



ESOP Compensation during Economic Distress

Invigorating Employee
efforts towards Growth



Current Economic Scenario

- As India gradually eases lockdown restrictions allowing businesses to re-open, there prevails a **major challenge** to
 - Forecast the demand, revenues & earnings
 - Run supply chain & logistics efficiently
 - Recover the liquidity crises
- Immediate need to **review Cost Outlays** to make financing viable
 - Revenues are uncertain but Fixed Costs are known
 - Review the Fixed & Variable Cost to manage liquidity
- **Permanent employees are fixed operating cost**
 - Significant part of working capital
 - requiring cash outlay



Current Economic Scenario

- As per the type, size and feasibility the businesses are considering to **rationalize the employee cost** by:
 - Lay off and furlough
 - Salary Cuts
 - Restructuring of Salary
- Such decisions could **detriment the business** as:
 - The employees lose their Trust in employer
 - Low Employee Morale makes them ineffective and unproductive
 - Businesses could miss an opportunity due to unavailability of resources
 - Employee feels insecure and uncertain about his financial prospects
- Organizational **restructuring is inevitable**
 - Retaining right talent essential for recovery & growth



Using ESOPs to survive downturn

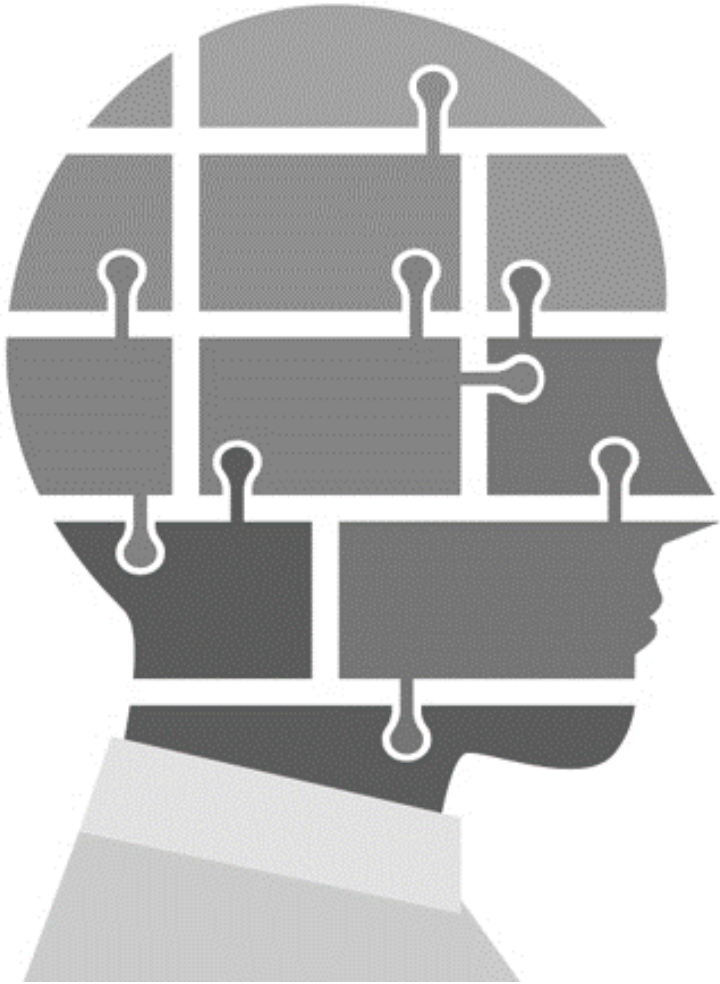
1

- As the businesses are opening their mind to new practices & adopting the 'New Normal'
 - **relook at the Traditional Compensation Practices**
 - **consider 'Share based Compensation' of employees through ESOPs.**

2

- ESOPs are an effective way using which company can
 - **defer the Compensation Cost of Permanent Employees**
 - **settle this liability in future**
 - **make Non Monetary compensation through Equity**
 - **Motivate the employee to run the extra mile**

Benefits of ESOPs



for Employer:

01

Minimize attrition with additional reward

02

Steer employees towards organization's vision

03

Freedom to Channelize funds in other priority area

04

Derives unparalleled Employee Loyalty

05

Retention of employees with stellar performance

06

Attract employees who can be potential assets to the organization

Benefits of ESOPs

for Employee:

01

Wealth creation through equity ownership

02

Grow professionally by creating tangible value

03

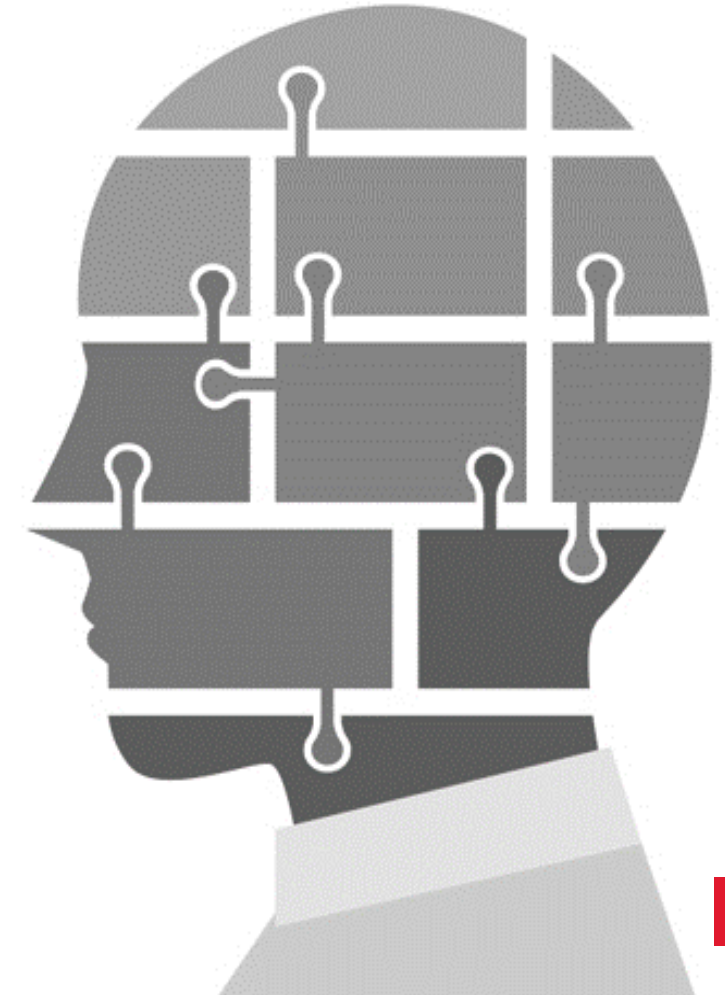
Improve job security and satisfaction

04

Stock Monetization far exceeds the regular remuneration

05

Derive direct benefit from Acquisitions & Strategic Investments



ESOP- Not just 4 letter word!




An illustration showing three stylized business figures in dark suits working together to build a large, multi-tiered structure made of red puzzle pieces. The figures are positioned at different levels of the structure, with one at the top, one in the middle, and one at the bottom. They are holding large red puzzle pieces, suggesting they are in the process of assembling the structure. The background is a light blue sky with a few white clouds and a faint cityscape silhouette at the bottom. A dark grey horizontal bar is overlaid across the middle of the image, containing the title text.

Understanding ESOPs

Practical Considerations & Implementation

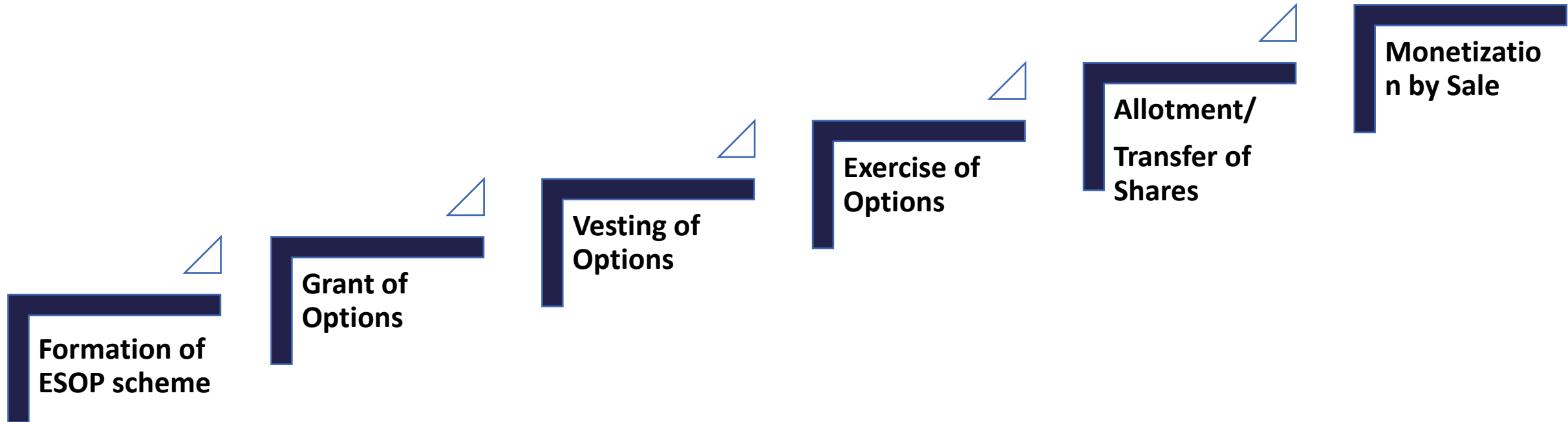
What is ESOP

ESOPs are a form of Share Based Compensation where **employees are awarded shares of the company for the value of their service**



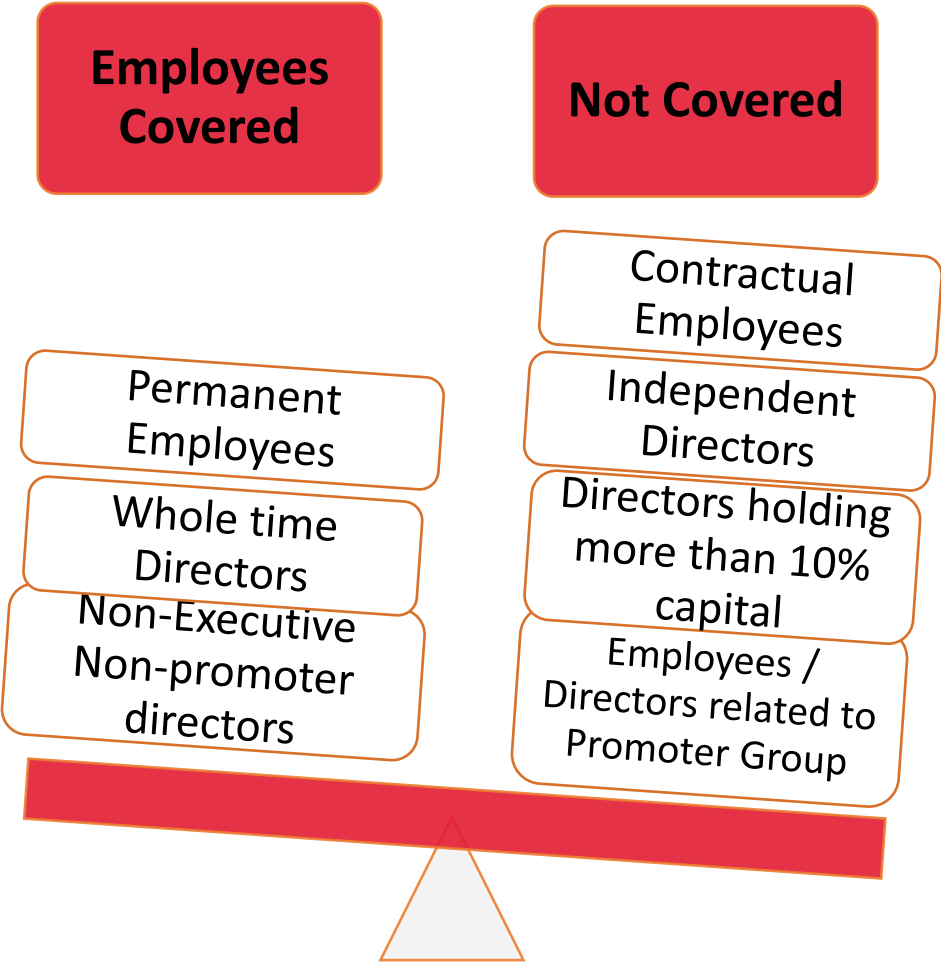
Employee	<ul style="list-style-type: none">• Permanent Employee
Stock	<ul style="list-style-type: none">• Equity Shares of the company
Option	<ul style="list-style-type: none">• Option not an obligation
Plan	<ul style="list-style-type: none">• Long term Incentive Plan

How do ESOPs work



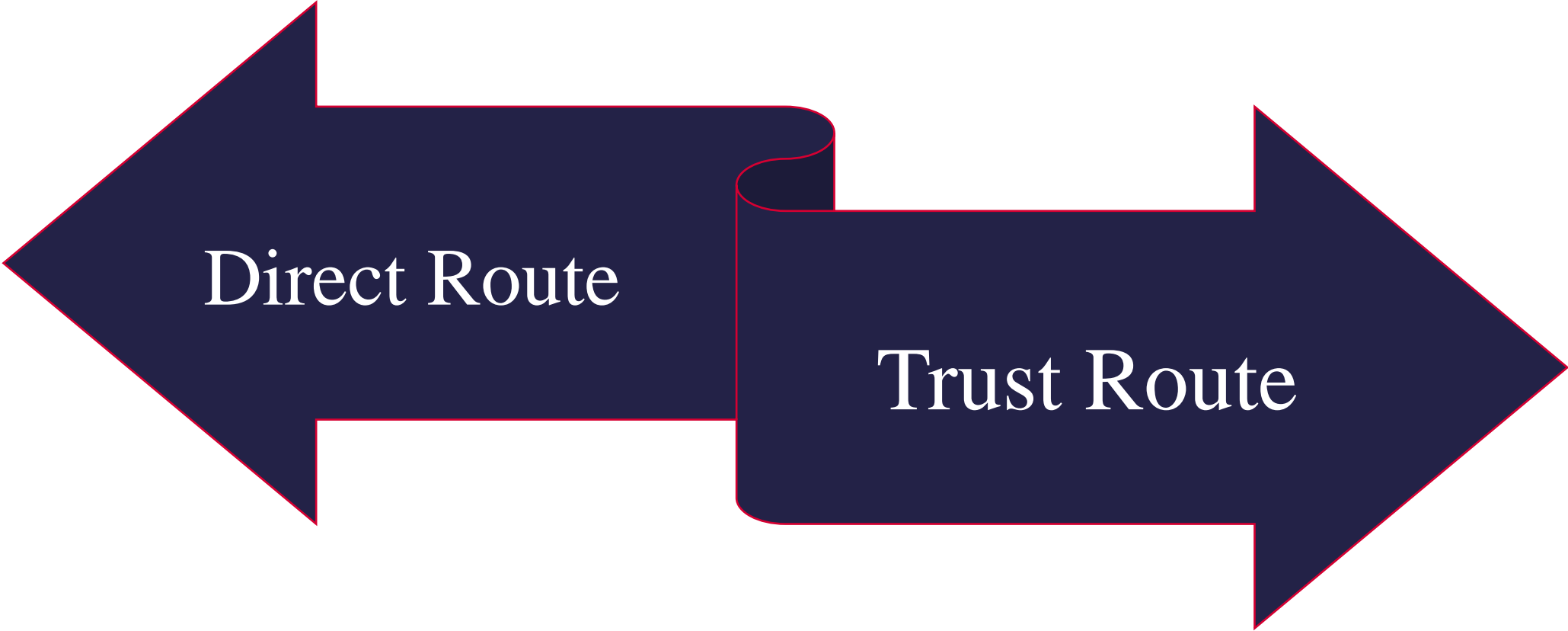
- Vesting requires **continued service** over a specified period of time
- Upon vesting of options
 - employees can **exercise the options**, and
 - get shares by paying the **pre – determined exercise price**

Eligible Employees



of Company, its holding & subsidiaries + Foreign employees

ESOP Implementation



ESOP Implementation

Direct Route

Company

1 Options to buy shares

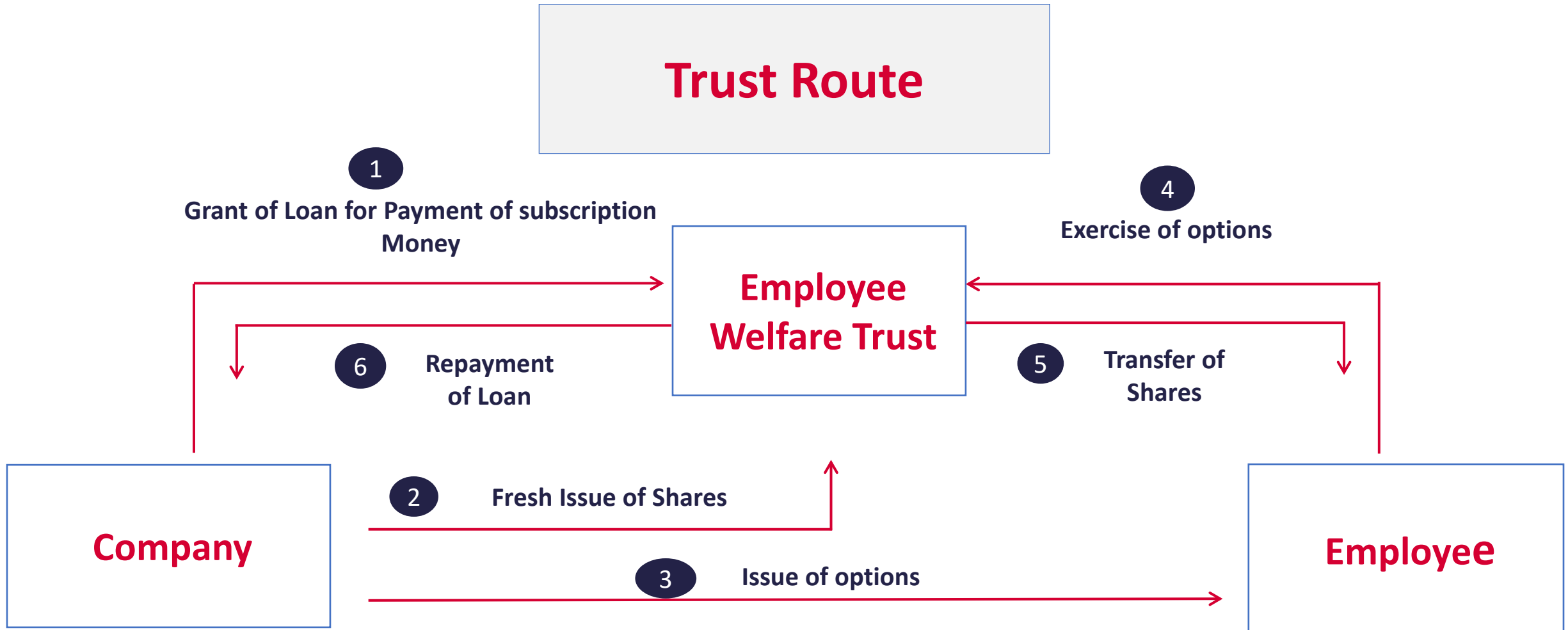
2 Exercise of Options

3 Issue of shares

Employee



ESOP Implementation



ESOP Implementation

• Acquisition of Shares by Trust

Trust can
acquire
shares by

Secondary Market
Acquisition



- Trust acquires shares from stock exchange
- Extend direct benefit of dealing at market prices
- No dilution of promoter holding
- Facilitate cashless exercise & easy exit

Fresh
Subscription
from Company



- Extend high benefit to employee by fresh allotment at the same price as the discounted exercise price
- Facilitate cashless exercise
- Easy exit through direct sale to acquirer (unlisted company)

Alternative Restructuring Modes

Stock Appreciation Rights (SAR)

- Linked to the **performance of company**
- Right to benefit equivalent of the **appreciation in the equity value**
- Pay the appreciation value in **shares**

Restricted Stock Units (RSU)/ (PRSU)

- Award subject to **fulfillment of certain underlying conditions**
- Predicated on the occurrence of certain events e.g. **continued employment and/or achievement of certain business measures**

Phantom Stocks (Cash Settled SAR)

- **Alternative form of SAR**
- Pay appreciation in cash instead of Equity
- Monetary incentive **proportionate to the growth of the company**

Practical Considerations

- **Employee Coverage**
 - Eligibility Criteria
 - Selective or Widespread
 - Vertical dissemination or Horizontal dissemination
 - Operating Function vs Support Function
- **Choosing the right Plan**
 - Objective of Plan
 - Value to be extended
- **Share Pool & Source**
 - Percentage of Employee holding **vis a vis Promoter/Founders'**
 - Pool concentration at various stages- **Early/Growth/Mature**
 - Fresh Allotment vs Secondary Market Acquisition

Practical Considerations

- **Vesting**

- Vesting Period
- Vesting Schedule- **Graded Vesting vs Cliff Vesting**
- Vesting Condition- **Loyalty based/Performance Based/ Market Based**

- **Grant Price**

- Requirement of Valuation
- Pricing methodology for unlisted companies
- Standard Price or Differential Pricing
- Pricing Criteria- **Face Value/Market Price/ Discounted Price**

Practical Considerations

- **Exercise**

- Exercise Period- Time based vs Event based
- During the Employment before Exit Event
- Post Cessation of Employment

- **Funding of exercise**

- **Lock in**

- Legal Requirement

- **Monetization**

- Sale on Stock Exchange
- Event Based- IPO/Strategic Sale/ Management Buyout
- Cash Settlement

Practical Considerations

- **Legal Concern for Listed Company**
 - **Listing Compliance**
 - **Mandatory Appointment of Merchant Banker**
 - **In Principle Approval**
 - **Listing Approval**
 - **Disclosures with Stock Exchange**
 - **Maintaining Minimum Public Shareholding with ESOP Trust**
 - **PIT Law Compliance**
 - **Pre clearance**
 - **Contra Trade**
 - **Exercise during Trading window closure**
 - **Disclosure by:**
 - **ESOP Trust**
 - **Employee**

Why now

- **Attractiveness of ESOPs in the present scenario**
 - **Manage liquidity** with non monetary compensation
 - Grant of options at the **prevailing low prices** makes ESOP exercise **highly attractive and affordable** for employees
 - Employee get great value as the **stock price soar in future**, realizing true benefit of ESOPs
 - Company can extend **lucrative value to key employees** who are instrumental in its recovery & growth process
 - **High value** ESOPs involve **low number of option grant**, protecting the dilution of promoter's holding
 - Company gets dual benefit of **cash saving along with tax benefit**

*Suppose your pre-covid prevailing price was Rs 30-35/- per share but the present stock price is Rs 20/-
If the future stock price in 3 years is Rs 50/-per share,
Grant of ESOP at Rs 20/- or the face value of Rs 10/- will result in gain of Rs 30/- or Rs 40/-, as the case may be.*

ESOPs as a Continued Practice

- **For Start-ups**

- **New Opportunities** *(as per NASSCOM Start-up Pulse Survey – Q1 2020)*
 - 54% looking to pivot to new business opportunities
 - 40% want to diversify into growth verticals like Healthcare, Edtech
 - 50% enhancing focus on emerging tech like AI, IoT, Cloud
- Start-ups operate under **multiple constraints**
- They **need best talent** but have limited financial capacity
- ESOPs help **achieve twin objectives**
 - hiring the best, and
 - retaining the best for long periods of time

ESOPs as a Continued Practice

- **For Listed Companies**

- ESOP is an **integral compensation tool** as per prevailing market practice
- **Repeat practice** intended to continuously appraise and incentivize the employees
- **Easy Monetization by sale on Stock Exchange** makes it highly lucrative
- Can be used to **increase public holding and promote trading** of shares on stock exchange

- **For Financial & IT Sector**

- Financial Sector along with the IT Sector are the **top employers extending ESOPs to employee**
- The **competition is tough** with need to retain talented employee
- Special Stimulus provided to NBFCs under **AtmaNirbhar Bharat Package** to boost growth
- Make **employees partner in growth** with ESOP

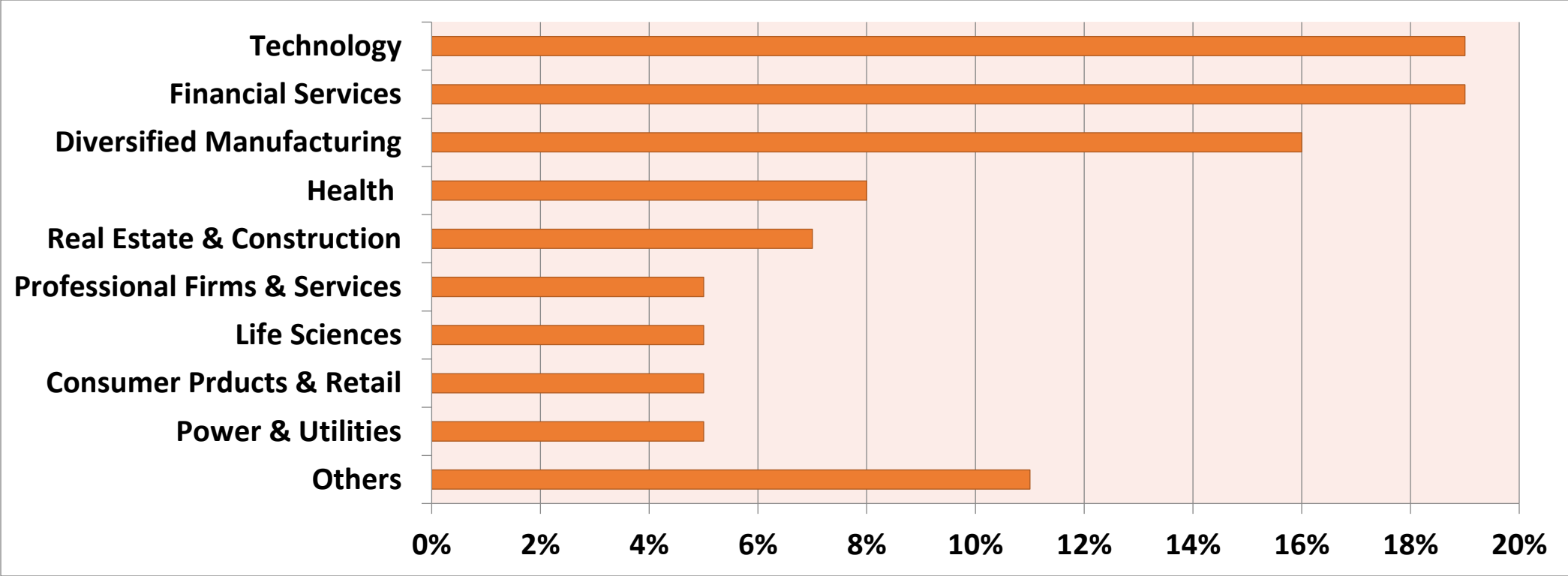
ESOPs as a Continued Practice

- **For Business Expansion & Research**

- ESOPs to key employees working on **specific projects** of
 - Expansion
 - New Product/Service
 - Long Gestation period
- **DISCOMS and Real Estate Sector** struggle with **weak finance & unprecedented cash flows**
- **Research** requires **continuous dedicated efforts** of the employees over extended period of time (**Healthcare & Bioscience**)
- Directly share the **benefit in proportion to growth & expansion** with vesting of ESOP

ESOPs as a Continued Practice

INDUSTRY PRACTICE OF ESOP



Source: EY Share Based Incentive Plan Survey 2019 (respondents: 74)

Regulatory Regime

Companies Act, 2013 along with Rules

Income Tax Act, 1961 (including Rules and Circulars issued there under)

Applicable Accounting Standards- Ind AS 102/ Guidance Note 18;

SEBI (Share Based Employee Benefits) Regulations, 2014

SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015

SEBI (Prohibition of Insider Trading) Regulations, 2015

Foreign Exchange Management Act, 1999 (including Rules and Regulations enacted there under)

Accounting & Book keeping

- ESOP is an Employee Compensation Cost to be recorded in books
- Accounting undertaken in accordance **with IndAS 102 or the Guidance Note 18** (as applicable) issued by ICAI
 - Book the Employee compensation by measuring grant date Fair Value (or intrinsic value*)
 - Valuation of the Option using certain valuation techniques
 - The Fair Value (or intrinsic value*) of the option is recognised in the **books proportionately over the vesting period**
- The operations of the **ESOP trust should be included in stand-alone financial statements** of the Company
- **Regulatory disclosures** (MCA & SEBI) need to be made in the Financial Statements & Annual Reports regarding the ESOP grants made

ESOP Taxation

- Taxation in hands of Employee
 - **Event 1: Allotment of Shares**
 - Perquisite Income = FMV on Exercise – Exercise price paid
 - Eligible Start-up Employee may pay tax:
 - *on Exit from company*
 - *on Sale of shares*
 - *Maximum 5 years deferment*

Whichever is earlier
 - **Event 2: Sale of Shares**
 - Capital Gain = Sale Consideration – FMV on Exercise
- Taxation in hands of Companies
 - ESOP cost is allowed as an ascertained expense u/s 37
 - Deduct TDS on perquisite income of the employee at the time allotment/ transfer of the shares

ESOP Management



The diagram features a stylized tree with a central orange circle at the base containing an upward-pointing arrow and the text "ESOP Guardian". From this base, several branches extend upwards, each ending in a purple circle with a white icon and text. The circles represent various features: "MIS" (with a person and document icon), "Access-24/7" (with a person and clock icon), "Reminder" (with a clock icon), "Compliance" (with a document and checkmark icon), "Customizable" (with a wrench and screwdriver icon), "Transparency" (with a circular flow icon), and "Documentation" (with a document icon). The background of the slide is light gray with a faint silhouette of a city skyline at the bottom.

ESOP
GUARDIAN
MANAGE AT YOUR EASE

A WEB BASED
COMPREHENSIVE SOLUTION FOR
ESOP MANAGEMENT

Thank You

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