer	5,000	7,500	10,000
	Staff	1,500	3,000	4,500
Operations	Director	12,500	20,000	27,500
	Technical	5,000	10,000	15,000
	Manager	2,500	5,000	7,500
	Staff	1,500	3,000	7,500
General & Admin	Director	10,000	15,000	20,000
	Manager	2,500	5,000	7,500
	Staff	1,000	3,000	5,000
	Administration	500	1,500	2,500



With the help from the cap table established in the Business Planning workbooks, take some time to consider and draft your own option matrix.

f. Compensation alternatives

For companies in the very early stages, traditional salaried, full-time employees may be an unaffordable luxury. Some alternatives to having full-time employees include hiring part-time workers or using independent contractors.

Independent contractors

Independent contractors are a good source of manpower if you need specific work done and don't have the funds to hire a full-time employee. Keep in mind that the contractor work arrangement must have certain characteristics to distinguish it from an employee relationship, otherwise you may be liable for statutory payroll expenses and source deductions such as EI, CPP and income tax payments. Read the following article for insight on the distinction between employees and contractors and your legal obligations to each.



Read this article to learn more about the legal implications of hiring [employees versus independent contractors](#).

g. Funding

Alternative compensation funding

A number of funding sources exist to support employers who hire temporary employees such as summer students, apprentices, interns, co-op students or new employees just out of school. Funding also exists to hire a temporary CEO-in-Residence. To access details on the various funding programs available, click the link below.



Find the latest on an array of [private and public funding sources for Ontario companies](#).

2. HR Budgeting

Using the hiring calendar you established in Building Block 1 and the compensation strategy you developed earlier in this workbook, you should now set a budget for HR expenses. This budget should incorporate salary as well as the expected costs of performance incentives and any employee rewards. You'll also need to take account of any legislated and non-legislated employee benefits, as well as the costs of recruiting and hiring new employees.



Use the HR budgeting tool in the Section 2 of the Compensation planning document to estimate the costs of adding new staff at various levels.

With a completed hiring calendar, recruiting strategy, compensation strategy and HR budget, you are now ready to proceed to the final Building Block in the Human Resources Management series, *HR Policies and Procedures*. The final workbook is designed to help you develop a comprehensive set of HR policies for the day-to-day management of your employees as you grow your company.