



## ESOPs as a reward: Cash realization is the key

The value of long-term incentives as the biggest retention tool needs to be derived without much hassles, delays and uncertainties to serve its purpose well

BY HARSHU GHATE

**R**etention and reward are the two key reasons for employers to grant stock options to employees. Almost all the companies (more than 90 per cent), who grant stock options, feel that the retention objective is achieved. What is left unsaid is if the employees have realised the cash from the perceived ESOP gains. This last leg of the ESOP cycle is mostly unattended by the employers. As the process owner of this plan, the HR team should be aware that if one is selling the ESOP idea to employees as a 'Reward', the pitch will be effective only when the employee realises that reward in the normal course and without much hassles, delays and uncertainties.

Most of the time, the delays and hassles are explained as inevitable under the pretext of legal provisions. In fact, if one were to dwell deeper into the process and legal provisions and look at the available workarounds, it is possible to simplify the process, make it more employee-friendly and hassle-free.

Realization of cash is a major showstopper in the case of ESOPs of unlisted companies. Sale of shares is not easy since they are not traded. Many plans of such companies are silent on the 'liquidity route' for the employees. Some keep it at the discretion of the company. While there is no ready liquid market for such shares, it is possible to provide exit for the employees, because there is no ban per se on the transferability of the shares. Unlisted companies have several routes to choose from, such as purchase by the existing/new investors, purchase by other employees (internal market), and buy-back by the company. It is possible to provide for either of these routes or all the routes in a sequence. Unlisted companies do face some challenges in terms of price discovery for shares, but these can be addressed by providing a uniform mechanism with the help of professionals. Process for issue of new shares,

their transfer and buy-back is much simpler in private companies as compared with listed ones.

As far as listed companies are concerned, the most common bottleneck is frequency of issue of shares and their listing. Many companies accumulate all the exercises for a quarter and make an allotment once a quarter (coinciding with the quarterly Board meeting). This means that an employee can realise his gains only once a quarter and not when he wishes to. During this period, he is exposed to the financial risk (because he had paid the exercise price) and the market risk (prices could vary significantly during the quarter). An average employee is not equipped to manage either of these risks. The end result is that the employee is left with an impression that ESOPs

**ALMOST ALL THE COMPANIES (MORE THAN 90 PER CENT), WHO GRANT STOCK OPTIONS, FEEL THAT THE RETENTION OBJECTIVE IS ACHIEVED**

are speculative risky instruments where realization of the gains is uncertain and time consuming.

Listed companies can allot shares more frequently (even weekly), use the trust route to park listed shares, offer cashless exercise to employees, facilitate provision of loans, provide for online payments. Most of these can be achieved through automation or by outsourcing of plan management to specialized service providers. It is possible to reduce the exercise-to-cash process time from 30 - 45 days to less than 10 days by implementing these measures.

The key to a successful ESOP experience is to focus on 'enabling liquidity' as much as on the 'design' of stock options. ■

Harshu Ghate, MD and CEO, ESOP Direct