

## Personnel Management

Hiring, firing, and managing  
employees

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## To be discussed

- Hiring employees
- The employment contract
- Tax and payroll issues
- ISOPs
- Employee motivation
- Firing employees

## Hiring employees

- Avoid hiring friends or friends of friends
- Be professional in your job search
  - Advertise the position widely (Monster)
  - Carefully screen resumes
  - Interview the prospect following a script
  - [Check references!](#)
  - Do not hire on the spot

## The employment contract

The employment contract in a state like California *must* be prepared by a qualified corporate attorney. Generally executive contracts are written differently than employee contracts. The employee is normally identified as an *at-will* employee, which gives them the right to quit without cause and gives you the right to fire them without cause. The contract includes [job description](#), [list of duties to be performed](#), [wage or salary](#), [vacation](#), [sick leave](#) and [personal time provisions](#), and a very lengthy section which [protects the company's IP](#), including that on which the employee works.

## Tax and other payroll issues

- You must pay your employees properly and on time – they can take you to the California Labor Commissioner or sue you if you don't
- You must submit income and FICA taxes properly and on time
- Good idea to have ADP or similar handle payroll
- Above 60 employees will be required to have health insurance

## Incentive Stock Option Plans

- (for details ask to see my Econ 104 detailed lecture on ISOPS)
- Stipulated in the individual ISOP contract, one per employee
- Generally grants employees the right to buy company stock at a low value after vested over 3-5 years, good incentive value and lowers payroll costs

## Employee motivation

No business will run well if it degenerates into a war of management vs. employees. Employees should be made to feel part of an important team and should be made aware of what the company is trying to do. Reasonable special attention should be given to the workplace environment, commuting problems, ergonomics, and management must be aware that any employee can occasionally have personal problems to which management should be reasonably sensitive.

Management should have a strong working relationship with employees but should not get too chummy. The clear identity of hierarchy must be maintained in any business.

Problem employees should be fired without hesitation in a startup.

## Firing employees

- *At will* contract allows you to fire employees at any time for no stated reason
- Employee must be paid all compensation owed, including accrued vacation time, sick leave, etc., within 24 hours of the time of dismissal – the penalty in California is one day's pay for each day late.

## **ISOPs, ESOPs, and 401ks**

**Incentives for employees ..**

### **What, generally, is a stock option incentive plan?**

**The stock option incentive plan is a contract that gives the employee the right to periodically purchase a given quantity of stock at a price that is fixed on the day of the contract.**

**For example, a stock option plan might allow you, Daffy Duck, to purchase 2,000 shares of InTelSys stock every year on the anniversary date of your employment for the next four years, at the price of \$0.50 per share, regardless of the future price of the stock.**

**Your hope, of course, is that the stock's value rises far above \$0.50 per share.**

## **Terms, features, and issues** **Mudd Finance**

- **Vesting and the vesting period**
- **Exercise price**
- **Cliffs**
- **Exercise and the exercise date**
- **The contract itself**
- **The relevance of the companies cap plan**
- **Directors, advisers, consultants**
- **Fair market value**
- **Incentive Stock Options and Non-qualified Stock Options**
- **Qualified versus non-qualified (IRS)**

## **Mudd Finance**

### **What is fair market value?**

**For a privately-held company, it is typically the most recent price of that same class of stock sold to investors. If investors recently paid \$0.50 for the stock, then FMV is \$0.50.**

**However, if it has been awhile since the stock has been sold, the FMV can be adjusted up or down by the Board if the company's business has materially improved or deteriorated.**

**Major exception: if there is more than one class of stock.**

## **Qualified ISOPs versus non-qualified**

- **Generally, the qualified ISOP requires the stock to be offered to the employee on the date of the contract at the fair market value of the stock on that date. The non-qualified plan will typically offer the stock at a price below, sometimes considerably below, the FMV.**
- **The primary difference in the impact of these two alternatives is on taxes for both the employee and the company. In the case of the employee, a poorly designed non-qualified plan can impose a serious tax burden on the employee when the stock options are exercised.**

## **Tax considerations**

- **The qualified ISOP**
  - **There is no tax of any kind until the stock is sold.**
  - **If the stock has been held for more than one year *and* the option was exercised more than two years ago, the gain (Sales price - Exercise price) is taxed at the lower capital gains tax rate.**
- **The non-qualified SOP**
  - **When the option is exercised, the difference between the exercise price and the FMV on that date must be reported on a W2 as earned income.**
  - **When the stock is sold, the difference between the sales price and the exercise date FMV is taxed like the qualified ISOP.**

## **The well-designed cap plan and ISOP**

- **Create two classes of stock minimum: common and at least one class of preferred.**
- **For all funding past first round, sell only preferred.**
- **Subscription to preferred should say that preferred is convertible to common, 1-1, at exit.**
- **Law allows FMV of preferred to rise while common FMV stays low, even with conversion rights.**

## **What is an ESOP?**

- **Employee stock option plan, offered by mature publicly held companies.**
- **Similar to a qualified ISOP with generally the same tax considerations.**
- **Allows the purchase of the stock over a vesting period with cliffs like an ISOP.**
- **The difference? Usually the exercise price (called here the strike price) is set very close to or at the actual price of the stock as traded on the market (examples will be given in lecture).**

## **What is a 401k?**

- **Tax-deferred investment retirement plan**
- **A small selection of mutual funds.**
- **You pay no taxes of any kind, until retirement**
- **Withdrawals taxed at earned income rate then**
- **Early withdrawal penalties**
- **Your contributions to 401K reduce taxable income by same amount**
- **Company will have some designated matching scheme.**