



ESOP Structuring Series 1 / 4

ESOP Structuring – Grant Parameters

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Equity-linked incentive plans are implemented in different forms like Employee Stock Option Plans (“**ESOPs**”) and Stock Appreciation Rights (“**SARs**”). ESOPs include its articulated variants like Performance Stock Units (“**PSUs**”), Restricted Stock Units (“**RSUs**”), etc. Yet another type of equity plan widely adopted is Cash Settled – SARs (“**CSAR**”) or “**Phantom**” which derives value from equity but is settled in Cash. For ease of reference, all these are collectively referred to as “**ESOPs**”.

ESOPs broadly have 4 key stages/ aspects i.e. (i) Grant, (ii) Vesting (iii) Exercise/ Sale/ Monetisation, and (iv) Effective employee communication (“**ESOP Stages**”). Thus, the whole structuring process is narrated in 4 separate write-ups.

Parameters of these ESOP Stages often crisscross/ impact/ influence each other – which the respective write-ups have highlighted at appropriate places. Knowing the determinants and their mutual impact on other ESOP parameters is the **key to robust structuring strategy**.

This write-up may be helpful for any (HR/ Finance/ Legal/ Compliance/ Management) professional whether in practice, employment, or academics.

Grant is the starting point and sets the ground for decision making for further ESOP Stages.

Determinants	Details
Knowing the business	<p>Knowing the company as to it’s standing now, its goals and destination as per its business plan.</p> <p>Linkage: ESOP primary objectives</p>
Primary objectives of ESOP implementation	<p>Primary objective(s) provides direction to all decision makings under all ESOP Stages. <i>E.g.:</i></p> <ul style="list-style-type: none"> <i>If corporate growth is the primary objective, the vesting condition must reflect the business plan.</i> <i>If retention of talent is the key focus, vesting period and vesting schedule must be rationalised.</i>

	<ul style="list-style-type: none"> • <i>If talent attraction (or to fight poaching) is the key focus, the exercise price should be discounted or heavily discounted.</i> • <i>If Cash Salary rationalization or bringing equity culture is the key, the employee coverage becomes wider.</i> • <i>If bringing skin-in-the-game is the focus, there must not be any big discount.</i> <p>Linkage: Coverage/ Quantum of grant/ Vesting/ exercise/ sale/ monetization parameters</p>
Eligibility/ coverage	<ul style="list-style-type: none"> • Heavily depends on the primary objectives of Grant. <i>E.g. a narrow or broad coverage or Grant for a specific mission.</i> • This may involve working out 'eligibility criteria' for objective participation – this is particularly advisable in public/ listed companies as a matter of governance. • However, a tab/ filter is considered if the total ESOP requirement spills over the proposed ESOP Pool. <p>Linkage: ESOP Pool, Total Accounting Cost</p>
Individual Grant quantum	<ul style="list-style-type: none"> • Depends on level/ grade/ CTC of employee, industry practice, adequacy of benefit, performance/ contribution expected in terms of vesting conditions, etc. • It also depends on ESOP pool availability. In case of spill over, it can be managed with appropriate discounts in exercise price; however, accounting cost impact is also checked. • Individual Grant quantity should ideally be computed basis projected benefit over the vesting period; benefit should not be in-adequate nor should be over-adequate prompting to leave employment in both cases. <p>Linkage: ESOP pool, vesting conditions, exercise price, company growth rate (or sometimes Black & Scholes value), and accounting cost.</p>
Grant frequency/ cycle	<p>This is the periodicity of a Grant being repeated. Grant can be one-off or one-time, annual, six monthly or even quarterly. This depends on the objectives, pace of growth of company, etc.</p> <p>Linkage: Business plan, accounting cost, corporate tax saving, employee morale.</p>
Size of ESOP Pool	<ul style="list-style-type: none"> • As the ESOP Plans are long-term incentive plans, ideally equity/ benefit requirement for at least 3 to 4 years is estimated basis employee coverage. • ESOP Pool (if envisages primary shares) raises a question on equity dilution acceptability. If secondary, raises a

	<p>question capability of the company to give a loan to the Trust.</p> <ul style="list-style-type: none"> • An ESOP Pool may be created basis perception or industry practice, which is NOT recommended. • An ESOP Pool stands validated basis a simulation (or scenario analysis) done by an expert with vision on all the parameters of ESOPs including understanding of company/ business valuation, which is generally recommended. <p>Linkage: Grant/ allocation of ESOPs</p>
Source of shares	<ul style="list-style-type: none"> • Source of shares is an important decision making- it can be primary (diluting all shareholders equally) or secondary (requiring loan and trust route). • Sometimes, secondary shares are gifted by promoter/ shareholders, this case may be specially examined w.r.t. taxation on donor and recipient trust. <p>Linkage: ESOP Pool, Ceiling on loan</p>
Trust route or Direct route	<ul style="list-style-type: none"> • Trust or direct route is considered basis several use cases (<i>Please check our write-up: Series 1/3 on ESOP Trust</i>). • An ESOP Plan designer unavoidably tests the appropriate route effective from all commercial angles. <p>Linkage: Administration of the ESOP Plan particularly the Exercise stage</p>
Instrument selection	<ul style="list-style-type: none"> • Given the choice, it is prudent to check which from of ESOPs (i.e. ESOPs, RSUs, SARs, CSARs/ Phantom or a combination thereof) will be effective from all the angles. • It is seen that certain forms of ESOPs require reduced quantum of equity maintaining same amount of benefit. <p>Linkage: ESOP Pool, Accounting cost/ Corp tax optimization</p>

Needless to say that in case of companies in regulated sectors like banking and insurance, the Grant structuring is subject to sectoral guidelines on compensation.

Basis the Grant parameters decided, the subsequent parameters on Vesting, Exercise/ Sale/ Monetization, and Employee Communication are structured in a synchronised manner.

It is important to note that 'a predictable ESOP roadmap' can be obtained when all the parameters of the ESOP Stages are pragmatically determined with appropriate analysis and simulations with reference to applicable laws, practice, accounting, tax, resultant business growth/ valuation and last but not the least is ease of administration.