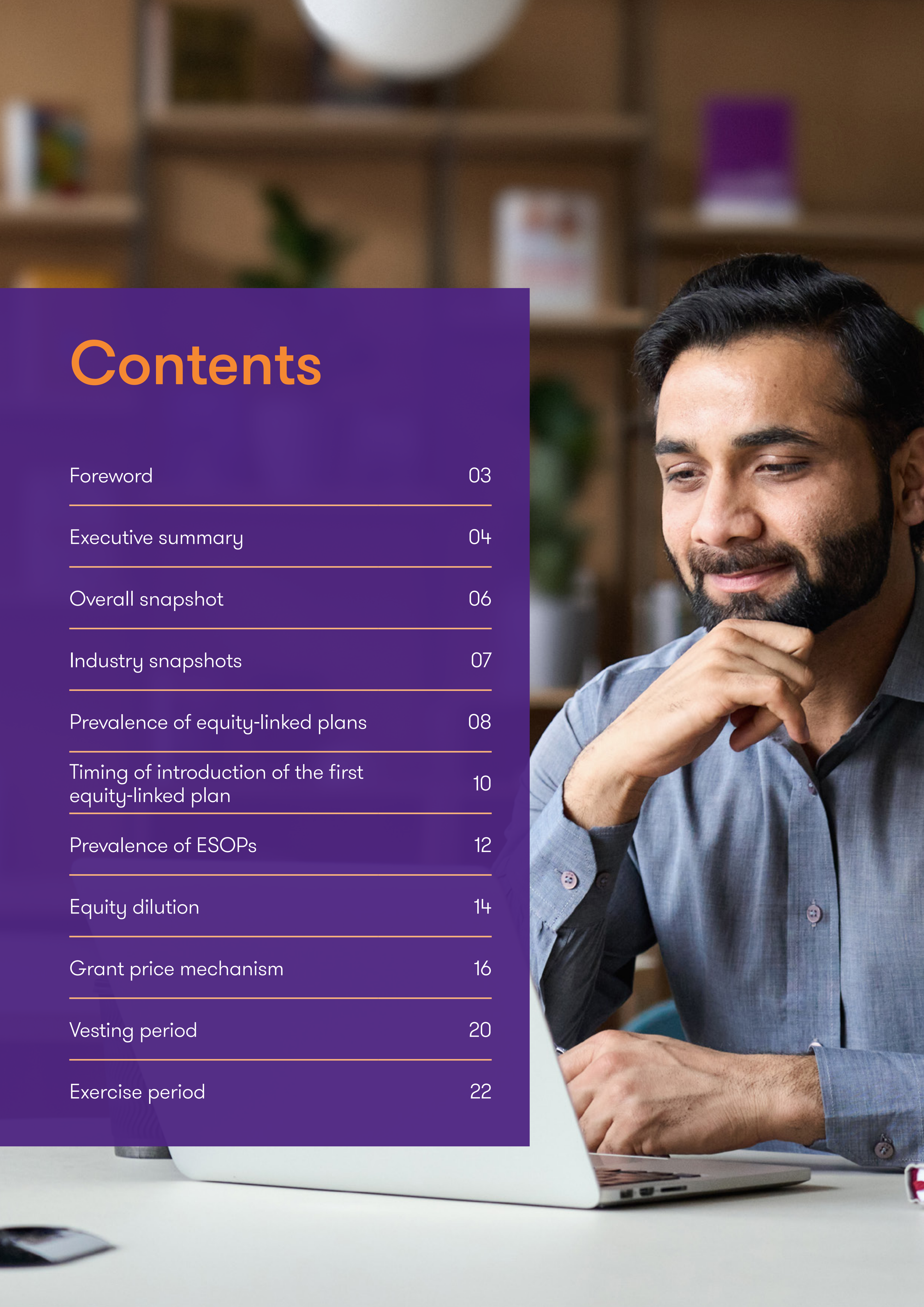
Equity-linked incentives

How ESOPs are leading the way in India

April 2022



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Foreword

The changing equity rewards landscape in India and the road ahead

Equity-linked incentives, especially employee stock options plans or employee stock options plans (ESOPs) have become a buzz word in the recent past. In addition to providing wealth creation opportunities, they act as a medium to instil a sense of ownership, thereby making it attractive to employees and employers alike. ESOPs and restricted stock units (RSUs) are now widely used by entrepreneurs as an effective tool in attracting an enterprising workforce which is looking to participate and benefit from the booming Indian market, especially in the mid-size and start-up space.

The trend of equity-linked rewards has seen a shift in the last few years. While they were typically limited to senior management and leadership, in recent times we have seen the coverage increase to also include younger and newer employees. This is driven by the ambitious millennial and gen Z workforce, who are inclined towards faster growth and instilling a feeling of entrepreneurial spirit. There has also been an increase in the trend of introducing ESOPs a couple of years before companies are looking to go public. This is driven by the need to ensure that the critical talent which is required to drive the company to a successful listing can be retained and adequately rewarded for their contribution to the organisation growth. Even start-ups which don't have plans for listing, find ESOPs to be a very attractive tool for attracting and incentivising critical employees. In Q1 of FY22, Indian start-up employees have made over USD 83 million through ESOP buybacks[1].

To explore this trend further, Grant Thornton Bharat undertook research of 700 listed companies across seven sectors. The report explores the prevalence of equity-linked rewards in India, and the reward strategy adopted by some of the market leading firms across various sectors. We hope that this detailed research will enable business leaders to review their own reward strategy against the backdrop of prevalent market practices.

While equity-linked instruments are a very attractive option for employees, a fine balance is required when designing an incentive plan which caters to the interests of employees, shareholders and the organisation equally.

At Grant Thornton Bharat, we have a robust team of tax, accounting and human capital consulting experts who come together to design and deliver holistic ESOP solutions. Our bespoke solutions are tax efficient and help balance expectations and objectives of all stakeholders.

Ritika Mathur
Partner
Human Capital Consulting

1. Inc 42: https://inc42.com/buzz/indian-startup-employees-made-through-esop-buy-backs-already-in-2022/

Executive summary

Through this report, Grant Thornton Bharat details the existing practices and prevalence of multiple facets and design parameters of an employee stock option plan.

The details in the report are based on intensive research of **700 listed companies** across different sectors. This report aims to provide insights and market benchmarks to business leaders to adopt a suitable long-term incentive instrument for their critical talent with the aim to attract, retain and create ownership.

Data is based on top

700

companies
(100 across each major sector)

Research data of the past

5

years
(31 March 2016 onwards)

Hopefully, this report will encourage business leaders to reassess and modify their existing reward strategies and perhaps adopt the most suitable instrument before the ship sails and it's too late.

The insights from this report can also help organisations in designing the right kind of compensation and reward plans for their employees and critical staff in the post-pandemic era. Linking your reward strategies to metrics will nudge more employees to become productive and outcome oriented while embracing new work cultures.

Sectors

- Consumer, retail and e-commerce
- Financial services
- Automotive and manufacturing
- Healthcare and life sciences
- Real estate and construction
- Media, technology and entertainment
- Others

Prevalence

- Prevalence of different long-term incentive plans in the entire lifecycle of the organisation
- Prevalence of ESOPs as on 31 March 2016
- Prevalence of ESOPs as on 31 March 2021

Parameters

- Introduction pre/post-initial public offering (IPO)
- Equity dilution
- Grant price mechanism
- Vesting period
- Exercise period

Overall snapshot

700

companies included in the overall research

357

companies have had a long-term incentive plan

248

companies had an active ESO plan in place as on 31 March 2016

3%

is the average equity dilution for companies with ESOP, with the figure ranging from 0.05% to 17%

4.08

years is the average vesting period for all companies with ESOP, with the period ranging from 1-10 years

4.25

years is the average exercise period for all companies with ESOP, with the figure ranging from 1 month to 10 years

Industry snapshots

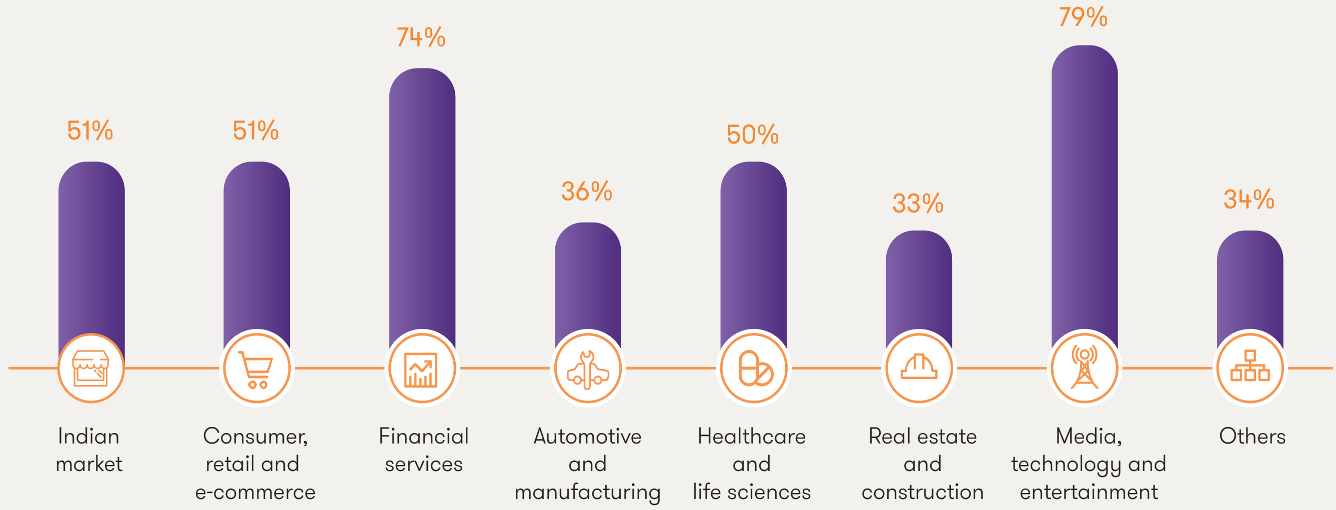
	Prevalence of long-term incentive plan (LTIP)	Average equity dilution	Grant price prevalence	Average vesting period (in years)	Average exercise period (in years)
Consumer, retail and e-commerce	51%	2.17%	Either equal to fair market value (FMV) or equal to face value, in most cases	3.7	4
Automotive and manufacturing	36%	2.17%	Equal to FMV, in most cases	3.9	4
Real estate and construction	33%	2.30%	Equal to FMV, in most cases	4.1	3.5
Financial services	74%	4.90%	Equal to FMV, in most cases	4.1	4.1
Healthcare and life sciences	50%	3.02%	Either equal to FMV or equal to face value, in most cases	4.2	4.1
Media, technology and entertainment	79%	4.26%	Equal to FMV, in most cases	4.2	4.9

Prevalence of equity-linked plans

(across the company's lifecycle)

This section details out the percentage of companies across industries that currently have or have had an LTIP in place at any point in their lifecycle. Further, it breaks down that figure into the type of instruments prevalent across those companies, i.e., employee stock options, restricted stock units (RSUs), employee stock purchase plans (ESPPs) and stock appreciation rights (SARs).

Overall LTI relevance



Key insights

ESOP

ESOP refers to an employee benefit plan under which a company grants stock options to its employees.

RSU

RSU is a type of compensation benefit for employees. It is a deeply discounted option usually given free of cost or at the face value and often granted to the employees based on their performance.

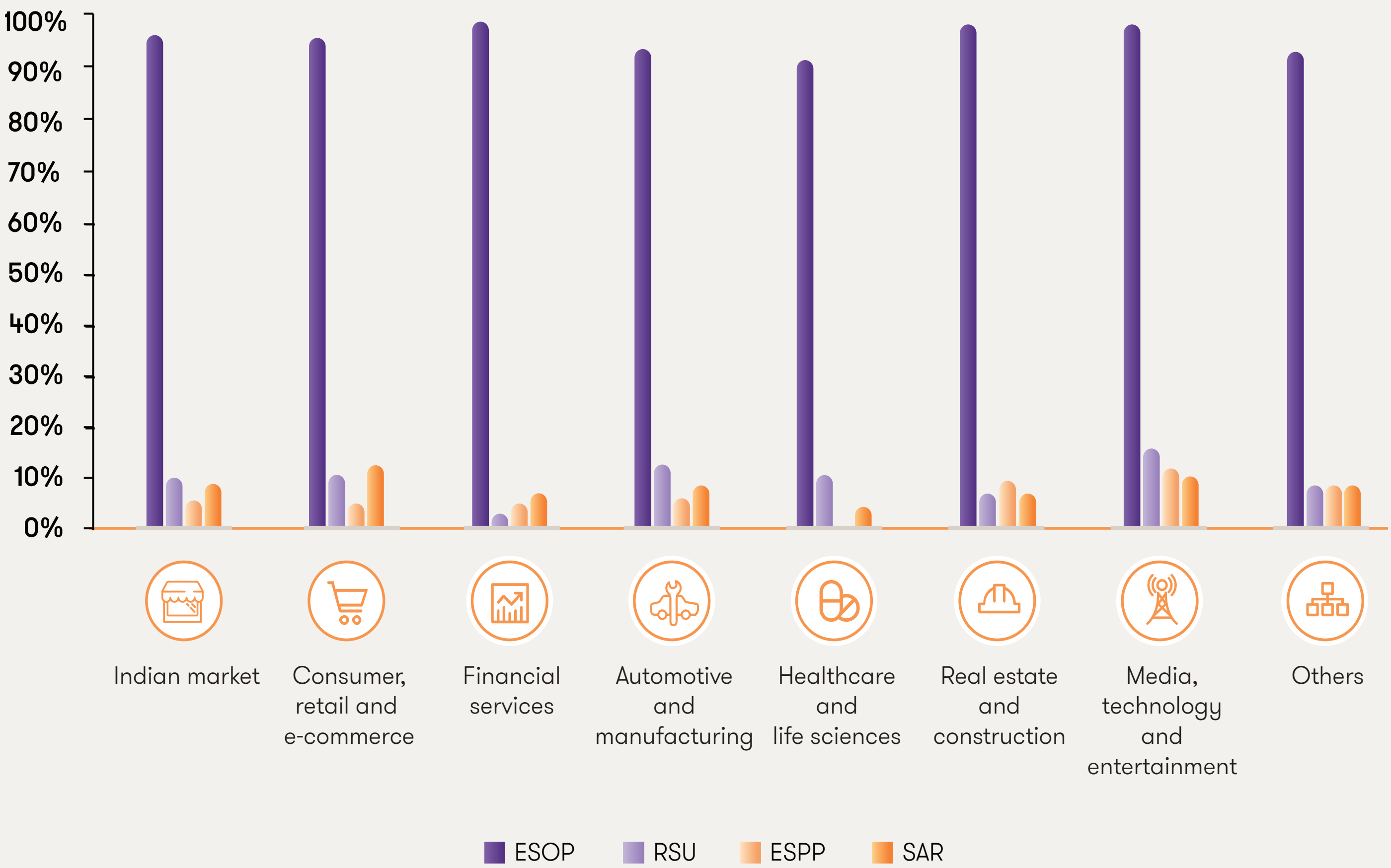
SAR

SAR is an employee compensation method in which employees are given an amount equal to the appreciation in the value of shares over a specific period.

ESPP

ESPP is a company-run program in which participating employees can purchase company stock at a discounted price. Employees contribute to raising capital through such plans. This is also prevalent in companies that are very near to an IPO/offer for sale (OFS).

In the manufacturing, automotive and the real estate and infrastructure sectors, small cap companies adopt equity-linked incentive plans at a much higher rate than bigger companies. There is a large potential for mid and large-cap companies to adopt equity-linked plans to ensure maximum benefit.



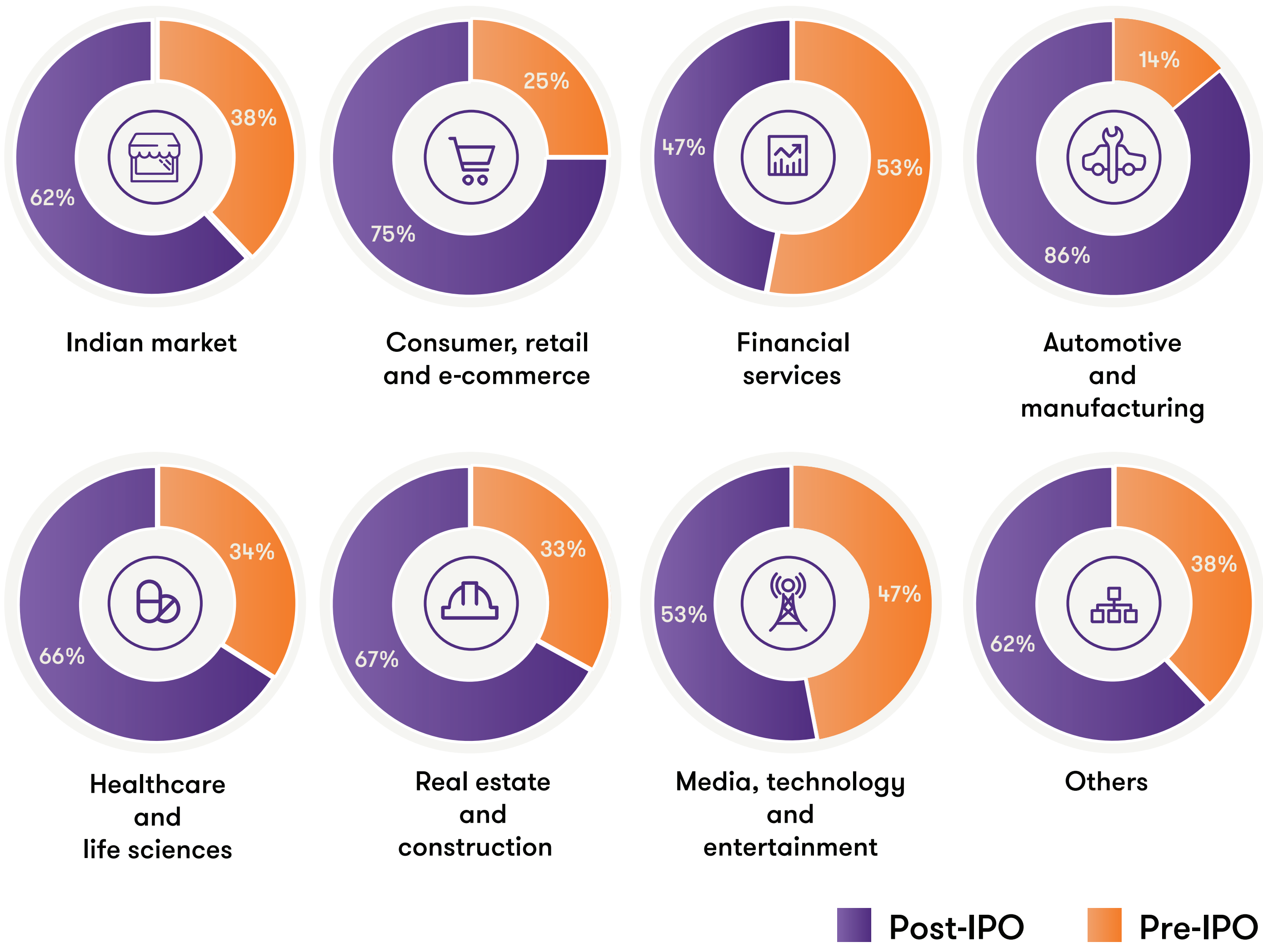
Timing of the introduction of the first equity-linked plan

(across the company's lifecycle – pre/post-IPO)

This section explains the prevalent trend around the timing of the introduction of the first LTIP across organisations in relation to their respective initial public offerings (IPOs), i.e pre-IPO or post-IPO.

Key insights

Traditionally, companies have introduced equity-linked LTIs to employees post IPO. However, in recent times, companies have discovered one to two years prior to the IPO to be the best time for granting ESOPs, or in some cases earlier than that, as it provides a greater wealth creation opportunity for employees. It also drives ownership in the employees at a critical juncture in the company's lifecycle while they plan for an IPO.


38%
62%
Indian market
25%
75%
Consumer, retail and e-commerce
47%
53%
Financial services
14%
86%
Automotive and manufacturing
34%
66%
Healthcare and life sciences
33%
67%
Real estate and construction
53%
47%
Media, technology and entertainment
38%
62%
Others
Post-IPO
Pre-IPO

Prevalence of ESOPs

(as on 31 March 2016 and 31 March 2021)

Consumer, retail and e-commerce

31% 38%

Financial services

53% 69%

Automotive and manufacturing

19% 28%

Healthcare and life sciences

36% 37%

Real estate and construction

21% 20%

Media, technology and entertainment

63% 63%

Others

25% 29%

● Prevalence as on 31 March 2016   ● Prevalence as on 31 March 2021

Key insights

In the last

5 years,

companies from consumer, retail and ecommerce, financial services and manufacturing and automotive sectors have moved towards ESOPs

69%

of the companies in financial services, while

63%

of the companies in technology, media and telecom sectors have had an active ESOP

Real estate and infrastructure sector holds potential in accepting

ESOPs

as a useful tool for growth

Equity dilution

(average percentage approved basis the latest active ESOP as on 31 March 2016)

Equity dilution signifies the average percentage of shareholder's equity approved for dilution across industries, under the latest employee stock option plan in place as on our cut-off date, i.e., 31 March 2016

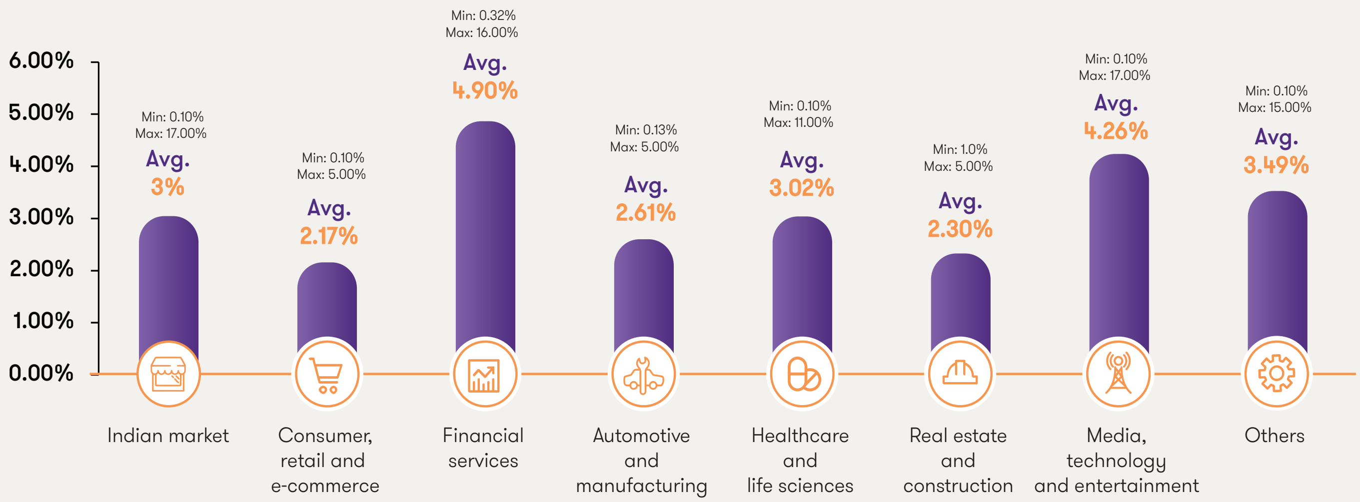
Key insights

The **average equity pool** approved for ESOPs has been **above 2%** for all sectors across categories.

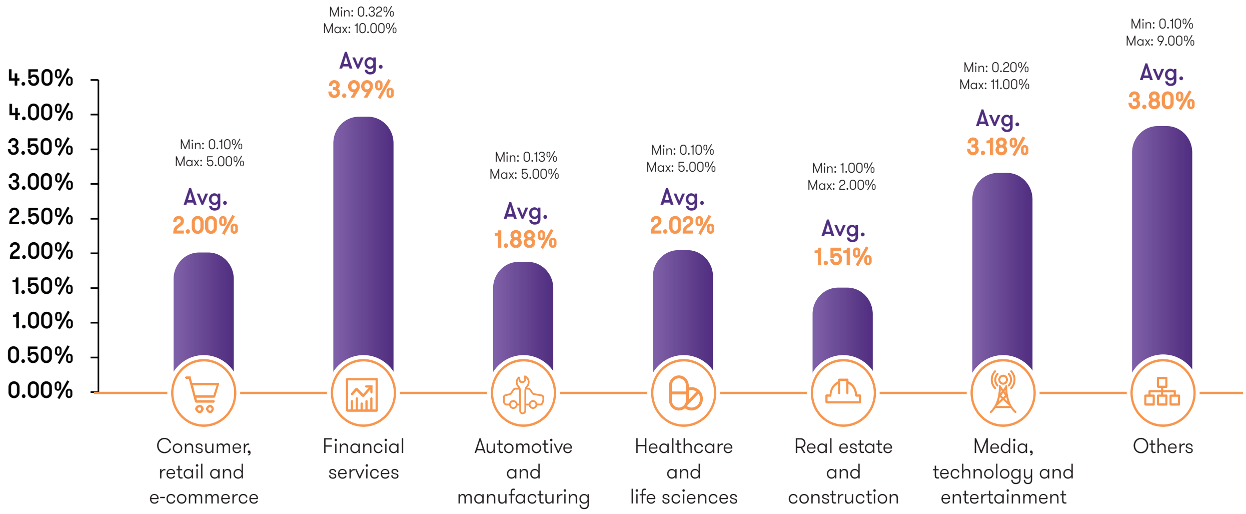
Financial services sector is willing to dilute **5%** of its equity for ESOPs, while **consumer, retail and e-commerce** hover around **2%** dilution.

Employers, across different sectors, are willing to **invest more** in equity-linked incentive plans.

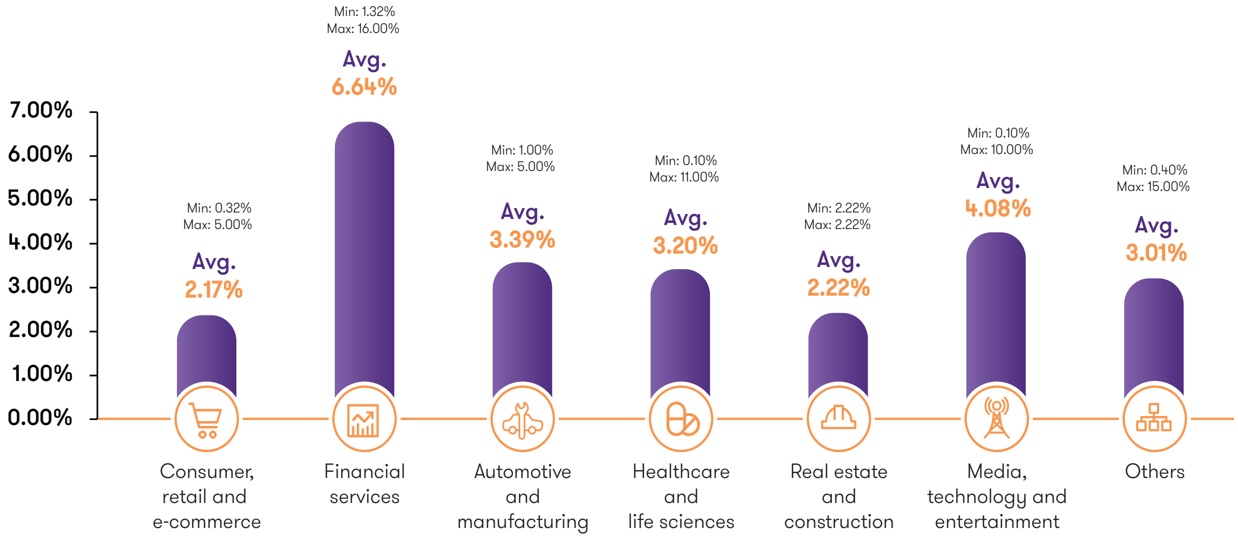
Overall



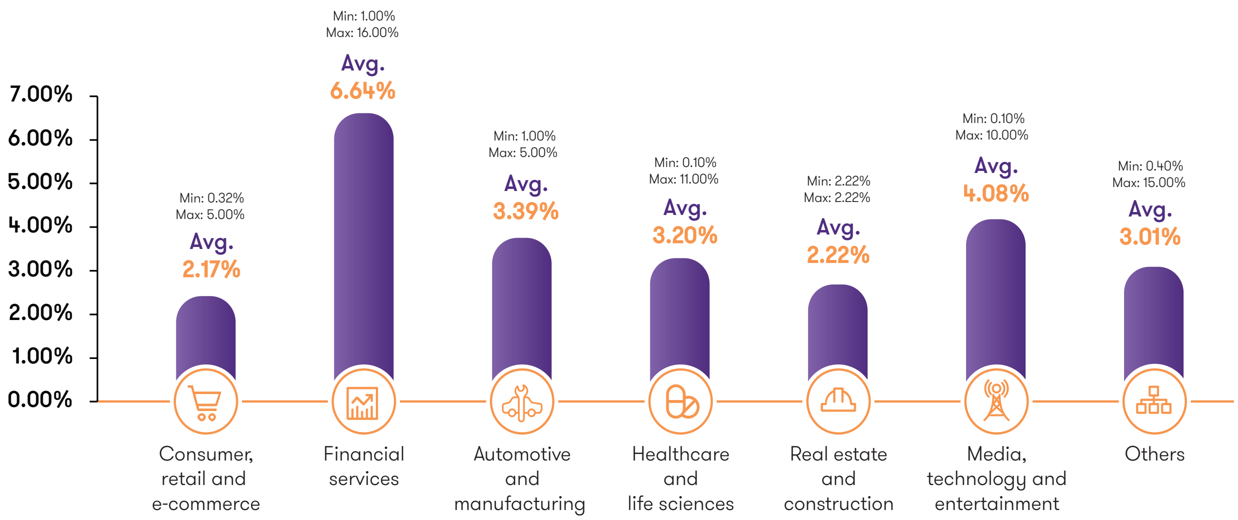
Large-cap companies



Mid-cap companies



Small-cap companies

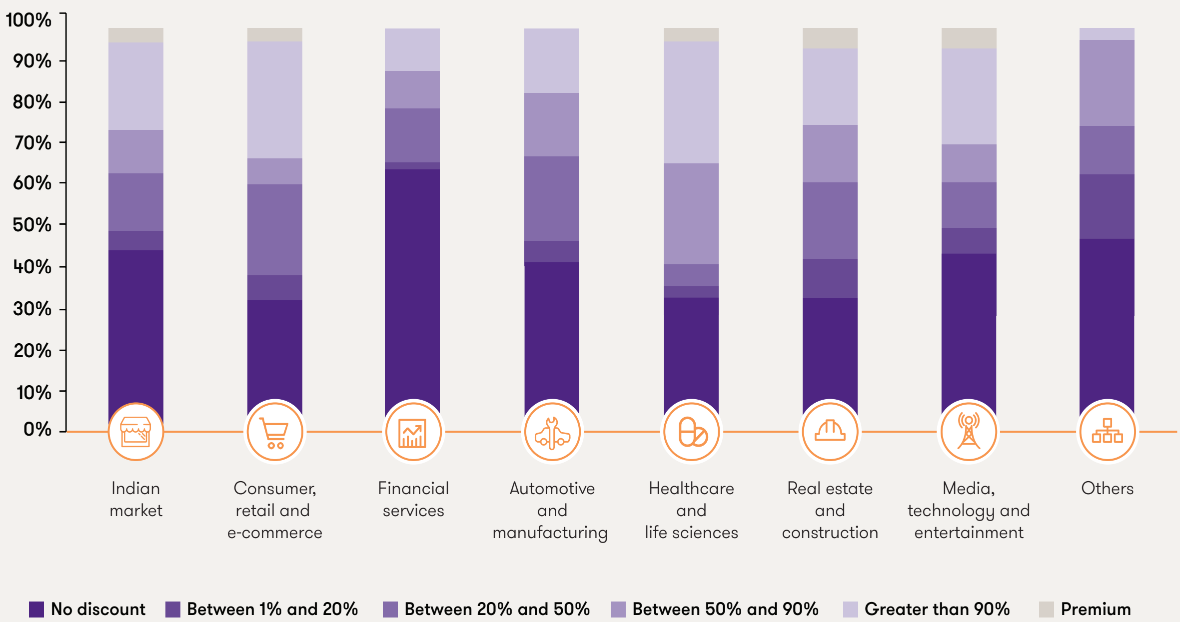


Grant price mechanism

(basis the latest active ESO plan as on 31 March 2016)

Grant price mechanism signifies the maximum discount percentage offered across organisations under the latest employee stock option plan in place as on our cut-off date, i.e., 31 March 2016.

Overall



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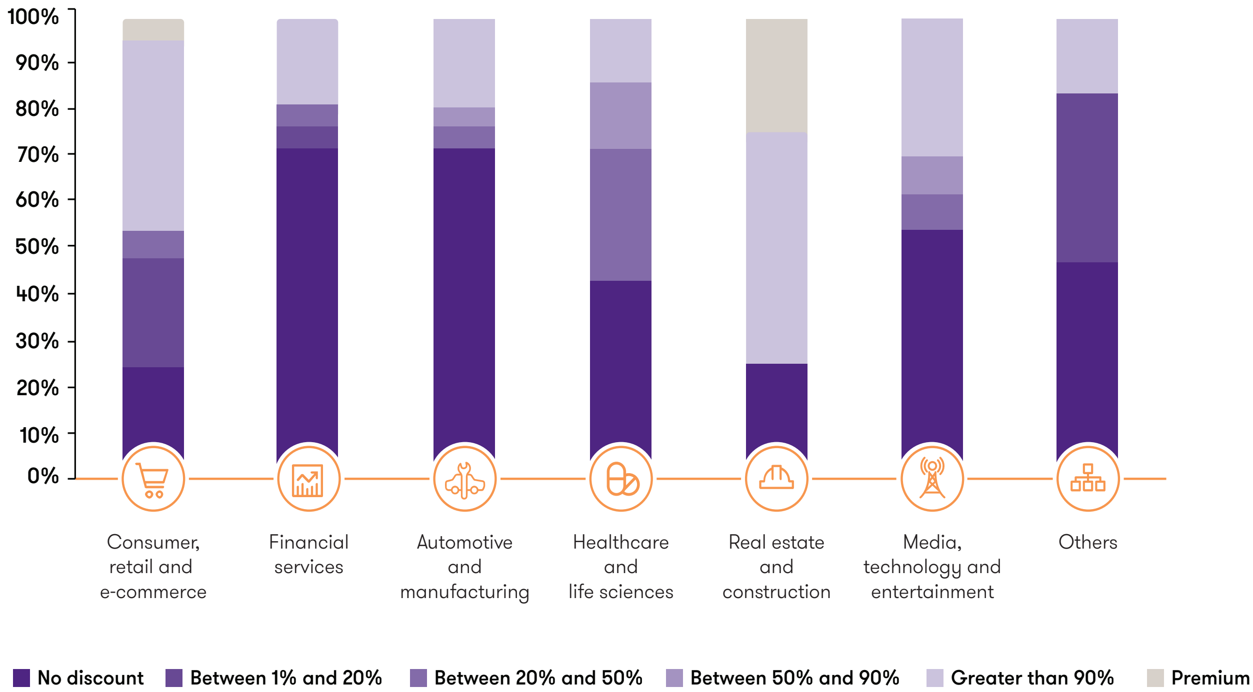
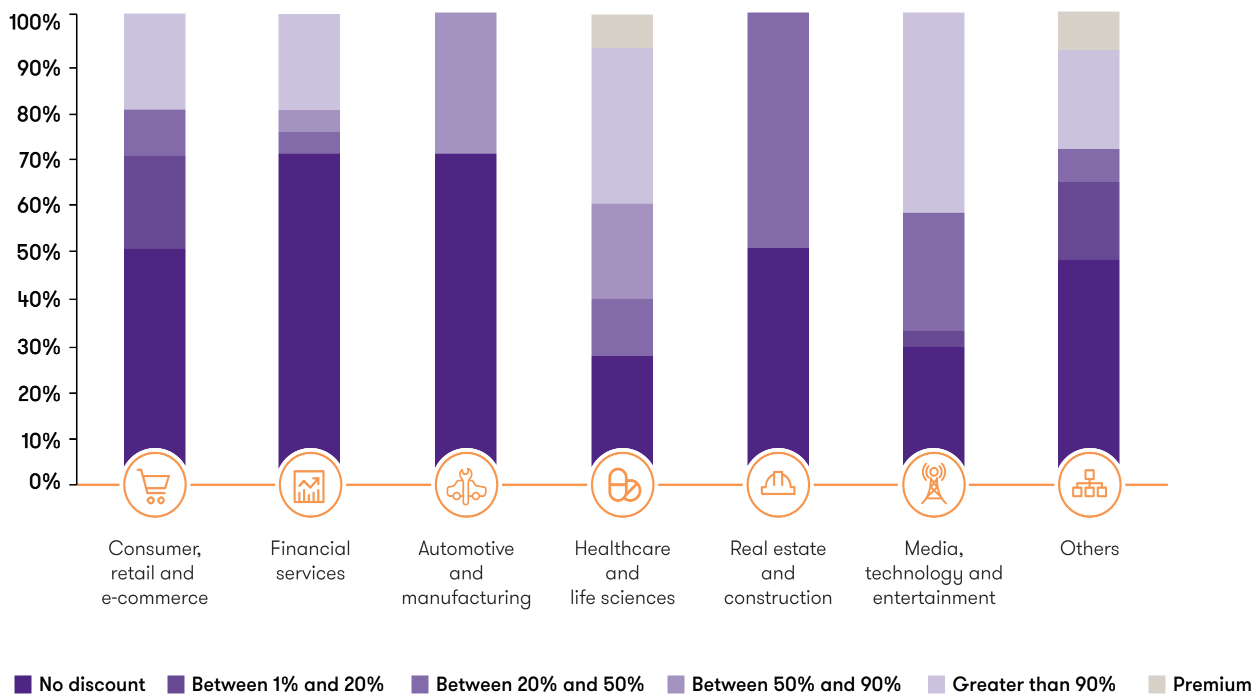
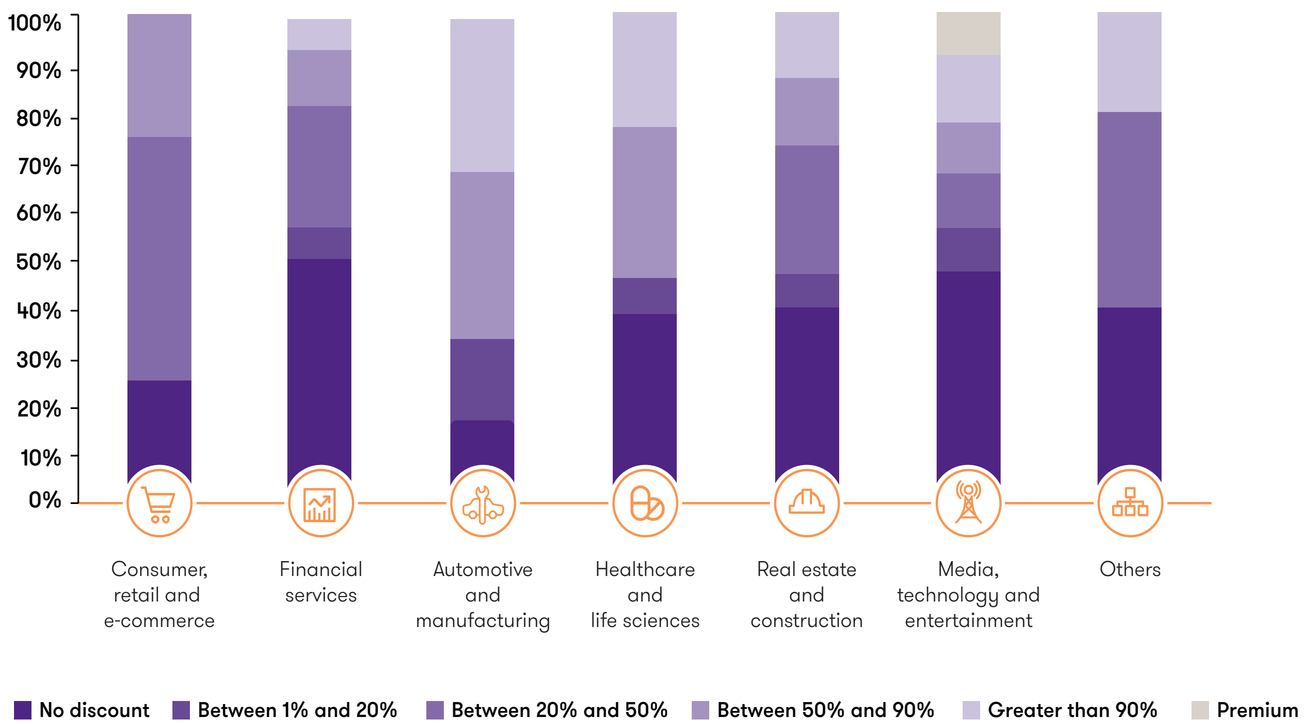


Mid-cap companies



Small-cap companies



Key insights

Pricing trend for mid-size companies, with an objective to reward employees for future value creation, **is granting options at a discount of 0-20%.**

Large and mid-cap companies offer options at **face value to critical and senior employees.**

Pricing trend for larger organisations and start-ups is granting options at face value (i.e., **discount greater than 90%**). These are often organisations which are facing a challenge in attracting/retaining talent due to competition, or are looking to reward people for past value created.

Vesting period

Average period (in years) basis the latest active ESO plan as on 31 March 2016

Vesting period signifies the average time period (in years) from the date of grant, before which employees are not allowed to exercise the options granted to them, under the latest employee stock option plan in place as on our cut-off date, i.e., 31 March 2016.

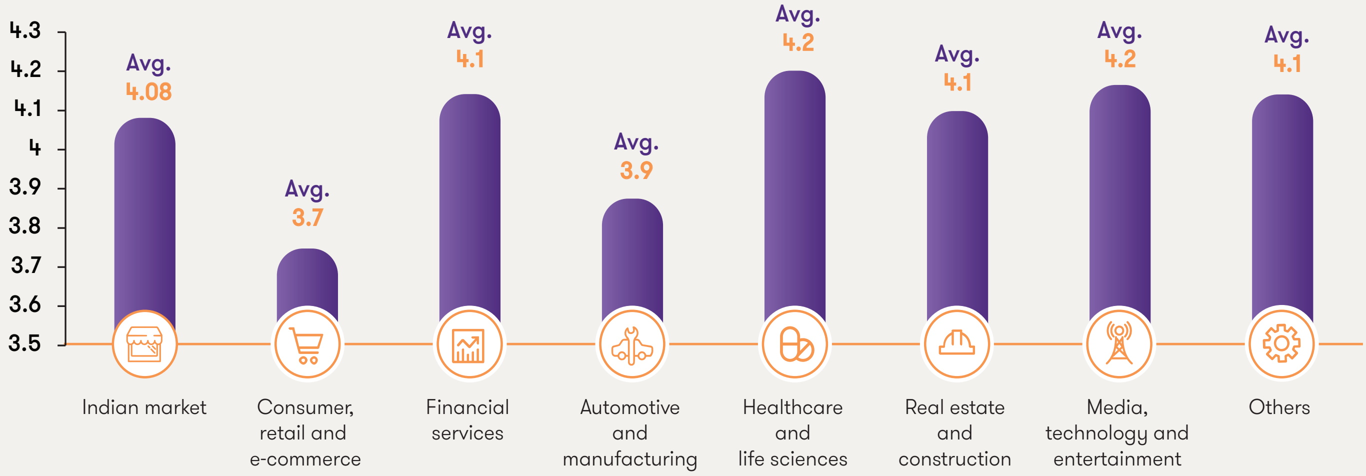
Key insights

The average **vesting period** across sectors is **four years,** following a tranch-based schedule, as opposed to a one-time vest.

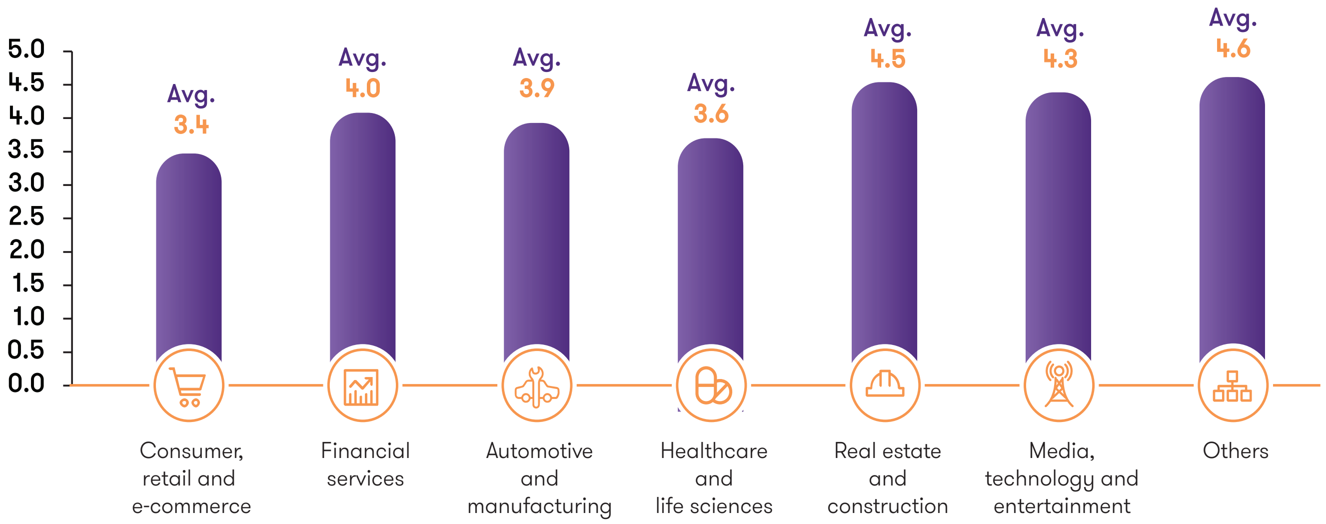
The most common **vesting schedule** is either **back loaded or linear,** i.e, 20 or 25% every year.

Mid-cap companies have a larger vesting period than large and small-cap companies.

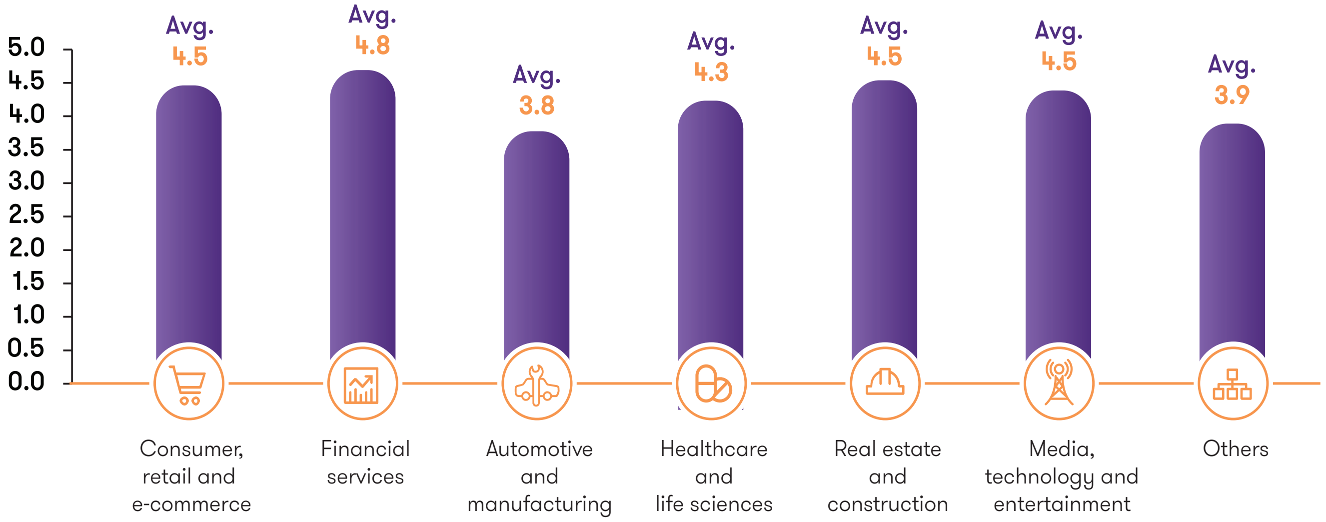
Overall



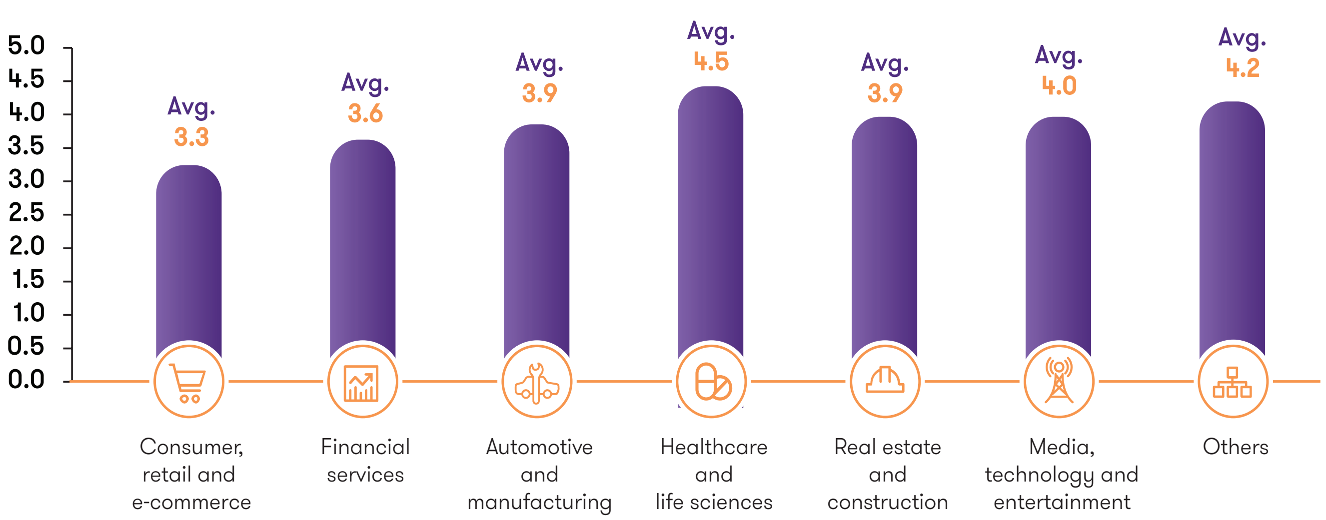
Large-cap companies



Mid-cap companies



Small-cap companies



Exercise period

Average period (in years) basis the latest active ESO plan as on 31 March 2016

Exercise period signifies the average time period (in years) from the date of vesting, during which employees can exercise the options granted to them, under the latest employee stock option plan in place as on our cut-off date, i.e., 31 March 2016.

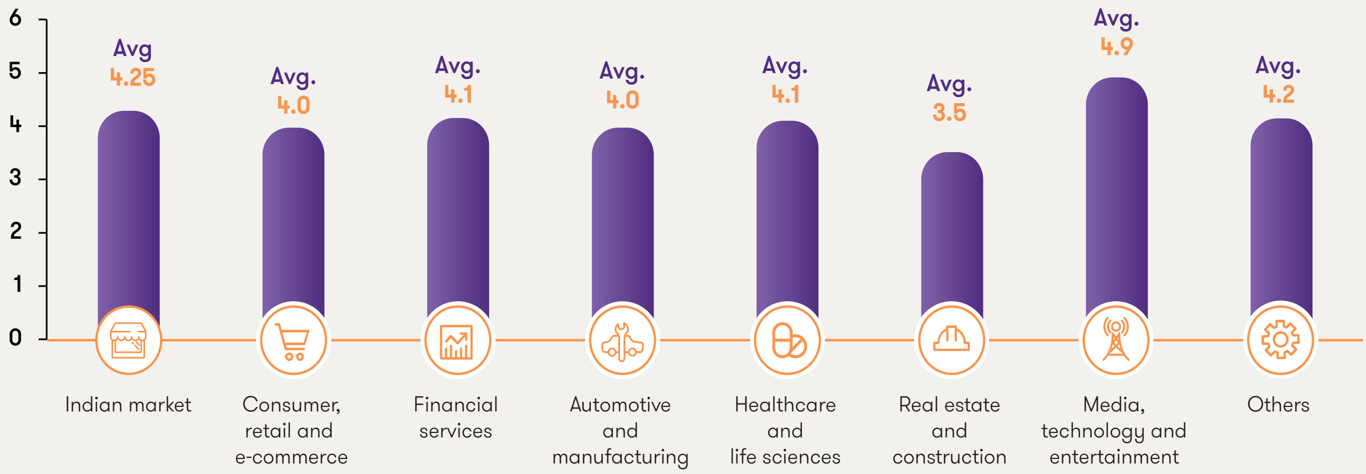
Key insights

Exercise period from the date of vesting **is equal to the vesting period** from the day of grant.

Companies give an **equal time window as the holding period** to exercise different vesting options.

Mid-cap and large-cap companies across sectors are the higher outliers with an **exercise period of five years.**

Overall



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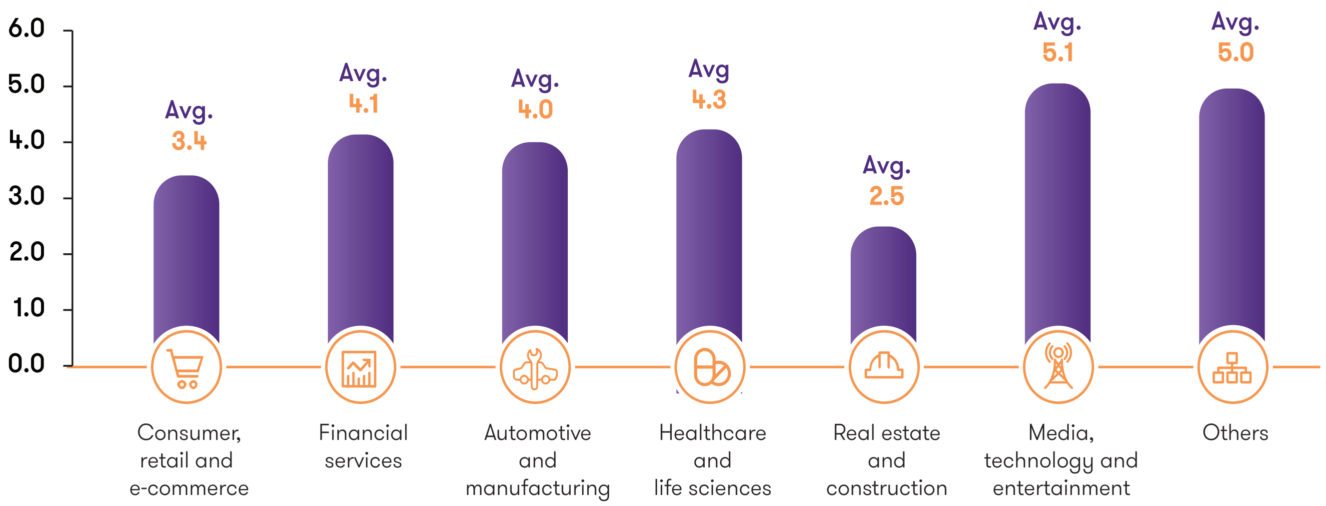
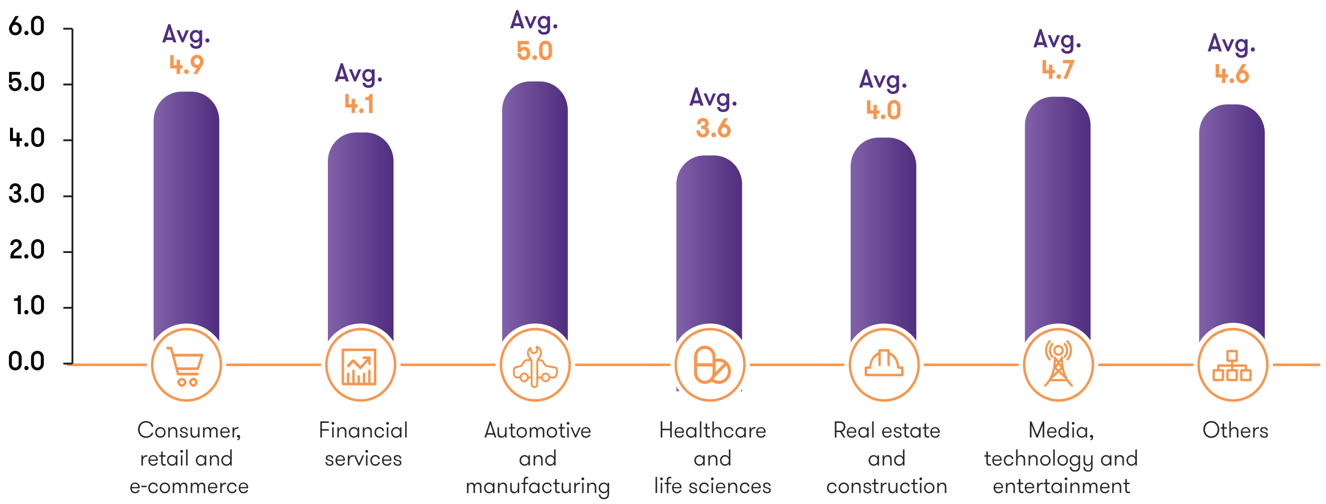
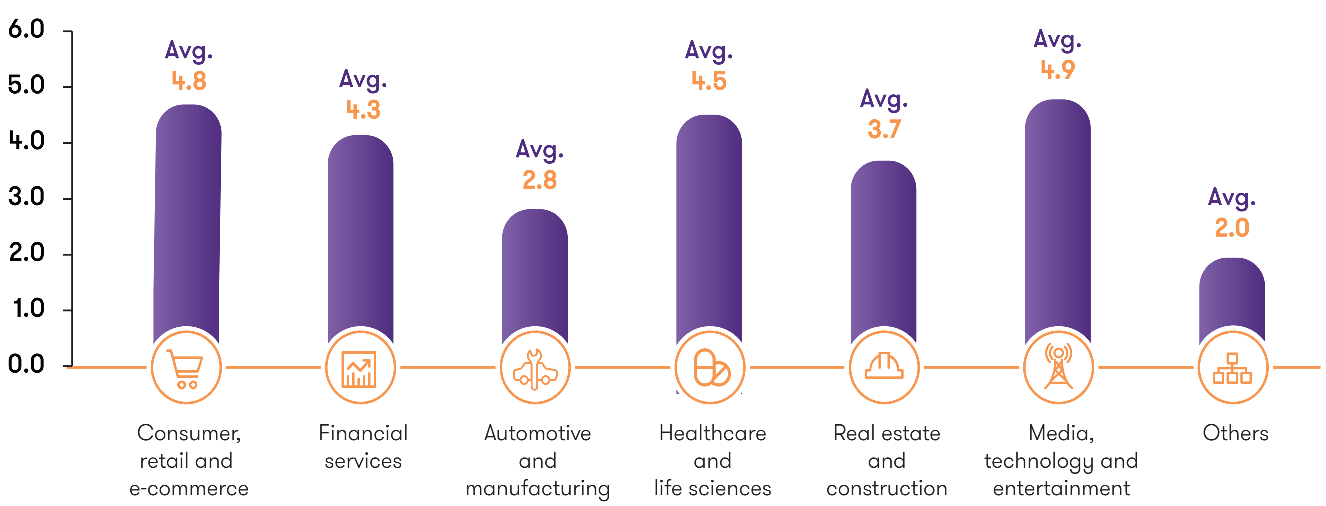


Mid-cap companies



Small-cap companies



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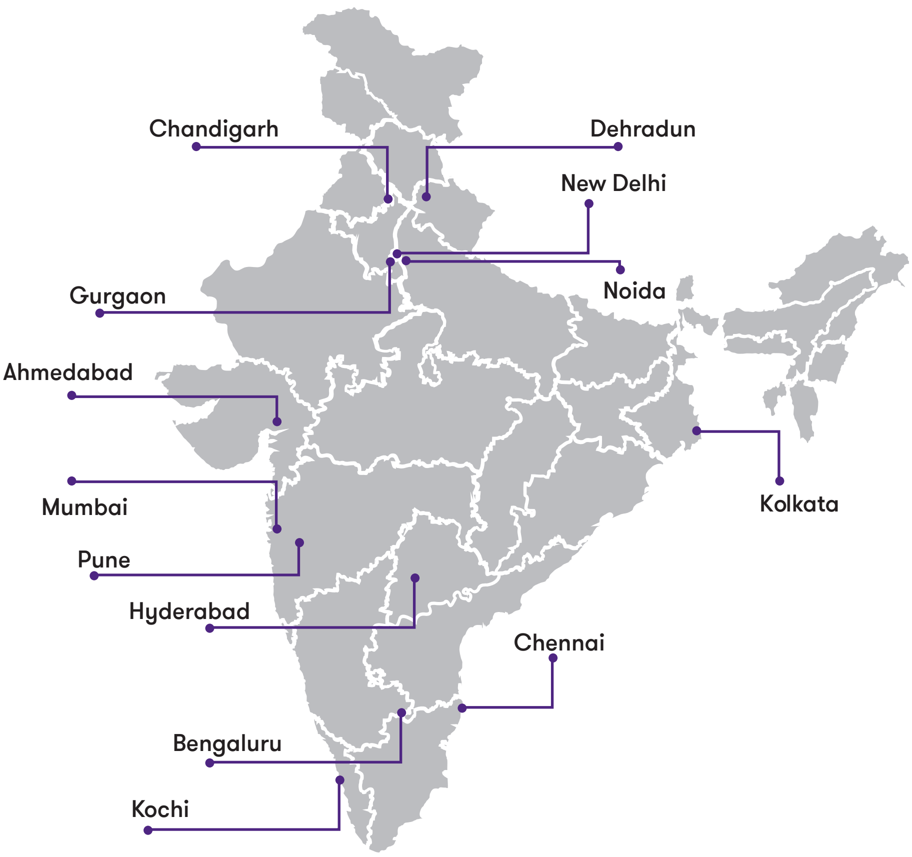

Acknowledgements

Authors

Ritika Mathur
Partner
Human Capital Consulting

Nikhil Popli
Senior Associate
Human Capital Consulting

ESOP Solutions team

Ritika Mathur
Partner
Human Capital Consulting

Sridhar R
Partner
Tax

Akhil Chandna
Partner
CFO Services

Editorial review	Design
Pranjal Bhatnagar	Himani Kukreti
Prateek Bajaj	Vikas Kushwaha

For media enquiries, write to

media@in.gt.com

Notes

Notes

Contact us

To know more, please visit **www.grantthornton.in** or contact any of our offices as mentioned below:

NEW DELHI
National Office,
Outer Circle, L 41,
Connaught Circus,
New Delhi - 110001
T +91 11 4278 7070

NEW DELHI
6th Floor, Worldmark 2,
Aerocity,
New Delhi - 110037
T +91 11 4952 7400

AHMEDABAD
Unit No - 603 B, 6th Floor,
Brigade International
Financial Center,
GIFT City Gandhinagar,
Ahmedabad - 382355
T +91 79 6900 2600

BENGALURU
5th Floor, 65/2, Block A,
Bagmane Tridib, Bagmane
Tech Park, CV Raman Nagar,
Bengaluru - 560093
T+91 80 4243 0700

CHANDIGARH
B-406A, 4th Floor,
L&T Elante Office Building,
Industrial Area Phase I,
Chandigarh - 160002
T +91 172 4338 000

CHENNAI
9th floor, A wing, Prestige
Polygon, 471 Anna Salai,
Mylapore Division, Teynampet,
Chennai - 600035
T +91 44 4294 0000

DEHRADUN
Suite No 2211, 2nd Floor,
Building 2000, Michigan Avenue,
Doon Express Business Park,
Subhash Nagar,
Dehradun - 248002
T +91 135 2646 500

GURGAON
21st Floor, DLF Square,
Jacaranda Marg,
DLF Phase II,
Gurgaon - 122002
T +91 124 462 8000

HYDERABAD
Unit No - 1, 10th Floor,
My Home Twitza, APIIC,
Hyderabad Knowledge City,
Hyderabad - 500081
T +91 40 6630 8200

KOCHI
6th Floor, Modayil Centre Point,
Warriam Road Junction,
MG Road
Kochi - 682016
T +91 484 406 4541

KOLKATA
10C Hungerford Street,
5th Floor,
Kolkata - 700017
T +91 33 4050 8000

MUMBAI
11th Floor, Tower II,
One International Center,
SB Marg Prabhadevi (W),
Mumbai - 400013
T +91 22 6626 2600

MUMBAI
Kaledonia, 1st Floor, C Wing,
(Opposite J&J Office),
Sahar Road, Andheri East,
Mumbai - 400069

NOIDA
Plot No 19A, 2nd Floor,
Sector - 16A,
Noida - 201301
T +91 120 485 5900

PUNE
3rd Floor, Unit No 310-312,
West Wing, Nyati Unitree,
Nagar Road, Yerwada
Pune - 411006
T +91 20 6744 8800

For more information or for any queries, write to us at GTBharat@in.gt.com

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