Buoyant stock market prompts cos to offer Esops to retain talented employees

Shailesh Menon, ET Bureau, Sep 25, 2010, 06.04am IST

MUMBAI: A buoyant stock market, coupled with brighter business prospects, is prompting companies to offer stock options to retain talented employees. Also joining the employee stock option plans (Esop) rush are unlisted companies, waiting for private equity investments or companies on the verge of going public.

The trend could pick up in the coming months since some of the companies with high percentage of promoter holdings may consider the Esop route to dilute stake and comply with the 25% minimum public shareholding norms, said Esop consultants.

Given the volatile market, companies are assigning longer vesting periods —say 3-5 years — for employees to reap the benefits of a profitable conversion. Companies like Ashoka Buildcon, Microsec Capital, VA Tech Wabag and Eros International have preset Esop plans (structured a few years ago) with a conversion price well below their IPO offer price.

"We wanted our senior executives to stay with us till the IPO. So, we offered them Esops at conversion prices way below the IPO offer price. They'll make good money, if they sell their shares on listing — even if the stock closes at a discount on debut," said a senior official of a company that plans to hit the market in the coming week. Lanco Infratech, Wipro, Ambuja Cements, Cairn India, ITC, M&M, Suzlon Energy and Mastek are among the listed companies that have granted stock options to their employees in the past two months.

According to brokers, employees should avail themselves of Esops, as they stand a better chance to make money since the medium-to-long-term outlook on the stock market is positive. Pre-IPO Esop offerings help employees get shares of the company at much less cost. A stock option is valuable since it gives employees a right (with no obligation) to purchase the shares at a pre-set price.

If shares increase in value, employees will be able to purchase the shares at the lower option price. However, if the share decreases after the option is granted and vested, employees can choose not to exercise the options, and are thus insulated from the risk of downward movement of the company's share price.

"Esop is a unique way of rewarding deserving employees. It brings about a sense of ownership in them (employees)," said **Harshu Ghate, CEO, Esop Direct**, an Esop consulting firm.

According to **Mr Ghate**, the trend will gather steam in the coming months, as companies, where promoters hold 75-80%, could use the Esop route to dilute holding. "Companies will not prefer a public issue as it will be an expensive and tedious process. Granting Esops will be the most viable way to skim low percentages of promoter holding," **Mr Ghate** added.

As per Sebi norms, all companies have to maintain public shareholding at 25%. Unlisted companies — waiting for private equity investments — are also setting up Esop trusts to comply with term-sheets of PE funds. Most PE funds prefer to invest in companies where senior employees are allotted shares since it means they are likely to stay with the company for a longer duration.

One aspect that is going against Esops is the perquisite tax (perk tax) that employees will have to pay while converting Esops at a profit. As per perk tax, employees are required to pay tax on the price differential at conversion and also capital gains tax while selling their shares.