Esops being sweetened

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The corporate world is witnessing an overhaul of employee stock option plans (ESOPs). With markets down, the old plans have lost their glitter, and companies are now looking at pricing stock options afresh or issuing fresh ones.

Over half a dozen companies have either issued fresh ESOPs or restructured their old plans. IndiaInfoline and Indiabulls re-priced their stock options to make them attractive. Others, including HDFC, HDFC Bank, Axis Bank, Mastek, Religare Enterprises and Suven Life Sciences, have issued fresh ESOPs in the recent past.

Idea Cellular, which issued ESOPs at a price much higher than the current market price, will not price the option plan afresh. Instead, it is working on fresh options at a discounted price, say senior company officials.

"The situation is abnormal, and most companies' ESOPs are under water. Their possible alternatives are re-pricing the existing options, cancelling existing options and issuing fresh options, with the same or altered terms," said Harshu Ghate, managing director of ESOP Direct, a Pune-based firm which designs more than half the ESOPs issued by companies in India.

"Nobody will buy vested shares unless there's some difference between the market price and what the employee has to pay. By re-pricing ESOPs or issuing fresh ones, a company sends a strong signal to its employees that it is interested in a long-term relationship," said Ramesh Iyer, managing director of Mahindra & Mahindra Financial Services.

According to market experts, if an ESOP is priced 20-30 per cent higher than the prevailing market price, it is possible that the employee may see prices recover enough to see his option becoming valuable.

But some companies prefer to re-price their ESOPs. IndiaInfoline has moved a shareholder resolution to re-price options issued in 2005 and 2007 in line with current market prices which are much lower. The brokerage will also plans new ESOPs, which could result in the issue of up to 50 million new equity shares in lieu of 55 million warrants during the currency of the scheme.

"The objective of our ESOP scheme is to get employee ownership so as to motivate them to operate with an ownership mindset," said Kapil Krishan, chief financial officer of IndiaInfoline. The company has proposed to increase the maximum discount at which share options can be issued from 25 per cent to 35 per cent. The four- member team of ex-CLSA employees, namely Bharat Parajia, H Nemkumar, Aniruddha Dange and Vasudev Jagannath, may be eligible for options which will give them a right to buy shares aggregating to over one per cent stake each in the company, says the resolution placed for shareholder approval.

Indiabulls Financial Services has cancelled ESOPs issued in 2005 and 2006, and replaced them with a fresh series at Rs 95.95 per share.

"By cancelling the old unexercised options we can issue fresh options that are in line with the current market price and also delay the dilution in stock that might have otherwise happened in a few months. We believe that most companies which have issued ESOPs that are now under water, will cancel the old series and issue fresh ones," said Gagan Banga, chief executive officer of Indiabulls Financial Services.

When a company cancels unexercised ESOPs and issues fresh ones, the vesting period starts afresh. This means employees have a to wait a certain amount of time (usually a year) before they are allotted the right to buy shares in the future at a pre- determined price. Experts say if the pricing ensures a profit, it helps employee bonding.

"Many companies with ESOPs have seen their market prices fall by between 60 and 90 per cent. As a result, the old ESOPs have no value. Resetting the prices now could be with a view that appreciation over the next year or two could be as high as 50 per cent. Therefore, the ESOPs will prove to be very attractive in engendering employee loyalty," says M M Miyajiwala, Voltas executive vice- president.

By canceling old ESOPs and issuing a fresh series, companies can avoid amortising the difference between the ESOP exercise price and the market price on the day of vesting. Effectively, the cancellation will help companies boost accounting profits, say experts. "Even the fringe benefit tax is required to be paid by companies only when the vested options are actually exercised by employees by paying the issue price of shares," said Ghate of ESOP Direct.

"This is probably the right time to issue ESOPs and the recalibration of these plans is just starting in India. This instrument is seeing its second phase of development here, where option awards are now getting more closely tied to performance and the conditions of vesting are being tweaked to more closely align management incentives with shareholder wealth maximisation," said Manish Sabharwal, chairman of staffing firm Teamlease Services.