Employee Stock Option Plan (‘ESOP’)

ESOP is a critical part of an organisation’s compensation strategy. Over the years, ESOPs have acted as stimulus to enhance employee motivation, morale and retention while linking compensation with long term performance horizons.

There are several types and forms of ESOP plans prevalent in India and globally. The type of plan adopted by a Company is usually dependent on the unique business needs and the organisation’s philosophy.

India landscape – Types of plans and prevalence - (% of participant companies)

- **Is there a Long Term Incentive Plan?**
  - Yes – 65%
  - No – 35%

- **Number of Long Term Incentive Plans**
  - 1 Plan – 52%
  - More than 2 Plans – 3%
  - 2 Plan – 45%

- **Types of Plans**
  - Stock Option: 51%
  - Restricted Stock Unit: 39%
  - Long Term Performance Cash: 16%
  - Performance Shares: 12%
  - Stock Appreciation Rights: 6%
  - Any Other: 2%

% exceeds 100% since some companies have more than 1 plan

Pre- IPO Companies set aside a sizeable portion of equity for ESOPs (All are median numbers)

<table>
<thead>
<tr>
<th>Approved Pool for ESOP</th>
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<tbody>
<tr>
<td>(% of share capital)</td>
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<tr>
<td>Overall Median</td>
<td>PE/VC Stake &lt;25%</td>
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<tr>
<td>Financial Institutions</td>
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<tr>
<td>Tech Companies</td>
<td>PE/VC Stake &gt;50%</td>
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Source – Deloitte Executive Compensation Survey 2021 and Pre-IPO Equity Analysis by Deloitte
Employee Stock Option Plan for emerging Companies

Key consideration for an ESOP

Key questions for the management

01. How will the presence of such incentive schemes be viewed / aligned to management objective?

02. Have you assessed the tax, regulatory, compliance, accounting and reporting impact of ESOP?

03. Can the stock incentives become an integral part of the compensation strategy?

04. Are you an ‘eligible start-up’ that qualifies for the deferment of tax payments by employees?

05. Have you considered appropriate recharge arrangements in case of group ESOPs?

06. Is your plan compliant for grants given to overseas employees?
## Considerations in designing a new plan

<table>
<thead>
<tr>
<th>Design parameters</th>
<th>What question does it answer?</th>
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<tbody>
<tr>
<td>Vehicle</td>
<td>Given the objectives and constraints, which are the feasible long term incentive vehicles? What is the optimum vehicle. For instance, as per Deloitte study, 61% of companies which participated in the study chose ESOPs, 39% chose Restricted Stock Units.</td>
</tr>
<tr>
<td>Exercise price formula</td>
<td>How will the exercise price be determined?</td>
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<tr>
<td>Coverage</td>
<td>What filters govern employee eligibility?</td>
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<tr>
<td>Grant frequency</td>
<td>How often will the grants be made?</td>
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<tr>
<td>Approach to determine grant quantum</td>
<td>How will the number of units for each covered employee be determined?</td>
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<tr>
<td>Vesting condition</td>
<td>When will the units vest? Under what condition(s)?</td>
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<tr>
<td>Exercise period</td>
<td>When can the units be availed? How can process of exercise be eased for employees?</td>
</tr>
<tr>
<td>Stakeholder implications under various scenario</td>
<td>Shareholders - Estimated dilution, Performance-Reward relationship, related challenges from shareholder advisory bodies Company - Cash outgo, P&amp;L expense Employee - Earning opportunity, Upside/downside</td>
</tr>
<tr>
<td>Special considerations, if any</td>
<td>Provisions for change in control, corporate actions Provisions which can enable reversing of expense in case certain outcomes are not achieved Post IPO requirements e.g., ratification of the scheme</td>
</tr>
<tr>
<td>Administrative provisions</td>
<td>How will resignations or group transfers or retirements be treated?</td>
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</table>
Deloitte will equip the management in understanding and implementing the requirements of various regulatory and tax provisions, financial reporting impact and sector specific regulations. We will leverage Deloitte's deep expertise and technology solutions to provide a practical, business-oriented view on design, implementation, accounting, valuation, regulatory compliance and taxation with respect to ESOPs.

**How can we help?**

**Structuring**
- Understand the business objective and suggest an appropriate plan
- Assist in finalising plan parameters and drafting of plan, related documentation
- Benchmarking Analysis for determining eligibility
- Assist in rolling out plan to the employees, managing employee workshops

**Valuation, Accounting and Financial Reporting**
- Valuation of shares and options
- Advice on the appropriate accounting treatment of the ESOP plan as per Ind AS/Indian GAAP/ IFRS/ US GAAP
- Advice on appropriate accounting for group share based payments and recharge arrangements.
- Assistance in identifying disclosure requirements as per applicable GAAP

**Tax and regulatory Advisory support**
- Advice on Company law and SEBI regulations and assistance with regulatory compliances
- Assistance in withholding calculations and payroll reporting including use of Tax treaties to mitigate double taxation for mobile employees
- Deductibility of costs for the company and taxation of ESOP trust

**Cross border grants**
- Overseas tax regulations
- The need for an overseas addendum to the plan
- Beneficial overseas taxation regimes
- Recharge of costs, mark-up required and deductibility of the recharges
- FEMA compliances and filing requirements
Our value proposition

- Cross functional team with deep industry knowledge and transaction know-how
- Practical and solution-oriented approach
- Strong global assurance and tax practice and credible national presence with proven track record
- Deployment of technology solutions (online platform) for seamless execution and governance

Global tools

01. My Incentive Plan
02. Share based payment calculator
03. Memo Logic
04. GA Incentives Withholding tax calculator for 130 countries