Approaches to Sizing a Share Pool

Determining the appropriate size of a new share pool request is a critical step in a company's equity compensation strategy. Companies can leverage two main approaches (used independently or in tandem) to strategically align their share pool size with both internal needs and external expectations:

- **Ground-Up Approach:** This method involves calculating the projected annual equity value needed for grants, typically guided by burn rate, historical share usage and/or peer and market benchmarks. The projection is then scaled to cover the desired number of years the share pool should last (external stakeholders generally prefer a share request sufficient for 2-3 years).

  This approach may be suited for companies with controlled ownership, moderate share pool needs, strong shareholder relations, or no major strategic changes anticipated.

- **Directive Approach (based on Shareholder and Regulatory Expectations):** Institutional shareholders and proxy advisory firms, such as ISS and Glass Lewis, have guidelines on acceptable burn rates, dilution levels and share pool sizes. Aligning with these guidelines can help companies gain shareholder support for additional shares, especially when share pool requests are sizable.

  — Situations where this may be appropriate include:

    - Companies with meaningful institutional shareholder ownership.
    - Companies that require a significant increase in the share pool, or that have major plan provisions not aligned with shareholder interests.

Other Considerations for Sizing the Share Pool

Securing shareholder approval for additional shares requires a strategic balance. Companies must request enough shares to meet their needs while ensuring they obtain shareholder approval (greater than 50%). Gaining this support often involves addressing concerns about dilution and any potentially unfavorable provisions in the equity plan.

Beyond the approach itself, timing plays a critical role in deciding when to seek approval. This decision requires a deep understanding of the company's forward-looking compensation strategy and design, plan limits (i.e., is there a defined life span of the current plan?), growth objectives (whether organic or through M&A) and performance expectations.

Below are key factors companies should evaluate before determining their approach to sizing the share pool:

- **Ownership Structure:** Companies with a concentrated ownership base (e.g., founder owned) may face different, and often less cumbersome, approval dynamics than those with a distributed shareholder group.
- **Shareholder Expectations:** When deemed appropriate, alignment with market practices and adherence to institutional shareholders' voting criteria may guide decisions in terms of additional shares requested, as well as new plan provisions.
- **Maintaining Board Flexibility vs. Shareholder Support:** Directors often face a trade-off between retaining flexibility in their equity compensation programs and ensuring strong support from shareholders and proxy advisory firms. For example, some provisions in equity plans, such as evergreen provisions (which automatically replenish the share pool each year), or providing board discretion to accelerate vesting of awards upon a Change-in-Control event, can trigger concerns from investors and proxy advisors, who may view them as misaligned with shareholder interests. If the board prioritizes keeping these provisions in place, they may decide to forgo aligning the size of the share pool with the limits typically expected by shareholders or proxy advisory guidelines. In such cases, the company's ownership structure could influence this decision, as different shareholder groups have varying expectations.

Conclusion

Figuring out the best approach to sizing your equity plan’s share request depends on many factors. Understanding the main approaches to sizing a share pool and the other considerations mentioned above should help you start to think through the best way to determine your share pool request. For further guidance, Meridian can assist in evaluating which approach aligns best with a company’s current situation.