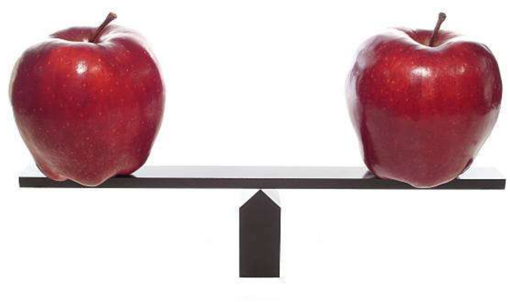

Comparative Analysis of Different Equity Incentive Plans – ESOP vs. SAR vs. ESPP vs. Phantom

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Equity Incentive Plans ("**EIPs**") are implemented in different forms like Employee Stock Option Plans ("**ESOPs**"), Equity settled - Stock Appreciation Rights ("**SARs**"), Employee Stock Purchase Plan ("**ESPP**"). ESOPs include its articulated variants like Performance Stock Units ("PSUs"), Restricted Stock Units ("RSUs"), etc. Yet another type of EIP widely adopted is Cash Settled – SARs ("**CSAR**") or "**Phantom**" which derives value from equity but is settled in Cash.

Although the DNA is almost the same in all these forms of EIPs as all seek to derive value from the underlying equity shares; these are different from each other in approach and mechanism. Thus, companies in different business situations like stage of business, shareholding pattern, equity dilution constraint, cash flow position, closeness to IPO, growth potential, etc. seek to adopt the form which suits them better.

For instance, a company is owned by two shareholders (SH-A and SH-B) with 49.9% and 50.1% shareholding respectively with a JV agreement that both parties' shareholding should be intact. Here, implementing an equity settled plan (like ESOP/ SAR/ ESPP) is almost impossible as equities cannot be allotted. Such company may test CSAR or Phantom and still give a wealth creation opportunity to its talents out of company's growth.

*Another instance (**in fact a myth buster**) could be, a company approaching IPO which has just turned PAT positive and has decent growth expectations in future. Promoters do not agree to dilute equity even by 2% to 3% and wish to implement a CSAR. A comparative analysis helps in this case may be with a surprising outcome that Accounting cost of CSARs may wipe out the PAT/ EPS substantially higher than that in case of ESOPs – as a consequence, eroding company's valuation by say 25%. It is still worthwhile to chase CSARs? or implement ESOPs with 2% to 3% equity dilution where there is no dent to the Company valuation?*

There are numerous interesting instances of a particular instrument befitting a situation to the exclusion of other. The essence lies in identifying the relevant aspects of these instruments and the extent of their impact to the Company, employees, shareholders, investors and other stakeholders.

This write-up is all about having a comparative analysis to have a first-hand impression of characteristics of different EIPs, as under:

Sl. No.	Particulars	ESOP	SAR-Equity	ESPP	CSAR/ Phantom
1	Governing rules/ regulations	Separate rules/ regulations are there for listed and unlisted companies.			No rule/ regulation.
2	Employee eligibility[1]	These can be kept identical due to DNA level similarity across these instruments.			
3	Vesting period/ schedule/ conditions				
4	Exercise price/ period[2]				
5	Treatment on employee separations				
6	Employee benefit				
7	Employee taxation[3]				
8	Equity requirement/ Equity dilution[4]	Yes. But, SAR-Equity requires much lesser equity than ESOP/ ESPP			No
9	Certainty of Equity requirement[5]	Yes	No	Yes	N.A.
10	Timing of equity dilution	Deferred	Deferred	Instant	N.A.
11	Ability to control employee retention & performance	Yes	Yes	No[6]	Yes
12	Employee Cash outflow	Yes (deferred)	Yes (deferred)	Yes (instant)	No
13	Corp Cash outflow	No	No	No	Yes
14	Accounting (A/c) cost	Yes (notional & deferred)	Yes (notional & deferred)	Yes (notional & instant)	Yes (actual & deferred)
15	Increase in A/c cost for a growing company	No	No	No	Yes[7]
16	Easy to understand (for a wider coverage)	Yes	No	Yes	Yes
17	Industry practice[8]	~80%	~7%	~6%	~8%

This comparison creates only a first-hand impression. **A company or its consultant wishing to examine suitability of an instrument of EIP should assign weights to each comparable basis such company's actual facts and circumstances.**

Our write-ups on other critical aspects of EIPs are available in our website and social media.

[1] *Listed companies have a wider employee coverage than unlisted companies; even they can grant to consultants working on exclusive basis. An unlisted company can have the same coverage only under a CSAR/ phantom plan.*

[2] *A shorter exercise period is kept in CSARs with a view to limit the Cash payout liability. This is not due to law but a practice.*

[3] *Employee taxation in case of ESOP/ SAR/ ESPS may be substantially managed in case of unlisted companies with suitable structuring. Unless there is special structuring, the tax impact is same across all forms of EIP.*

[4] *ESOPs are assumed to be granted with no discount. When ESOPs are granted at deep discount, it would require the same quantity of equity shares as that by SAR-Equity to pass-on the same amount of benefit.*

[5] *SAR-Equity Plan is not allowed to be carried forward post IPO due to uncertain equity requirement. Thus, IPO going companies must refrain from SAR-Equity irrespective whatever benefit it gives.*

[6] ESPP being an instant share purchase program is subject to lock-in restriction. It does not assure retention as the employee may leave after allotment and may sell shares when lock-in ends.

[7] *In case of CSARs, the A/c cost fluctuates due to Marked-to-Market (MTM) requirements. This reduces the PAT/ EPS with growth in company valuation – being one of the most disliked aspects.*

[8] Industry practice is important, as a company cannot afford having ESPP if maximum employees come from peers having ESOPs or vice versa.