



Any policy or corporate policy that in any way is connected with human beings must qualify from the personal perspectives, for its success in the long run. An ESOP policy, can be said to be "of the people, by the people, for the people". The such ESOP policy should ideally take care of all the people involved – be these shareholders, management, employees or the regulator.

All these persons are run by their own emotions, wishes, expectations, and principles. Most of these aspects are intertwined with each other, with some aspects portraying clashing interest and some common interest. *E.g., employees' wish of getting ESOPs at discount may appear to be clashing with Investors' wish of no discount. Potential valuation growth is a common interest area.*

The strategy for win-win lies in identifying and structuring the ESOP parameters in a sensible way that should satisfy all the stakeholders in the long run.

This write-up is an attempt to decode an ESOP policy in terms of its arts, commerce and science aspects which may be helpful in practical structuring.

### **The Arts Aspect**

The ESOP policy thinking starts with setting the “**philosophy**” of the primary objectives (like whether to attract, retain, reward, motivate to seek corporate growth, or to cross a specific milestone, etc. or any combination thereof) which often are generically stated. Little care is taken to actually linking the stated objectives with the mechanics of the actual ESOP policy.

The linking stated above is in terms of testing the mechanics scientifically in different scenarios, and making commercial provisions in respect of relative rights/ liabilities of the employees, shareholders, investors and the company so as to be conducive for achieving the primary objectives.

Communication planning in ESOP implementation is another critical task. The art or creative aspects of communication to the employees, investors or regulators is important. Policy and its allied legal documentations (like explanatory statement for

investors, grant letter, Employee FAQs, etc.) must be drafted from all these stakeholders' perspective with reasonable narration, simplicity, and transparency to bring-in certainty and predictability. It pays in the long-run.

### **The Commercial Aspects**

It is all about making a planning as to what an implementing company (a) intends to give to the employees on one hand, **via-a-vis** (b) expects to harvest in terms of value creation for the shareholders and other stakeholders, on the other hand.

Decision-making as to whom to grant, how much individually, total equity dilution, length/breadth of vesting, pricing/ discount, accounting cost impact, cash impact if any, corporate tax savings if any, etc., are connected not only with the employees but also deeply connected with the shareholders/ stakeholders.

In case of unlisted companies, structuring unavoidably involves deliberations as to whether employees should be allowed to exercise and hold shares prior to a liquidity event, whether they should be allowed to be in the Cap table or not, source of shares – whether primary or secondary to be used, whether a Trust route should be adopted (if yes, why), in case of multiple times valuation growth how to ensure tax efficiency for employees and the company, etc.

A transaction sails through with a happy ending when the commercial aspects meet both parties' ends. Thus, the commercial parameters must be carefully designed taking clue of all stakeholders' expectations leading to achievement of the objectives.

### **The Science Aspects**

The science aspects may be the last but never the least. As all the commercial parameters (stated above) are intertwined, and often requires validation as to whether all of these applied together are conducive to the objectives.

It involves analysis and may include employee behaviour study, peer group benchmarking, data analytics, projection of company valuation considering the business plan, expected benefit per option, change in expected benefit in a given range of performance delivery, and validation of (i) equity pool, (ii) vesting schedule/ conditions, (iii) exercise price/ period, etc. with appropriate revisions (if required). It helps in informed decision making with predictable outcomes.

**A company or its consultant while structuring and drafting an ESOP Policy should ideally work on all these aspects with a view to bring to the table an ESOP Policy helping the company in achieving its goals on a sustained basis.**

*Our write-ups on other fine-tuned aspects of ESOPs are available in our website and social media.*