



the definitive guide to

STOCK BASED COMPENSATION FOR EMPLOYEES

PREQUATE strategic finance *for* business impact

Stock based compensations for your organization

Mar 2019

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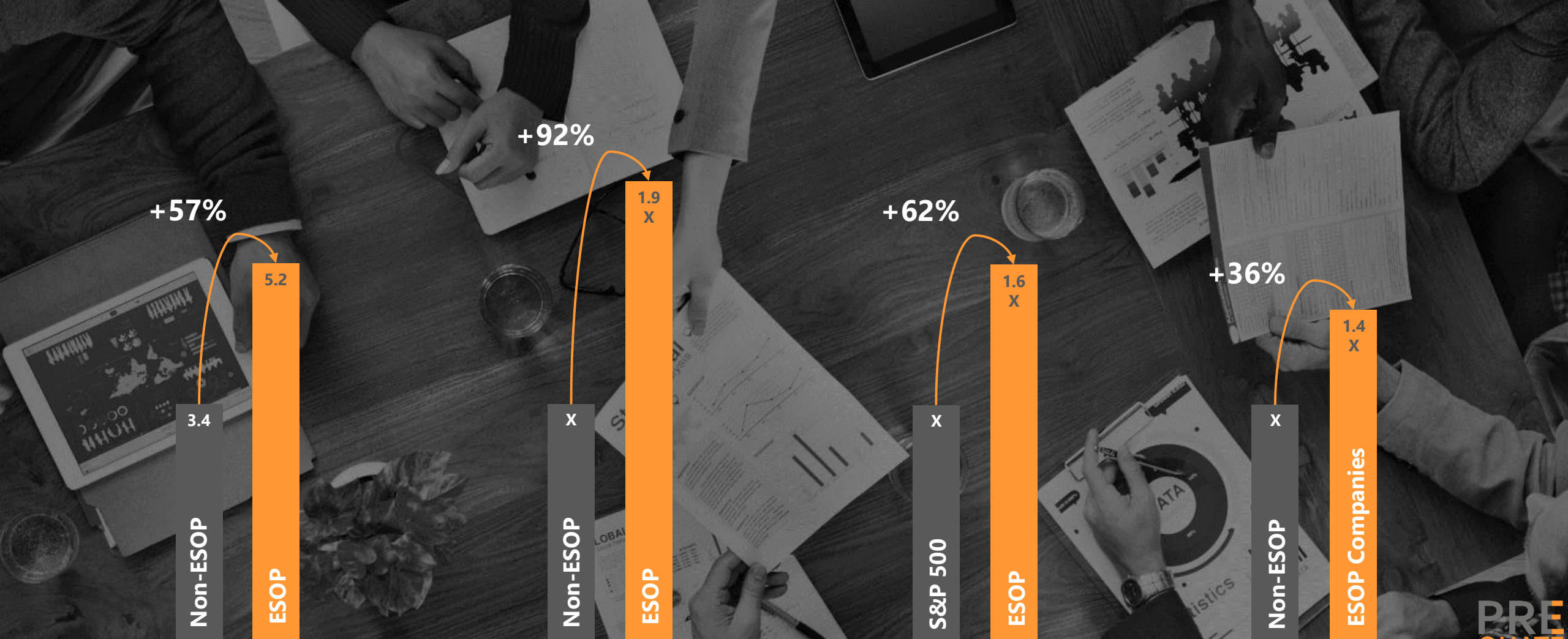
Further this document has been designed to collate all the relevant information about the subject matter and allow you to further read based on your interests. We thank all the contributors whose information and links we have shared in each page. This document intends to be the front face on the topic more than a research paper.



To win in the marketplace
you **must first win in**
the workplace.

PRE
QUATÉ

- Doug Conant
Former President & CEO, Campbell Soup Company



Average Tenure
in the company
in years

Average
Household
Income

Average
Returns
2002-12

Increased
Growth
over 10 years

ESOPs REALLY WORK

WHAT IS AN ESOP

Defines the coverage of employee levels of the plan, e.g., senior management only in this case.

In order to use the method, you need to be registered as a corporation with shares or similar stock units.

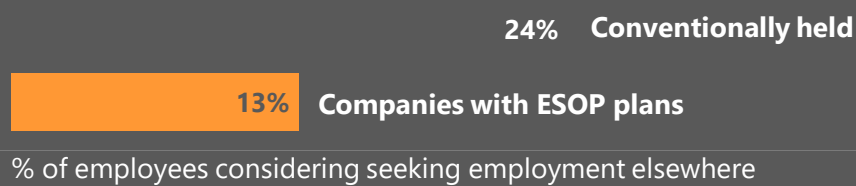
Equity/ Stock-based compensation is a method by which corporations use options to buy stock at subsidized/ no cost usually at a future date to incentivize, retain and reward their employees/ advisors.

Usually priced so that employees can own stock units at a price lower than fair/traded market value when they are eligible to buy.

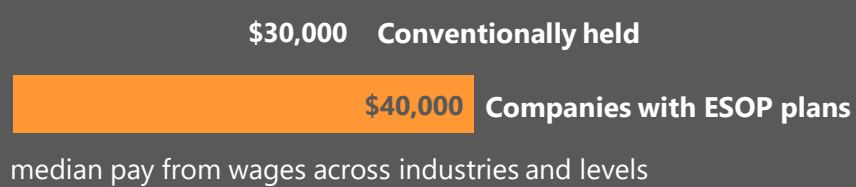
Incentivize. motivate or encourage to do something
Retain. keep someone engaged in one's service
Reward. give something in recognition of service, efforts or achievements

But only to company's/ parent company's/ subsidiary's/ holding company's employees.

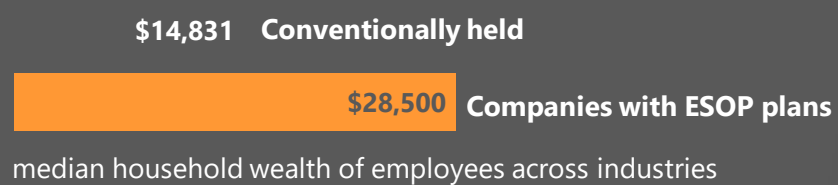
Less likely to leave



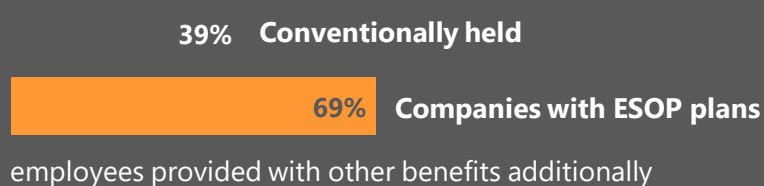
Earn more wages



Accrue more wealth



Receive more benefits



RESOURCES

2015 ESOP Survey, EO Foundation
Employee Ownership Foundation's 21st Annual Economic Survey

AMA Blog, Jerry L Ripperger
How Employee Ownership Benefits Executives, Companies, and Employees

Correlates of Employee Satisfaction
Journal of Applied Psychology, study by KJ Klein & RJ Hall, University of Maryland

93%

of companies that said ESOP deployment benefitted the company

83%

of companies that said their company's stock value increased on external appraisals

77%

of companies said it positively impacted employee morale and on-job performance

said profitability increased

69%

said revenue increased

78%

2018 NCEO Annual Survey
National Center for Employee Ownership Survey read with 2018 Update

2018 ESOP Economic Performance
Performance of ESOPs in organizations by BKD, CPAs & Advisors

Statistical Profile on EOs
National Center for Employee Ownership with Department of Labor for 2015

RESOURCES



MORE THAN ONE WAY

EQUITY

Employee Stock Option Plan (**ESOP**), Incentive Stock Options (**ISO**), Employee Stock Purchase Plans (**ESPP**), Non-Qualified Stock Options (**NQSO/ NSO**)

Allows employees to become share holders at a future date and at a pre-determined price, usually lower than the fair market price.

““ *I want my employees to be owners like me.*

Investors would want me to have ESOPs to retain talent.

We are expecting to go public/ get acquired someday soon.



AWARDS

Restricted Stock Units (**RSU**), Unrestricted Stock Unit (**USU**), Common Stock Alternative (**CSE**)

Allows employees to become share holders today but applies restrictions on the transferability or ownership to safeguard company interests.

““ *I want my employees to have a share of our success subject to...*

Flexibility to operate and option to buy-back is paramount.

I need to reserve certain rights as my investor wants them.



MIMIC

Phantom Stocks, Stock Appreciation Rights (**SAR**), Profit Pool, Strategic Deferred Compensation Plans, Profit Unit Plan (**PUP**)

Mimics equity interest but without altering or modifying the cap table to incentivise employees for current and future performance.

““ *I want them to partake in liquidity events.*

I believe their contributions are specific to certain areas mostly.

Stock dilution may impact me negatively in this scenario.



PRE
QUATE

Need
help?

RESOURCES

Investopedia
ISOs

Definitions of key phrases relating to the meaning, statutes, advantages & disadvantages of concepts

Investopedia
NQSOs

Definitions of key phrases relating to the meaning, statutes, advantages & disadvantages of concepts

Morgan Stanley
RSUs

Understanding RSUs, how to determine whether you received an RSU, restrictions, taxation

Investopedia
RSUs

Definitions of key phrases relating to the meaning, statutes, advantages & disadvantages of concepts

Investopedia
Phantom Stock
& SAR

Definitions of key phrases relating to the meaning, advantages + disadvantages

PhantomStock
Types of Plans

Types of Phantom Stock plans, meanings, advantages, uses of each type and related disadvantages

PhantomStock
Whitepaper

Definitions, types, uses, meanings, advantages and disadvantages, who uses what, when and how these work

GRANT

Issuing a stock option award to an employee usually read in conjunction with his employment agreement and statutes

Need help?

VESTING

The time period that an employee needs to wait for/ milestones which need to be reached/ performance that needs to be delivered when the employee can apply to receive the stock.

Vesting Schedule

Schedule of when what portion of stock becomes eligible for exercise

Accelerated Vesting

Procedure for premature vesting in situations such as buy-out/ merger

Trigger Vesting

Single/ Double Trigger of sale +/- employee exit that leads to vesting

Cliff Vesting

Time period during which no vesting happens till a certain date

EXERCISE

Act of buying the stock unit by paying the 'Exercise amount', if any, to convert the vested options to actual stock

Exercise Period

Time period when option holder can apply to receive stock units

Maturity

Period for which the Exercise period stays open

STRIKE PRICE

Price that the option holder pays in order to acquire the stock units which he is entitled to which is based on:

VALUE OF INCENTIVE AWARDED

FMV OF THE SECURITIES

AFFORDABILITY TO EXERCISE

PRE QUATE

ESOP Cheat Sheet

Alexander Jarvis Blog 50 Folds on ESOP Terms

ESOP, The Employers Perspective

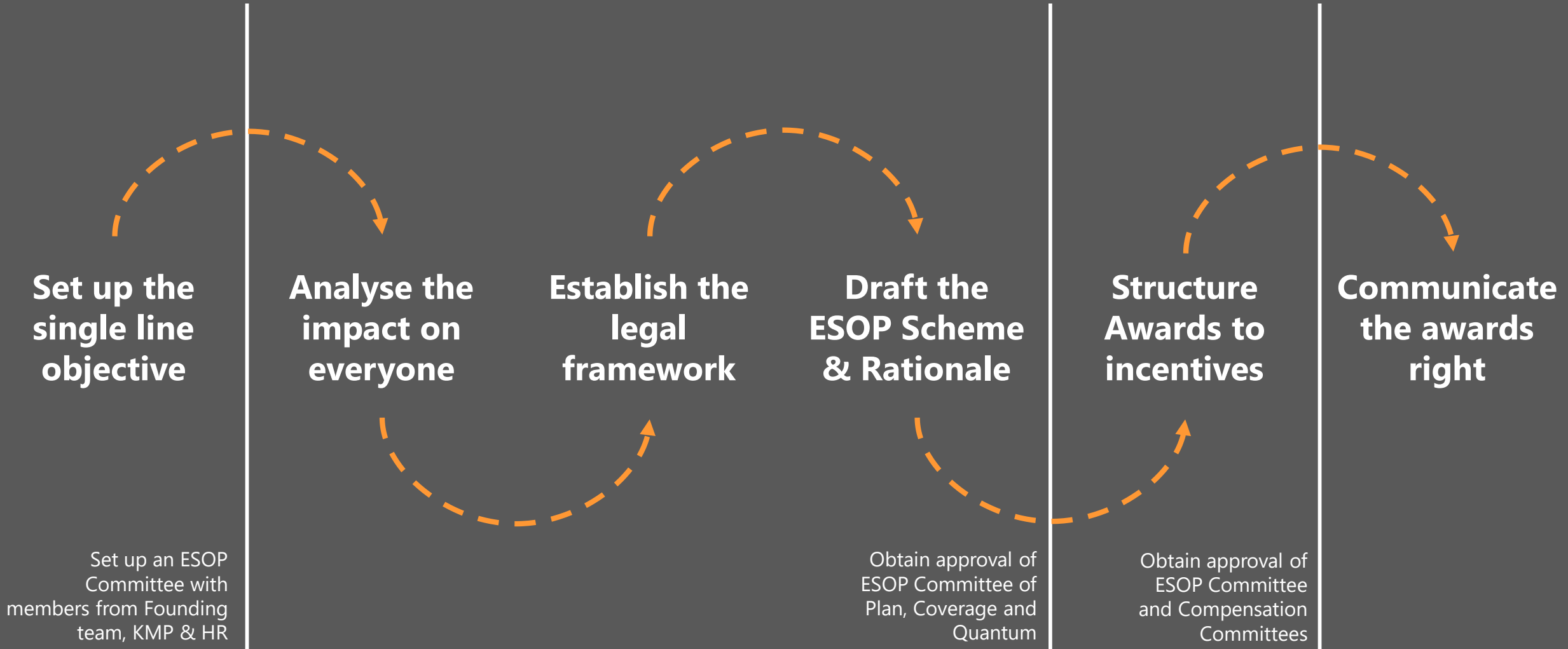
Clartax Blog on Key terms in ESOPs and what they mean

Regulators & ESOPs in India

Nishith Desai Associates whitepaper on ESOP terms

Accion ESOP Whitepaper

Best practices in ESOPs and term used with examples



PROCESS

**Set up the
single line
objective**

**Analyse the
impact on
everyone**

**Establish the
legal
framework**

**Draft the
ESOP Scheme
& Rationale**

**Structure
Awards to
incentives**

**Communicate
the awards
right**

Set up an ESOP
Committee with
members from Founding
team, KMP & HR

PROCESS

Defines the coverage of employee levels of the plan, e.g., senior management only in this case.

This is important to decide on the type of plan, e.g., using a Phantom stock award when ownership is not the objective.

This defines the performance goals that the plan may be attached to, e.g., revenue goals, investment goals or profit goals.

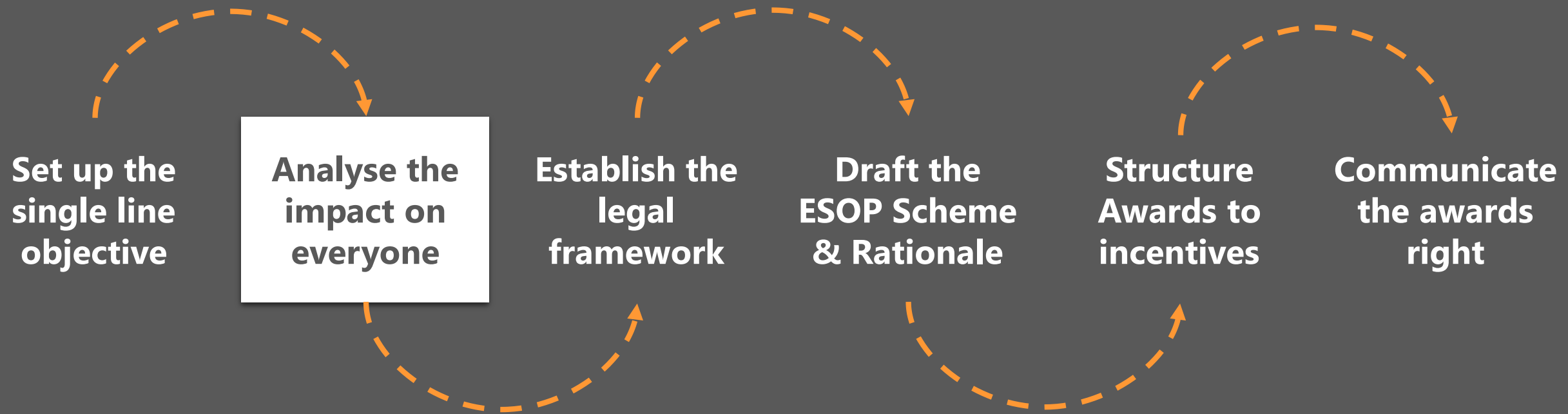
Structure is based on the goal of the plan, e.g., retention as a key goal would define length of vesting cycles/ encouraging ownership would define the exercise price.

To encourage, motivate and retain employees contributing to the overall management by enabling ownership while allowing them to accrue personal wealth and gain from the growth of the company.

This allows to decide on the quantum, tenure and conditions for exercise, e.g., holding period lengths before sale.

A simple comprehensive single sentence objective statement

A single sentence goal statement allows all stakeholders to be on the same page as to why the proposed plan is being setup and who it wishes to reward/incentivize. This ensures that future stakeholders are also in the know and aligned to the long-term objective.



PROCESS

ANALYSE THE IMPACT

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QUATE

RESOURCES

The Hartford
Magazine on
ESOPs

ESOP factors to consider and the
next generation

Money Today,
How to use
ESOPs

ESOPs SOPs By Tanvi Verma

Business
Standard,
Using ESOPs
productively

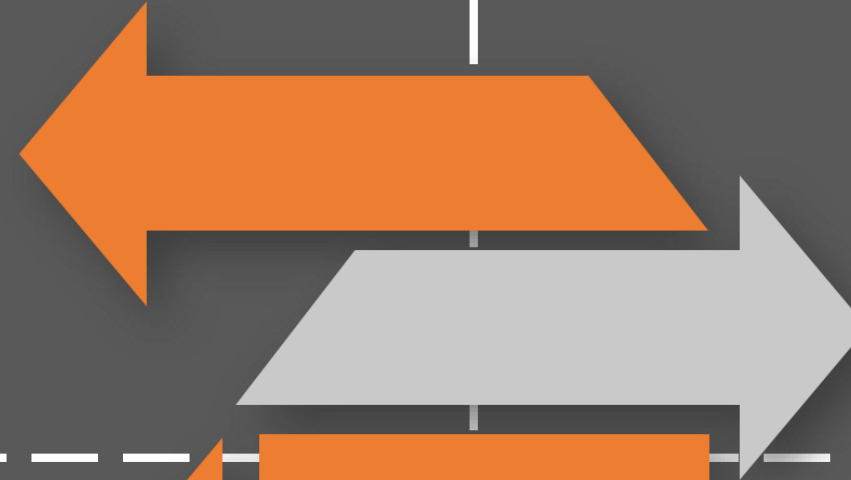
Risky but profitably

FINANCIAL

Impact on future cash flows, Ability to compensate in cash, Tax considerations at time of exercise, Cost of setting up and administration, buy-back need, Valuation expected over time

Value of incentives, ability to afford exercise, withholding tax requirements, payoff at exercise, salary-ESOP trade-off, other benefits provided

ON THE COMPANY

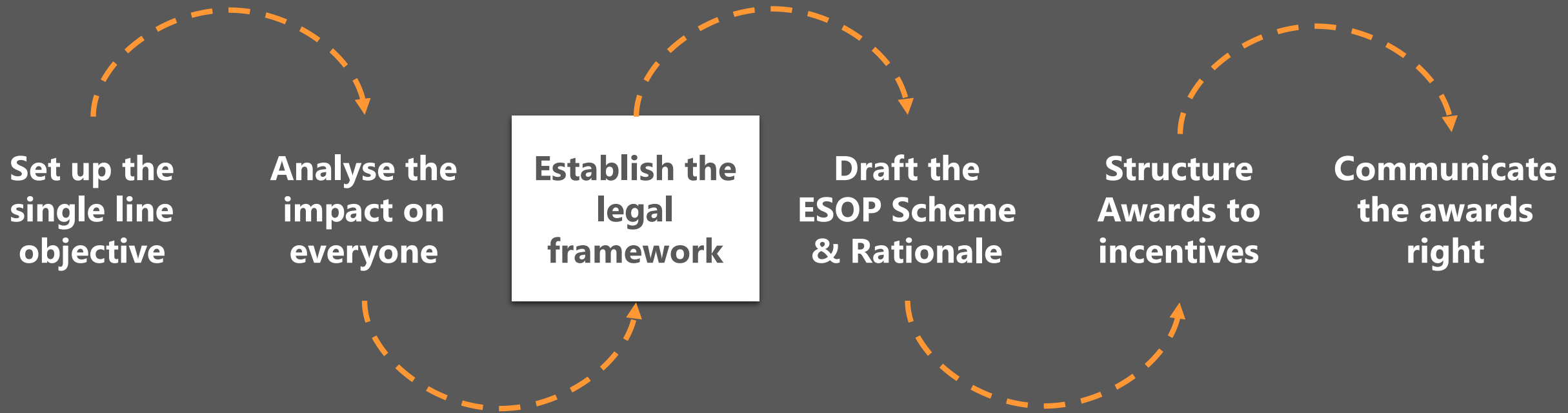


Timing of grant and plan, right communication to employees, management perception of risk factors, growth path visualized, need to having loyalty from team

Potential for growth, control in organization, selection of the right personnel for allotment, timing of exercise, alignment of incentives to objectives/ plan

ON THE EMPLOYEES

NON-FINANCIAL



PROCESS

RESOURCES

Rule 701, UpCounsel

Process, conditions to be fulfilled for availing safe harbour benefits

SEBI Regulations on ESOPs

Employee stock option scheme and employee stock purchase scheme guidelines, 1999

Changes in Tax on ESOPs, Forbes India

Changes in Tax Structure Will Impact ESOPs

How ISOs are taxed, The Balance

Taxation and impact on ISOs in US and under the tax reforms

ISO taxation detailed, TurboTax

Taxation and impact on ISOs in US and under the tax reforms

Sanction by **Special Resolution** by the Shareholders

Separate **Resolution for Additional issues** to employees

Separate **Resolution for grants to parent, subsidiary employees**

Authorisation for granting of ESOPs

Determining the Exercise Price (accounting norms and incentives)

Minimum Vesting Period of 1 year from grant

Decision on **Lock-in-period post exercise**

Transferability, - Non-transferable, or cannot be encumbered

Setting up the scheme

Exercise conditions, process, legal heirs, incapacity

Maintenance of Registers of Employee Stock Grants, Exercise

Forfeiture/Refund on expiry/ non-fulfilment of vesting conditions

Clarifying exercise

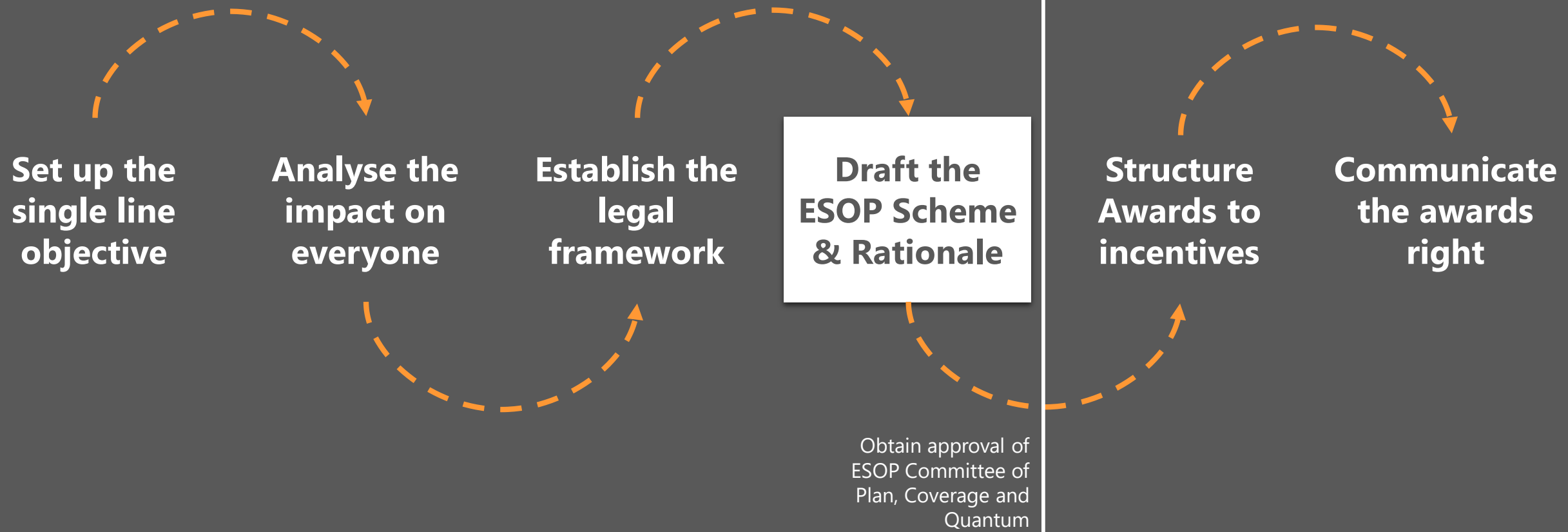
Disclosures in BoD Report summary of movement & financial impact

Disclosures of the Scheme Framework -Execution - Reporting

Variation from the ESOS Approval by special resolution

Communicating to stakeholders

Need help?



PROCESS

DECIDE AWARDS

PRE
QUATE

	Founding Team/ CXOs	Senior Team/ VPs & Above	Functional Teams	Support Teams
1 Segment your teams by function/ role				
2 Define Rationale for Awards	% ownership	Wealth accretion	\$ incentives	\$ incentives
3 Assign option multiplier for contribution	Negotiate	Negotiate + X times Base Salary	X times Base Salary	X times Base Salary
4 Assign \$ value to stock options	$\frac{\% \text{ holding at maturity} \times \text{Valuation at maturity}}{\text{Discounting factor}} = \$ \text{ value of holding}$	$\$ \text{ value of holding} + \$ \text{ value of award}$	$\frac{\text{Base Salary} \times \text{Option Multiplier}}{=} = \$ \text{ value of award}$	$\frac{\text{Base Salary} \times \text{Option Multiplier}}{=} = \$ \text{ value of award}$
5 Compute Awards offered	$\frac{\% \text{ holding}}{\text{Total Equity Units}} = \# \text{ of equity units}$	$\# \text{ of equity units of methods to left \& right}$	$\frac{\$ \text{ value of award}}{\text{Last Base Value discovered}} \times \text{Total Equity Units} = \# \text{ of equity units}$	$\frac{\$ \text{ value of award}}{\text{Last Base Value discovered}} \times \text{Total Equity Units} = \# \text{ of equity units}$

RESOURCES

ESOP Best Practices, Accion

Best practices, model examples, terms and calculators

Co-founder Equity Calculator, Foundrs

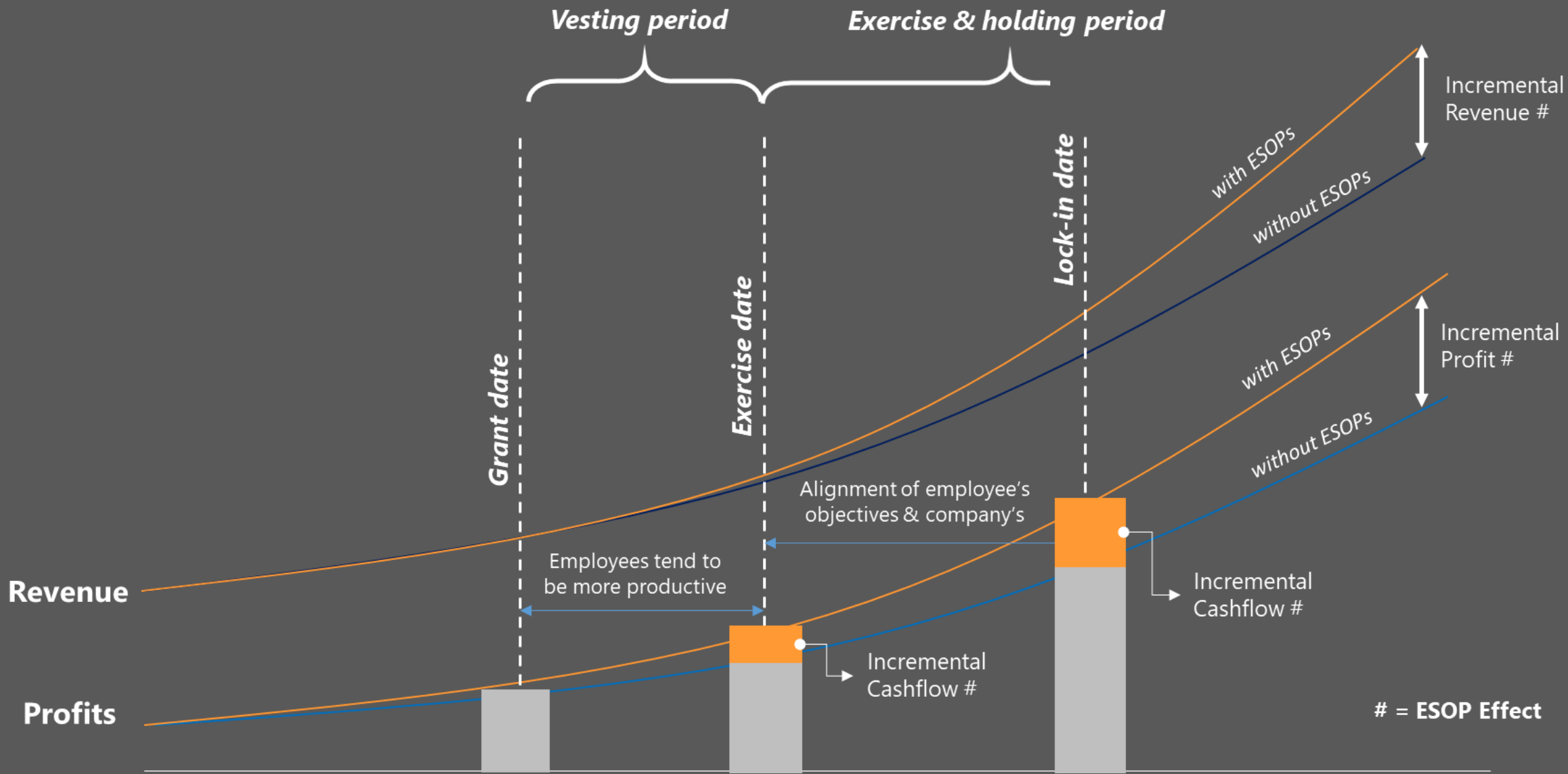
Objective way to assess value of co-founders & founding team

Co-founder Equity Split, Gust

Objective way to assess value of co-founders & founding team

Getting the value of stock options, McKinsey

How to get the most of your stock option pool and awards



EVALUATE PLAN'S IMPACT

Vesting Period	Tech 4Y	Serv 4Y	Manu 5Y	Other 5Y
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Most commonly chosen by MSMEs

Vesting Frequency	Annual 70%	Quarterly 20%	Monthly 10%
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Most trending

Exercise Period	Low 3m	Med 6m	High 12m
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Most commonly chosen by MSMEs

Award Allocation	Y1 30%	Y2 20%	Y3 20%	Y4 30%
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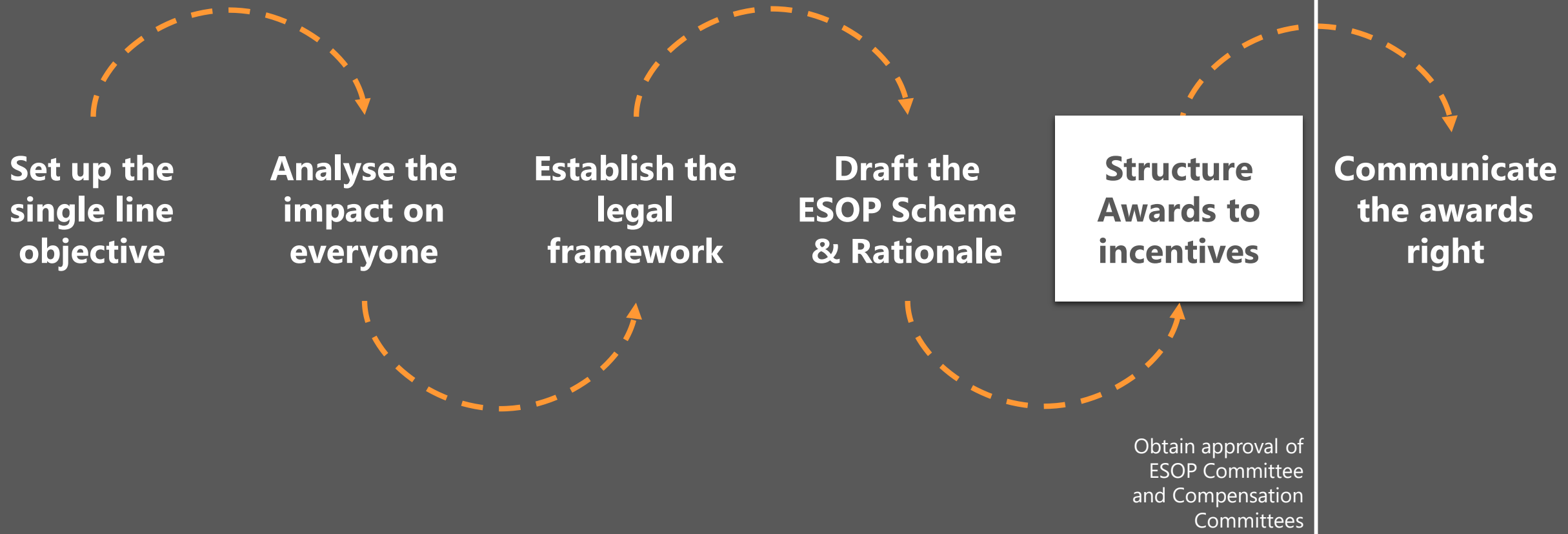
Most commonly chosen by MSMEs

Most commonly chosen by MSMEs

Lock-in Period	Low 0Y	Med 1Y	High 4Y
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Buy-back Option	Yes 40%	No 60%
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USUALLY



PROCESS

DECIDE AWARDS

PRE
QUATE

	Founding Team/ CXOs	Senior Team/ VPs & Above	Functional Teams	Support Teams
1 Segment your teams by function/ role				
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3 Assign option multiplier for contribution	Negotiate	Negotiate + X times Base Salary	X times Base Salary	X times Base Salary
4 Assign \$ value to stock options	$\frac{\% \text{ holding at maturity} \times \text{Valuation at maturity}}{\text{Discounting factor}} = \$ \text{ value of holding}$	$\$ \text{ value of holding} + \$ \text{ value of award}$	$\frac{\text{Base Salary} \times \text{Option Multiplier}}{=} = \$ \text{ value of award}$	$\frac{\text{Base Salary} \times \text{Option Multiplier}}{=} = \$ \text{ value of award}$
5 Compute Awards offered	$\frac{\% \text{ holding}}{\text{Total Equity Units}} = \# \text{ of equity units}$	# of equity units of methods to left & right	$\frac{\$ \text{ value of award}}{\text{Last Base Value discovered}} \times \text{Total Equity Units} = \# \text{ of equity units}$	$\frac{\$ \text{ value of award}}{\text{Last Base Value discovered}} \times \text{Total Equity Units} = \# \text{ of equity units}$

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How to get the most of your stock option pool and awards

DECIDE AWARDS

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Objective way to assess value of co-founders & founding team

Getting the value of stock options, McKinsey

Size of Option pool by Industry	Knowledge Industries				Asset Intensive		
	Tech 25%	BFSI 16%	Services 18%	Others 16%	FMCG 17%	Manu 16%	Others 10%

Allocation for Early team	First 10 Employees 5-10%	Next 20 Employees 5%	Next 50 Employees 5%	Next 100 Employees 5%
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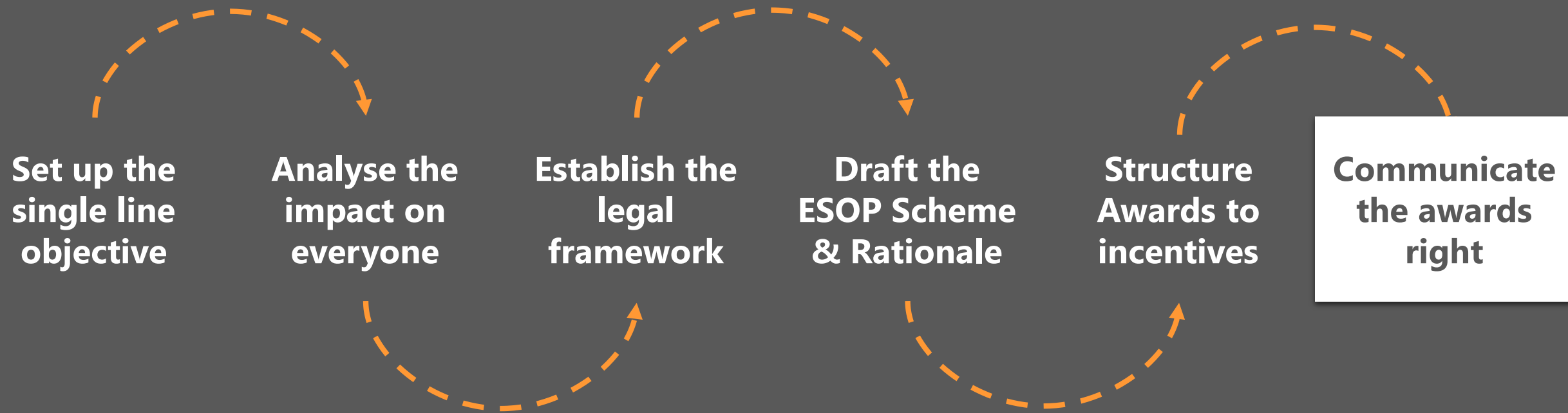
Evaluate Co-founder/ CXO Equity Split

CEO 2.5%	CTO/ CPO 1.5%	CFO 0.5%	CBO 1%	CMO 1%	CHR 0.5%
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Allocation by function	Board 2%	Mgmt 7%	Delivery/ Ops 5%	Sales/ Business 5%	Support function 3%
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Need help?

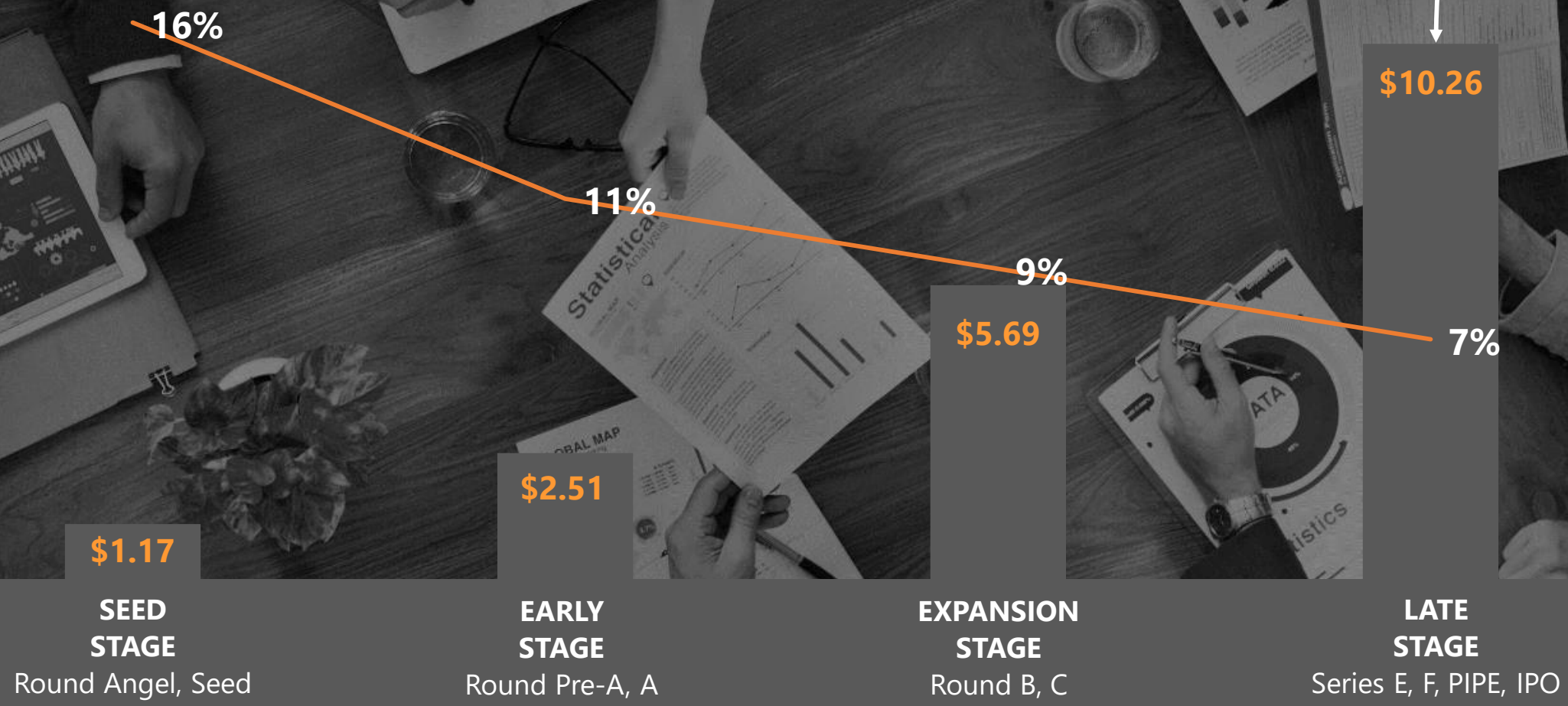
USUALLY



PROCESS

Amount in Pool as % of total equity

Value of ESOP pool over funding stages

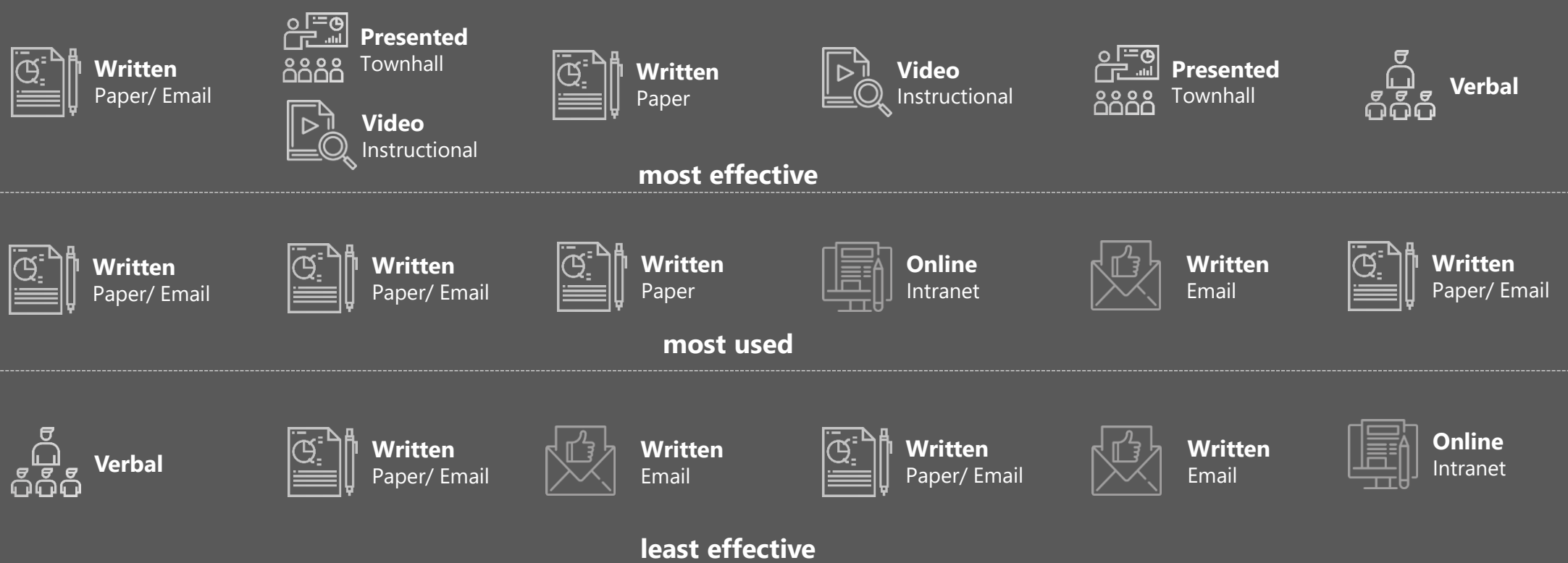


COMMUNICATE THE VALUE



74% of the employees were dissatisfied with organizations' measures to communicate.

- Ragan Survey, 2014



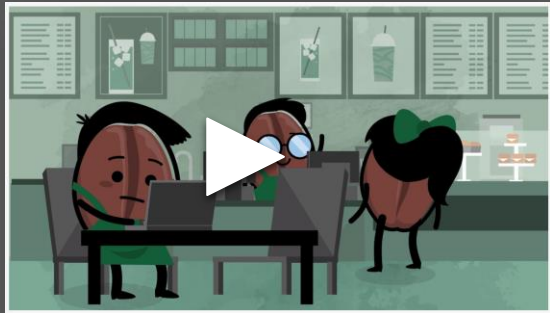
RIGHT MESSAGE

RIGHT MEDIUM

COMMUNICATE RIGHT



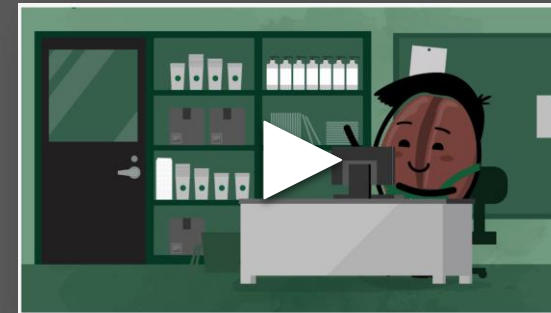
Starbucks' communication of their stock option plan is right on. Clear, concise and friendly in demeanour. This enables all employees to be clear and refer to it for any clarifications.



*Communicating Grants
& Plan*



*Communicating Grant
Valuation*



*Communicating
Vesting & Exercise*



Employees who believe that management is concerned about them as a whole person – not just an employee – are more productive, more satisfied, more fulfilled.

- Anne Mulcahy
Former Chairperson & CEO, Xerox Corporation

GOOD

Using Stock Options to dissuade Hostile Takeovers

RESOURCES

The CS Monitor
ESOP
gains as anti-takeover defence

Using Stock Options to Revive a flailing company

The Economist
An ESOP To The Workers

Using Stock Options to Facilitate Divestiture

The Menke Group
The Original History of the ESOP and its role as a business succession tool

BAD

RESOURCES

Stock Options causing financial harm

Gene Marks
Inc.com, Is there a problem with your ESOPs

Stock Options leading to exit of key employees

Bloomberg
Why ESOPs are a Complete Failure in India

Stock Options leading to dissatisfaction

Inc42
How ESOP exercise conditions can cause overall dissatisfaction

Now, can **Prequate** help?

Of
course

ESOP
SCHEME

GRANT
STRUCTURING

ESOP
AUDIT

BENCHMARK
STUDY

ESOP
REVIEWS

REVENUE
AUGMENTATION
STUDY

ESOP
VALUE STUDY

*strategic
management*

30 days

90 days

180 days

360 days



PRE QUATE

Looking to implement ESOPs/ evaluate them for your company?

[HELP ME EVALUATE MY ESOPs](#)

Click this if you need some help on your ESOPs right away.

There's something else I wanted to check with you guys on.

[SEE WHAT ELSE WE CAN DO](#)

Click this if you think you need help on something else that we could help with.

or

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