KPMG

ESOP survey report 2021

home.kpmg/in

Foreword

"You don't build a business; you build people and then the people build the business"
~ Anonymous

Organisations, have, by far realized that employees are one of their most valuable assets. A content and motivated workforce is the key to the sustainable growth of an organisation. An optimal compensation and reward strategy is integral to achieve desired objectives.

Employee Incentive Plans (EIPs) have over the years acted as a stimulus to enhance employee motivation, morale and retention and have been a catalyst in employee performance.

KPMG in India, through its Employee Stock Option / Ownership Plan (ESOP) Surveys in 2011 and 2015, endeavoured to present insights on leading industry practices, differentiators and trends based on its analysis of data collated from a range of organizations. There has been increased activity in the ESOP domain both in India and globally since then. Considering the changing regulatory environment, we re-launched the survey to understand the current trends.

The Equity Incentive Survey Report 2021, aims at guiding corporates and start-ups looking at establishing leading compensation practices, by providing them a preview to current trends and at the same time throwing light on few pertinent aspects from a tax, regulatory and accounting perspective. Any sector specific regulations should also be considered. The report also attempts to cover emerging global trends.

We had nearly 200 elite participants invest their valuable time in completing the survey. We sincerely thank all those who have contributed to this Survey, without which it would not have been possible. We believe this Survey will serve as a reference for Companies contemplating either to roll-out new plans or re-evaluate existing plans given the current trends (including COVID-19 impact) and regulatory landscape.

We hope you find this edition insightful and useful.

Rajeev Dimri

National Head of Tax
KPMG in India

Ajay Mehra

Partner and Head
Tax Markets and Strategy
KPMG in India

Parizad Sirwalla

Partner and Head
Global Mobility Services, Tax
KPMG in India

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

Key Highlights

68 per cent of the respondents have either implemented or are contemplating to implement an Employee Stock Option Plan vis-à-vis other types of Plans. **Information Technology companies dominate this space**

Employee retention continues to be the key objective for implementing a Plan

Equity shares is the **preferred choice of instrument** under any Plan

Participants preferred a single Plan for **all levels of employees** vis-à-vis multiple Plans

Companies prefer securities sourced by way of **fresh issue**

Companies prefer to **dilute not more than 5 per cent** of their holdings

Key senior executives continue to be the preferred beneficiaries under the Plan

Companies review stock ownership plans **annually** to assess impact vis-à-vis objectives

Companies prefer to grant Stock at **Fair Market Value**

Trust route does not seem to be popular amongst participants most likely due to additional administrative compliances and tax issues

Vesting and **Exercise** period is preferred at three to five years

Most companies emphasise on ESOPs as a part of their **hiring strategy**

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

Table of Contents

Types of EIPs - An overview

EIPs constitute an important element of an organisation's compensation strategy. Several variations of EIP mechanisms are prevalent in India and globally. Companies have flexibility to design an EIP catering to their objectives, within the overall regulatory framework.

Companies usually adopt one or more of the following types of EIPs, with variations in their specific terms tailored to their business needs and organisation philosophy.

- **Employee Stock Option Plan (ESOP)**

  An ESOP grants employees an optional right to purchase the securities of the company at a pre-determined price, within the defined exercise period. Stock options are subject to a vesting milestone which could be time or performance based or a combination of both.

- **Employee Stock Purchase Plan (ESPP)**

  An ESPP allows employees to purchase the company securities at a pre-determined date and price. The shares offered under ESPP may be subject to a lock-in period prior to sale.

- **Stock Appreciation Right (SAR) / Phantom Equity Plan (PEP)**

  Under SAR / PEP, the employees are allotted notional securities at a pre-determined price. On completion of the vesting conditions, an employee is paid cash equivalent of the net gain i.e. appreciation in the price of underlying securities without any cash investment. These plans generally result in cash outflows for the company.

- **Sweat Equity Shares (SES)**

  SES usually constitutes equity shares issued by the company to its directors / employees at a discount or for a consideration other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions.

The Securities and Exchange Board of India (SEBI) Guidelines also include the following employee benefit schemes (in addition to ESOP, ESPP and SES) which deal with the shares of the Company.

- **Stock Appreciation Rights Scheme (SARS)**

  SARS has been defined to mean 'a scheme under which a company grants SAR to its employees'. The regulation defines SAR as 'a right given to a grantee entitling him to receive appreciation for a specified number of shares of the company where the settlement of such appreciation may be made by way of cash payment or shares of the company. Any SAR settled by way of shares has been defined as equity settled SAR'.

- **General Employee Benefits Scheme (GEBS)**

  GEBS has been defined to mean ''any scheme of a company framed in accordance with the regulation, dealing in shares of the company or the shares of its listed holding company, for the purpose of employee welfare including healthcare benefits, hospital care or benefits, or benefits in the event of sickness, accident, disability, death or scholarship funds, or such other benefit as specified by such company'.

- **Retirement Benefit Scheme (RBS)**

  RBS means 'a scheme of a company, framed in accordance with the regulation, dealing in shares of the company or the shares of its listed holding company, for providing retirement benefits to the employees subject to compliance with existing rules and regulations as applicable under laws relevant to retirement benefits in India'.

Few Global Variants:

- **Restricted Stock Unit (RSU)**

  Under RSU, an employee is awarded an entitlement to receive stock at some specified date in the future subject to certain conditions. These conditions may relate to performance or tenure of employment. Until shares are delivered, the employee is not a shareholder and does not have voting rights or rights to receive dividends. RSUs are generally entitled to quasi-dividends.

- **Restricted Stock Award (RSA)**

  Under RSA, an employee receives an award of stock subject to certain underlying conditions. The employee is entitled to receive dividends and voting rights. The forfeiture conditions may be based on continued service over a specified period.

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

Income-tax - An overview

For Employees

Taxation of ESOPs in India has evolved over the years. Under the current tax regime effective April 2009, there is a two-stage tax trigger for an employee.

At the time of allotment of shares, the benefit is considered as a perquisite liable to tax as salary income. The perquisite is computed as the difference between the Fair Market Value (FMV) of shares as on the date of exercise and the exercise price. There are specific valuation rules prescribed for listed and unlisted companies. Unlisted companies need to determine the FMV by a Category I Merchant Banker registered with SEBI. The employer has a corresponding obligation to withhold tax on such perquisite at the time of allotment. Eligible start-ups are entitled to certain concessional tax provisions which allows deferment of the perquisite tax liability.

At the time of sale of shares by an employee, the incremental gains / loss arising thereon is considered as capital gain / loss, which is computed as the difference between the Sale Price and FMV considered for perquisite/FBT valuation. The taxation of such capital gain further depends upon the period of holding of the shares and whether the share is listed on a recognized stock exchange at the time of sale.

Where the shares are transferred by an employee pursuant to buy-back by an Indian domestic company, there is no tax in the hands of the employee. The company (both listed and unlisted) is liable to pay additional income tax on distributed income, on buy-back of shares, as prescribed.

For Employers

The issue of corporate tax deductibility of EIP discount has been a subject matter of debate over the years, with courts holding divergent views on this aspect. While some have held that discount on issue of stock options can be allowed as a deduction as it represents employee compensation for services rendered, there are also rulings to the contrary.

Further, deductibility of cost recharges by overseas parent to Indian subsidiaries has also been debatable.

For Employee Welfare Trusts

Several tax considerations also arise where EIPs are administered through employee welfare trust or similar special purpose vehicles viz. tax incidence for the Trust on receipt of shares onward transfer to employees, on actual transfer of shares to employee, on buy-back, etc.

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

Company Law - An overview

Company law provisions underwent a major overhaul in 2013, whereby, specific provisions and rules were notified for ESOPs and SES. Few key provisions in the context of ESOPs have been discussed below.

Indian companies implementing ESOPs, both public and private, are now required to comply with the provisions of the Companies Act, 2013 and the Companies (Share Capital and Debentures) Rules, 2014 (the Rules). Listed companies continue to be governed by SEBI Guidelines.

An ESOP has been defined to mean an option given to the directors, officers or employees of a company or its holding company or subsidiary, which gives them a benefit or right to purchase or subscribe to the shares of the company at a future date at a pre-determined price. In alignment with the SEBI Guidelines, the term 'employee' excludes independent directors, promoters, directors holding directly or indirectly more than 10 per cent of the issued capital and consultants. Eligible start-ups are eligible for certain concessions for a defined period.

The Rules lay down requirements with respect to shareholder approval and disclosures required in the explanatory statement to the notice for passing special resolution. A minimum period of one year has been mandated between the grant of options and vesting of option.

Amongst others, Rules have also been laid down for grant of loan by companies to employees and Trust for purchase of company shares. The value of shares to be purchased/ subscribed together with the money provided by the company cannot exceed five per cent of the paid-up equity and free reserves of the company. Also, constitution of the Trustees has been prescribed to ensure independence.

Any variations in the Plan would need to be carried out in compliance with the prescribed Rules in this regard.

In the Director's report, detailed disclosures are required to be made as prescribed with respect to the ESOPs.

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

SEBI Regulations - An overview

For listed companies, issue of shares under various EIPs is governed by SEBI (Share-based Employee Benefits) Regulations, 2014, few of which have been discussed below,

The definition of an eligible employee for the purpose of these schemes, is similar to that under the Companies Act, 2013. For implementing any ESOP, shareholder approval through a special resolution is required. Approval of shareholders by special resolutions is also required in other specified circumstances.

For the purpose of administration and superintendence of a scheme, a company is required to constitute a compensation committee with three or more non-executive directors out of which not less than one-half should be independent directors.

Schemes through Trust

A listed company can grant stock options to employees either directly or through a trust. Where the scheme involves secondary acquisition, gift or both, it is mandatory to implement a Trust structure with upfront shareholder approval.

The Trust is required to adhere to the limitations prescribed in the Guidelines, especially, with respect to secondary acquisition. These include that the Trust cannot deal in derivatives and should undertake only delivery-based transactions. Secondary acquisition by the Trust in a financial year should not exceed two per cent of the paid-up capital as at the end of the previous financial year. The total number of shares held by the Trust under secondary acquisition cannot exceed five percent of the paid-up capital as at the end of the financial year preceding the year in which shareholder approval is sought. Further, such shares need to be held by the Trust for at least six months whether off-market or on platform of stock exchange, except under specified circumstances. The company may lend money to the Trust on appropriate terms and conditions. The Trust is required to make disclosures and comply with the requirements applicable to insiders and promoters under the SEBI (Prohibition of Insider Trading) Regulations, 2015.

In case of winding up of a scheme implemented through a Trust, the excess money or shares remaining with the Trust after meeting all the obligations should be utilised for repayment of loan or by way of distribution to employees as recommended by the compensation committee.

Auditors’ certificate

At each annual general meeting, the Board of Directors are required to place before the shareholders, a certificate from the Auditors of the company that the employees’ stock option scheme has been implemented in accordance with the SEBI regulations and resolution of the company.

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

Foreign Exchange Regulations - An overview

FEMA provisions regarding EIPs would generally apply under the following scenarios:

Issuance of shares to Persons Resident Outside India

Indian Companies can issue shares under EIPs / SES to its employees / Directors who are resident outside India or employees / Directors of its holding company or joint venture or wholly-owned subsidiaries abroad. The Scheme needs to be drawn either in terms of regulations issued under SEBI or Company Law. The issuance of shares should follow the Foreign Direct Investment (FDI) Guidelines. It also prescribes a common form for reporting of issue of SES / options under EIP. Further, it has imposed an additional compliance requirement of obtaining a Merchant Banker / Chartered Accountant certificate for valuation.

Persons resident in India acquiring foreign securities under a global plan

An Indian resident employee can acquire foreign securities issued under an EIP. This is subject to the condition that the scheme is offered by the issuing foreign company globally on a uniform basis. Further, the Indian Company is required to comply with certain reporting norms. A person resident in India is also allowed to acquire securities issued by a foreign company under a Cashless EIP provided it does not result in any remittance from India.

Resident individuals can also avail benefit under the Liberalized Remittance Scheme (LRS). Under LRS, resident individuals can remit foreign exchange without end-use restrictions. The current limit is USD 250,000 per person per financial year.

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

Accounting Implications - An overview

With the Notification of the International Financial Reporting Standards (IFRS) converged Indian Accounting Standard (Ind AS) by the Ministry of Corporate Affairs in February 2015, accounting and reporting requirements for stock-based compensation have been addressed by Ind AS 102, Share-based Payment.

The Indian Generally Accepted Accounting Principles (IGAAP) do not include any comprehensive standard to cover this requirement, however, Guidance Note on Accounting for Employee Share-based Payments (Guidance Note / GN) issued by the ICAI provides principles for accounting of shared based payment to employees. Further, SEBI has also issued guidelines for accounting treatment of employee share option plans for listed entities which are broadly in line with Ind AS / GN .

Accounting under Ind AS 102

Under Ind AS 102, employee share-based plans (ESOP) are classified between equity settled or cash settled plans. In the case of equity-settled plans, the entity shall measure the goods or services received, and the corresponding increase in equity, at the fair value on the grant date. Further, such fair value is not remeasured. However, the estimate of the number of equity instruments that are likely to vest is revised, if necessary, until the instruments vest. For cash-settled transactions, the fair value of the liability is remeasured on each reporting date through the date of settlement. Any changes in fair value are recognised in profit or loss for the period. Grants in which the counterparty has the choice of equity or cash-settlement are accounted for as compound instruments. The classification of such grants will depend on the ability and intention of the entity.

Some of the other key requirements of Ind AS for share-based payments are summarized below:

Graded vesting

It is quite common for some of the grants to have graded vesting, i.e. the equity instruments granted vest in instalments over the specified vesting period. If the only vesting condition is service from grant date to the vesting date of each tranche, each instalment is accounted for as a separate share-based payment. As a result, a higher proportion of cost is recognized in the early years of the plan.

Modification and cancellation

Modifications of an equity-settled share-based payment arrangement are accounted for only if they are beneficial. If the fair value of the equity instruments granted has increased because of a modification to their terms and conditions, then the incremental fair value at the date of modification is recognised in addition to the grant-date fair value. Modifications that are not beneficial to the counterparty do not affect the amount of the share-based payment cost recognised. However, reductions in the number of equity instruments granted are accounted for as cancellations.

Cancellations by the entity or by the counterparty are treated as an acceleration of vesting, requiring any unamortised compensation cost to be recognized immediately.

Group grants

A share-based payment in which the receiving entity, the settling entity and the reference entity are in the same group from the perspective of the ultimate parent is a group share-based payment transaction from the perspective of both the receiving and the settling entities. In a group share-based payment transaction in which the parent grants a share-based payment to the employees of its subsidiary, the share-based payment is recognised in the consolidated financial statements of the parent, in the separate financial statements of the parent and in the financial statements of the subsidiary. For example, in case of stock option grants by the parent to employees of a subsidiary, Ind AS requires the subsidiary to recognize the cost of the share-based payment with a corresponding credit to equity, as a contribution from the parent.

ESOPs Trust

As per Ind AS principles, a Trust set-up to administer the share-based payment arrangements is required to be consolidated either in the standalone or consolidated financial statements of an entity. In such situations, it is very common for the sponsoring entity to give loans to the Trust for purchasing shares from the open market. Such loans given by the sponsoring entity to the trust shall be eliminated in the consolidated or stand-alone financial statements. Whereas, share held by the Trust are accounted as 'treasury shares' and are deducted from equity.

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

Valuation

The GN on ESOP recognises two methods of accounting for employee share-based payments, i.e., Fair Value Method (FVM) and Intrinsic Value Method (IVM) and permits the entities to make an accounting policy choice between these methods. However, an entity using IVM is required to make additional disclosures which are based on fair value computation methods.

Under IVM, the cost of an employee share-based payment instrument (say ESOP) is computed as difference between the market price of ESOP on the grant date and the exercise price of ESOP. Under FVM, the cost is computed using the option pricing models which include assumption around volatility, discount rates, dividend rates, current market value and other conditions attached, etc. Thus, costs for most ESOPs are generally expected to be higher under FVM, rather than IVM.

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

Global Trends

Consistent with our findings from the 2015 ESOP Survey, equity incentives continue to be a common component of global compensation. In fact, we have seen a general shift towards companies granting equity incentives broader and deeper within their organizations. Historically, senior level executives participated at the discretion of the company. Now we are seeing increasing participation at the middle management level across a wider geographical area. With increased employee mobility and the ongoing challenge to attract and retain talent, particularly, for emerging markets, the need for appropriate compensation packages has increased.

All-employee plans remain popular and, where they are adopted by multinationals, participation is offered across most if not all geographical locations. Share purchase plans are the most common form of all employee arrangements.

In the US, RSUs have surpassed the number of share option plans operated by multinationals across all geographical locations. Nil or nominal cost options, while adopted by some public companies, are more common in the private sector. It may be noted that nil cost options are not common in the US and certain other jurisdictions due to adverse tax consequences.

Deferred bonus arrangements have also become more common, in part due to regulatory requirements for senior staff in the financial sector which state that more of their pay is required to be delivered on deferred terms. In addition, increased life expectancy has meant that employees are enjoying second and third careers and choosing to defer income.

Other global trends in executive plan design include the increasing use of provisions providing for forfeiture in the event of gross misconduct, which again originated in the financial sector, but, has now extended more widely (for example, they are now reflected in the UK Corporate Governance Code).

Performance conditions are more prevalent in some countries than in the past, and while 'standard' earnings and total shareholder return targets remain common, there has been some evolution in the design of performance conditions (e.g. companies adopting measures more tailored to their business or combining multiple conditions). In the US, for example, we have seen a general decline in requiring participants to hit certain targets during the performance period. Measurement at one time at the end of the performance period is more common rather than measurement at two or more intervals during the performance period for small incremental payments.

Tax and regulatory rules concerning share plans continue to evolve, with more countries introducing annual employer reporting requirements, for example, Australia and Japan introduced mandatory reporting of equity incentives since 2015 and some countries amending locally tax-advantaged regimes e.g. Singapore. This means local Tax Authorities are much more focused on collecting taxes related to equity incentives through the introduction of tracking measures such as mandatory employer reporting.

Companies with more established global plans continue to seek ways of maximizing corporate tax and cash repatriation benefits by understanding how to secure local corporate tax deductions for the costs of equity incentives. This has forced them to review compliance status given their plans have become more visible to local tax authorities through the grant of benefits on the corporate side. In addition, their focus is on managing these programs, cost efficiently, maintaining compliance and meeting the demand for 'information hungry' participants through increased employee communication and the use of enabling technologies in the delivery of these equity incentives

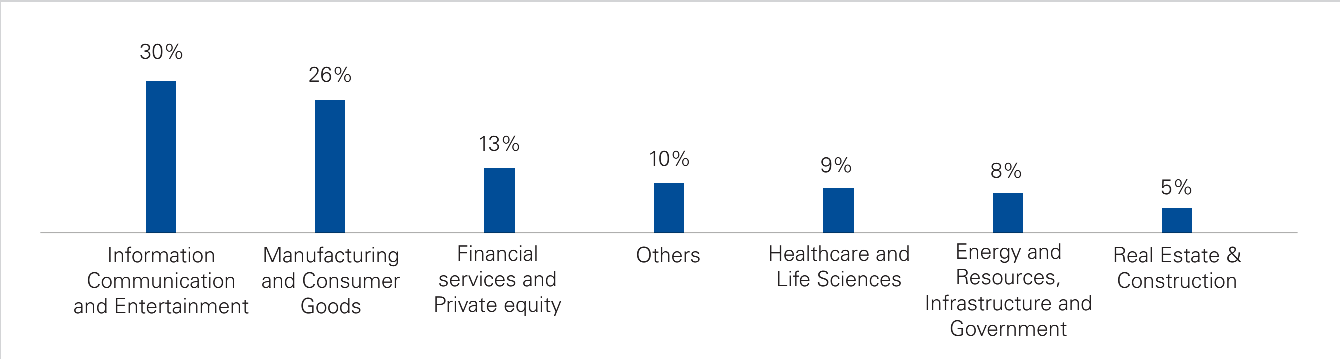
© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

Survey Analysis - Results

1. Overview - Trends

Participation – Type of Industry

The majority of participants were from the Information, Communication and Entertainment (IT) sector (about 30 percent) followed by Manufacturing and Consumer Goods sector (approx. 26 percent), Financial Services sector (approx.13 percent) and others. They either had an active Plan or were planning to implement one.



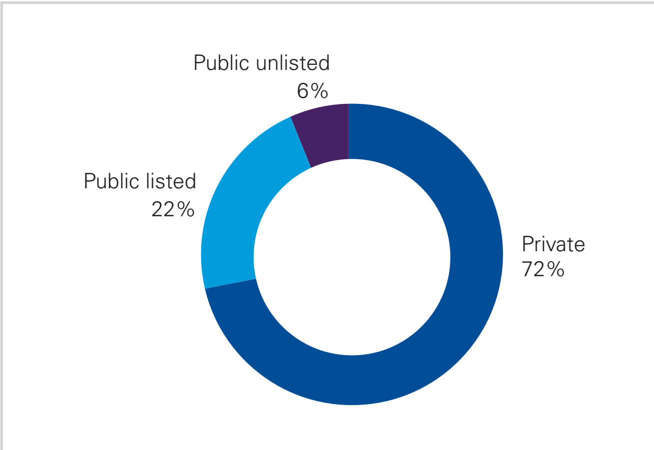
Source: 'KPMG in India's ESOP Survey 2021'

Historically, the IT industry in India has been the first to jump onto the bandwagon for ESOPs However, with ESOPs gaining momentum as a compensation strategy, the last decade has witnessed participants from other core sectors such as Consumer Markets, Automobile industry, Financial Services, etc.

Participation - Private vs. Public

In recent times, ESOPs have become common among private companies, to retain top talent.

Nearly 72 percent of the participants were private companies who either had a plan or were contemplating implementing one.



Source: 'KPMG in India's ESOP Survey 2021'

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

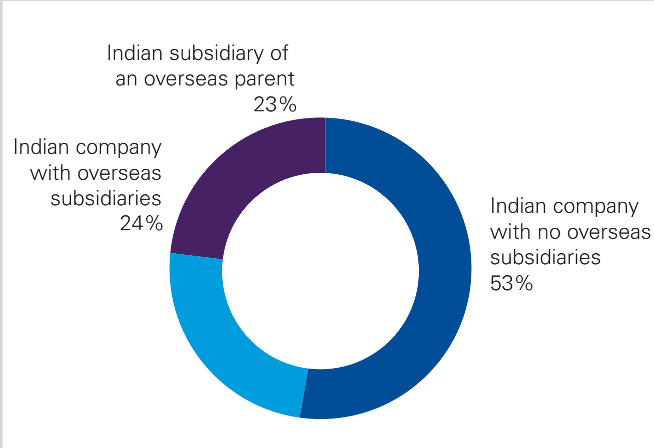
Tenure and employee strength

Nearly 68 percent of the participating companies were seasoned companies; i.e. companies who have had more than 10 years of operation and nearly 31 percent of the companies had an employee base of more than 2,000. This means that while the trends indicate start-ups are inclining towards ESOPs, long standing companies with large employee base continue to recognise ESOPs as a part of their overall compensation strategy.

Implementation by Subsidiaries

The Survey indicates that almost 53 percent of companies who have offered ESOPs, are Indian subsidiaries of an overseas parent.

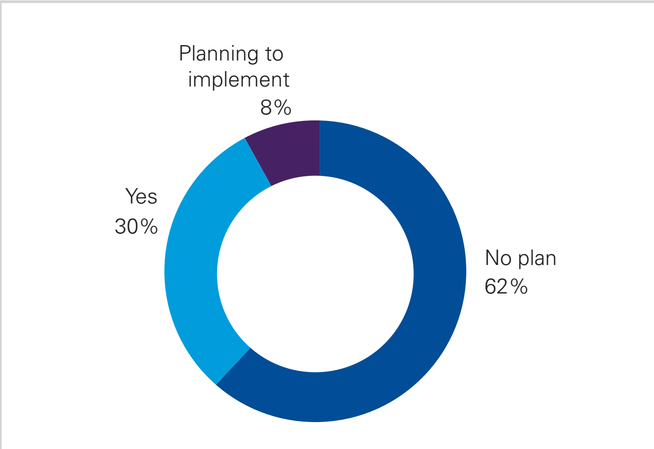
While this would basically mean accepting the Plan variant offered by the overseas parent, the Indian subsidiaries will have to also bear in mind the tax and regulatory compliances required to be adhered to in India, from an employer and employee perspective.



Source: 'KPMG in India's ESOP Survey 2021'

Current Existence of Plan

Almost 62 percent of the participants did not have ESOP Plan as most of these respondents predominantly felt that it was too complex to be implemented. However, with a fair understanding of regulatory aspects and proper planning and structuring, companies could reap rich benefits especially from talent acquisition and retention perspective by rolling out ESOPs.



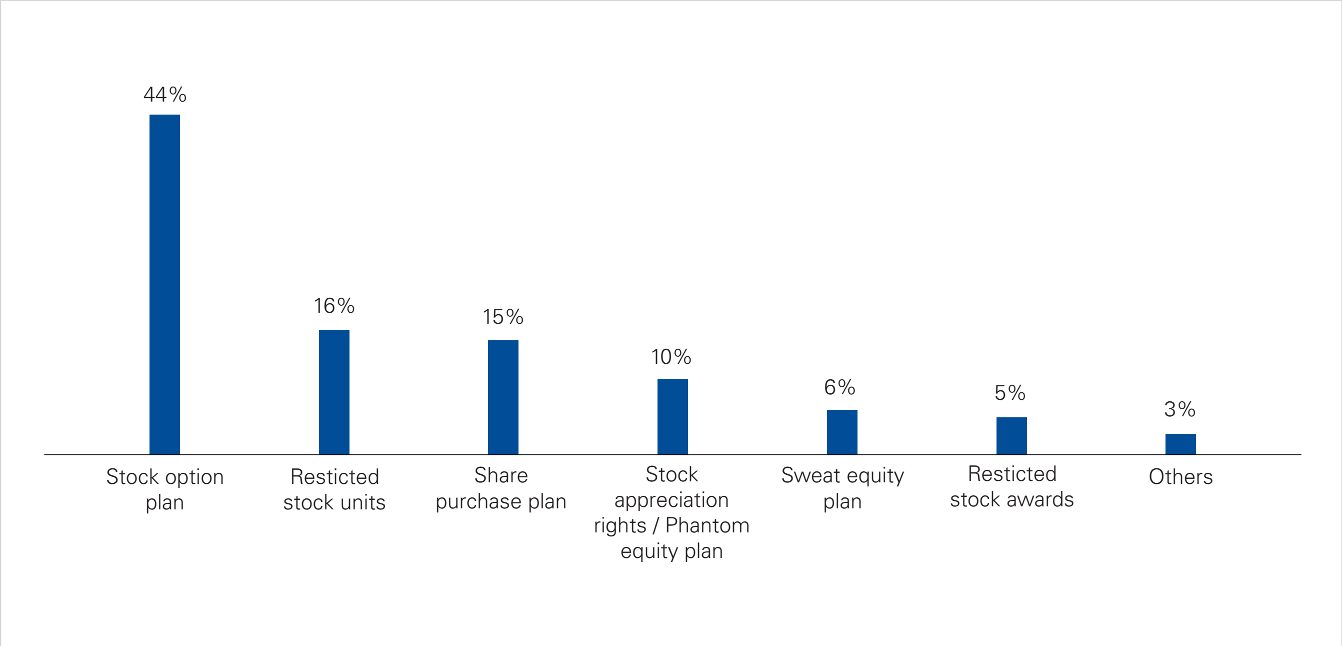
Source: 'KPMG in India's ESOP Survey 2021'

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

2. Key Considerations

Type of Plan

About 44 percent of the respondents have implemented / prefer to implement an Employee Stock Option Plan (ESOP) vis-à-vis other type of Plans. The Survey indicates that plain vanilla ESOPs appear to be popular. Other Plans such as ESPP, RSU and SARs are common in foreign jurisdictions.

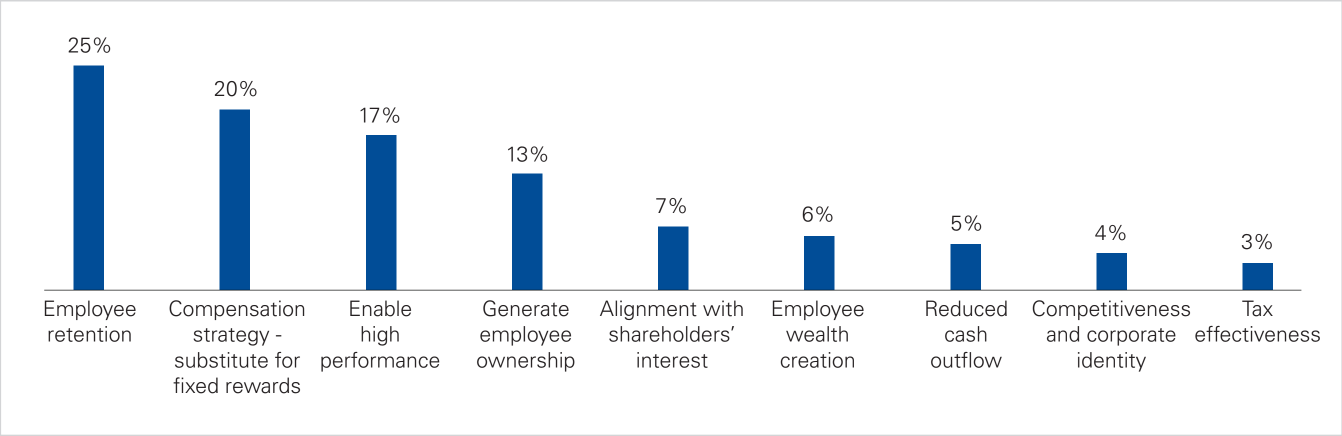


Source: 'KPMG in India's ESOP Survey 2021'

About 54 percent of the respondents emphasise on ESOPs as part of their hiring strategy to ensure prospective hires are aware of the benefits offered.

Objectives

The key considerations for designing an EIP are employee retention and thrust on compensation strategy. As companies are making efforts to build talent, ESOPs could serve as an attractive long-term incentive tool to attract and retain talent and enhance performance.



Source: 'KPMG in India's ESOP Survey 2021'

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

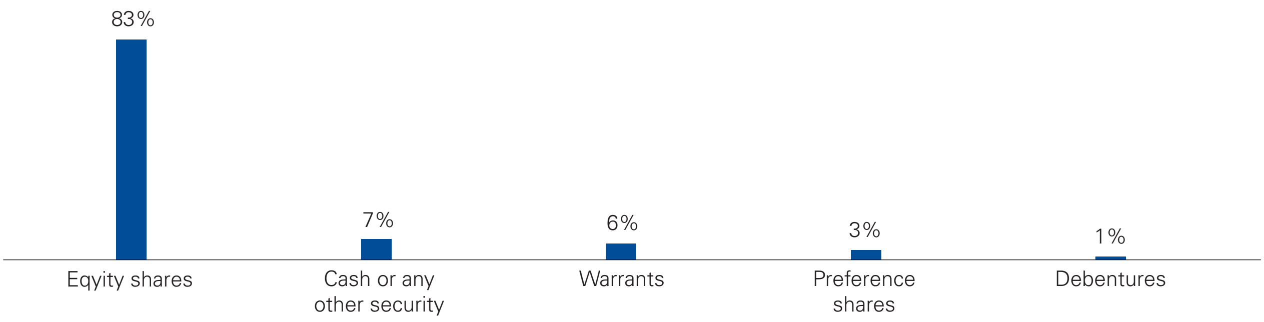
Indian Plans vs. Plans of foreign parent

Nearly 34 percent of the respondents expressed their interest in designing and implementing its own Plan while 30 percent of the respondents preferred to participate in a Plan incorporated by the foreign Parent. Cross border stock option plans, whereby Indian resident employees, participate in global stock option plans of their parent company (or any foreign company of the same group) are now in vogue. In either case, the Company as well as the employees will have to consider the applicable regulatory requirements to ensure smooth functioning.

Type of securities

83 percent of the respondents chose equity shares as the preferred security offered under the Plan vis-à-vis other types of security such as warrants, debentures, preference shares or cash settled options.

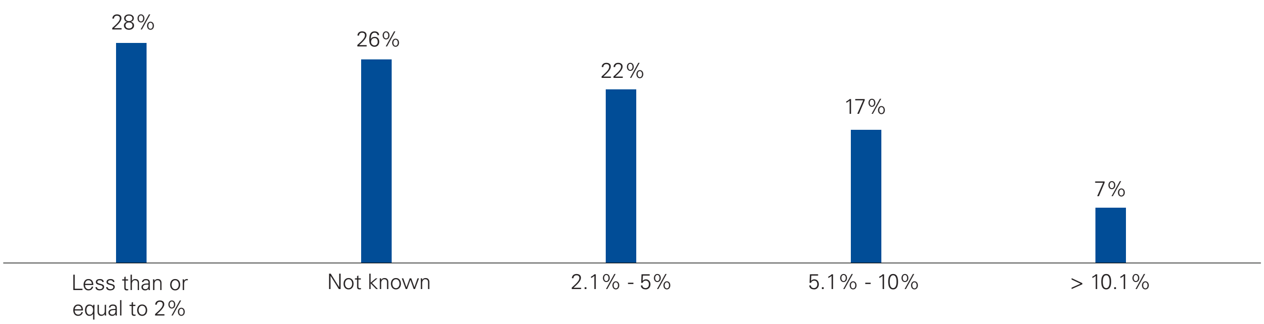
It continues to appear that Indian companies prefer to follow the conventional mode of incentivising their employees through ESOPs. Except a few companies, Indian companies are yet to evolve plans which are linked to warrants / other securities / any other variants of shares.



Source: 'KPMG in India's ESOP Survey 2021'

Percentage of allocation

28 percent of the respondents preferred to allocate less than or equal to two percent of its paid-up share capital. Further, 56 percent of the respondents preferred to issue new securities under the EIP. Typically, start-ups allocate a higher percentage of share capital towards the ESOP pool over the lifetime of the Company.



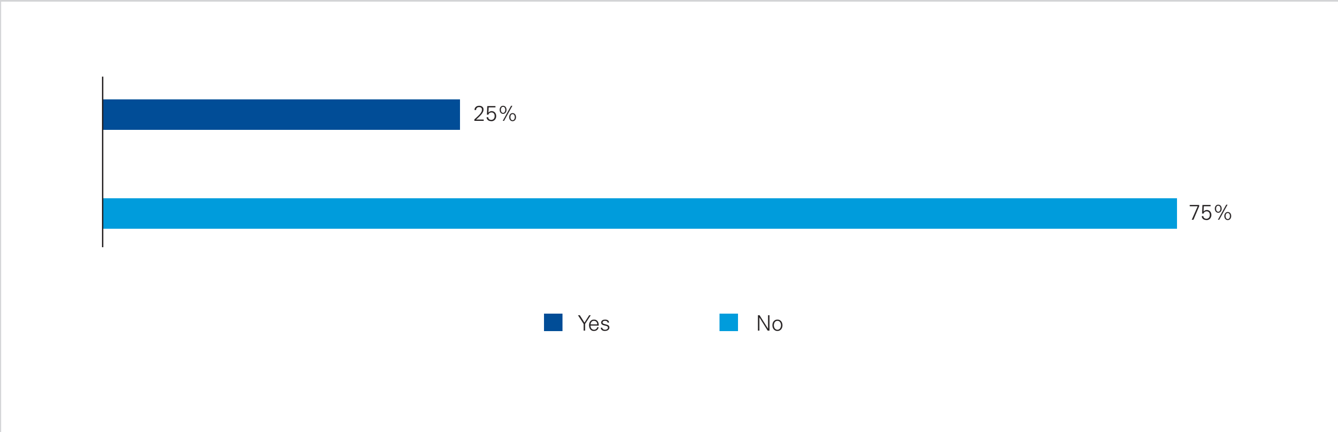
Source: 'KPMG in India's ESOP Survey 2021'

It is important to deliberate the quantum of equity one should allocate towards ESOP pool. The Company should also plan on effective utilisation of the same. Various factors such as intention to recruit new hires (especially top management) retention of high performers, expected increase in valuations, etc. should be considered while determining the pool.

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

Single vs. Multiple Plans

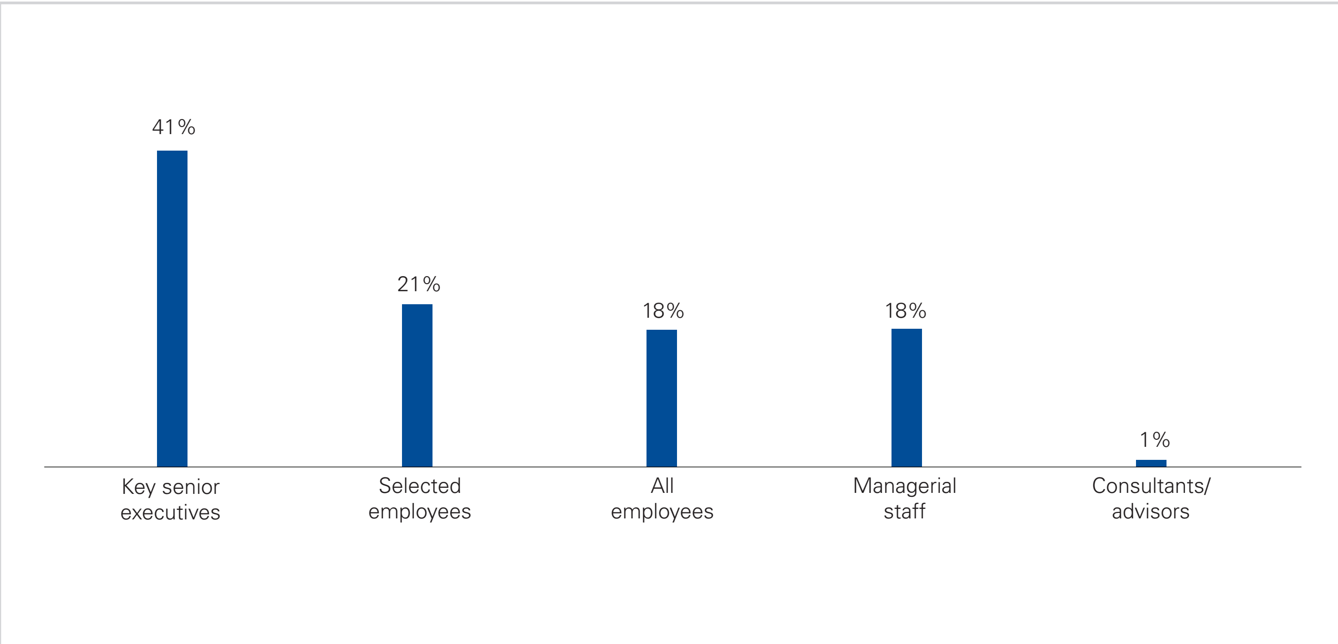
75 percent of the respondents believe that they would have a single Plan applicable to different levels of employees as compared to multiple types of EIPs. This would make it administratively more convenient for them to keep track of grants, vests, etc and at the same time, minimize additional compliance from a regulatory perspective.



Source: 'KPMG in India's ESOP Survey 2021'

Who should we incentivize?

41 percent of the respondents prefer to incentivize only key senior executives under an EIP. While there are a handful of provisions that need to be adhered to from a regulatory perspective on the eligibility criteria, companies will have to consider various aspects (such as tenure of employee, performance, importance to the company etc) before concluding on whom to remunerate or otherwise. Further, companies will have to be mindful of the compliance and regulatory requirements before allocating options to overseas employees.



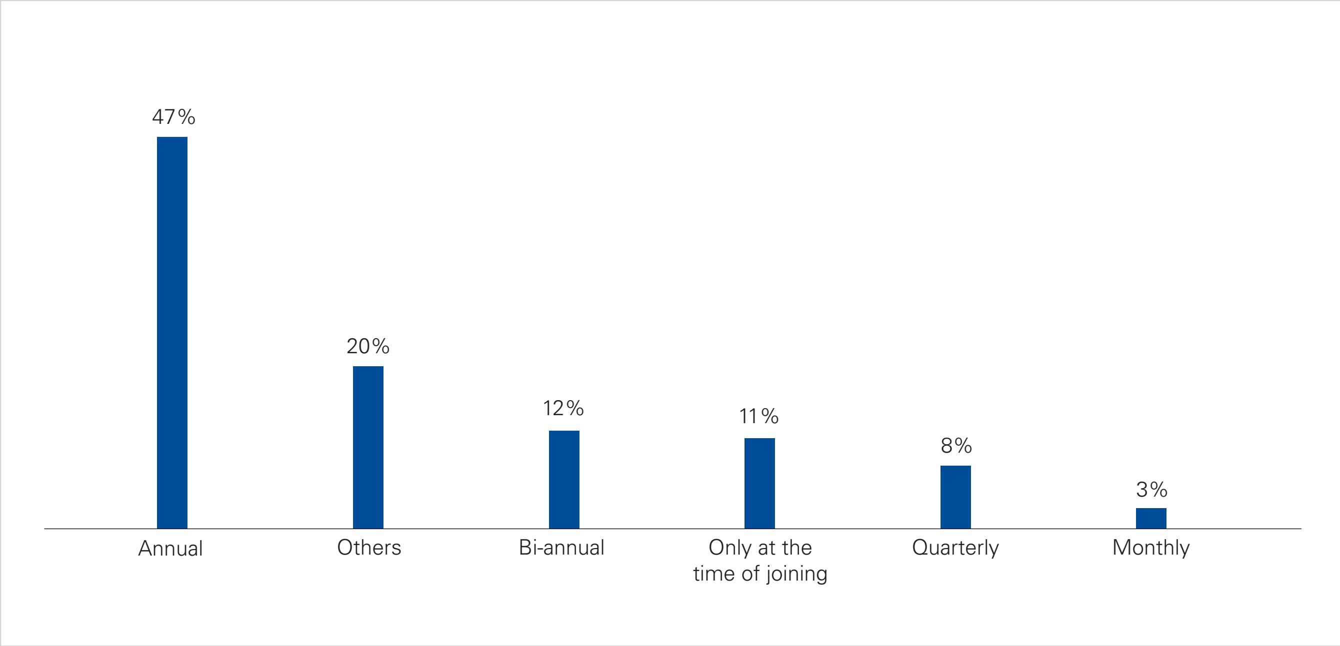
Source: 'KPMG in India's ESOP Survey 2021'

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

3. Life Cycle of the Plan

Grant

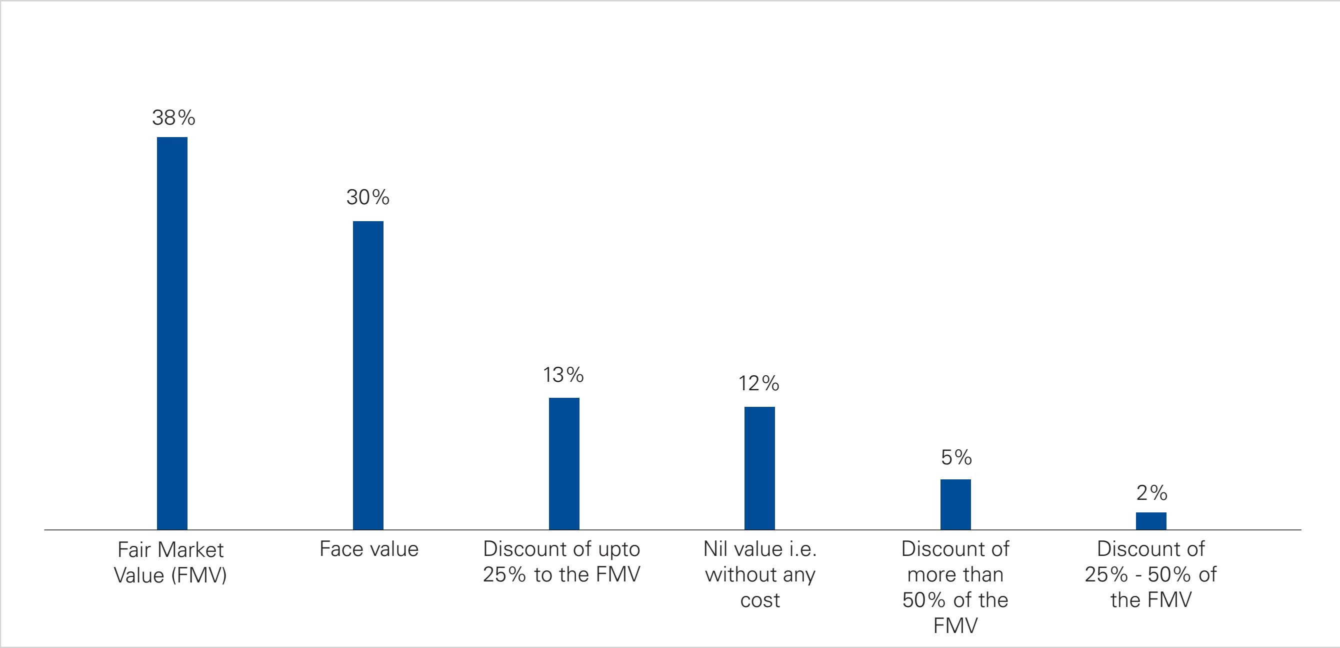
Almost 47 percent of the respondents annually offer / grant stocks under an EIP. The grants are based on a combination of several factors pertaining to the employee such as level of employee, performance of employee and company, employee's salary level, tenure of service, etc.



Source: 'KPMG in India's ESOP Survey 2021'

Grant Price

Nearly 38 percent of the respondents prefer to grant options at the Fair Market Value (FMV). The valuation should ideally be based on expectation of the stock price movement (volatility), the exercise price, life of the option, etc.



Source: 'KPMG in India's ESOP Survey 2021'

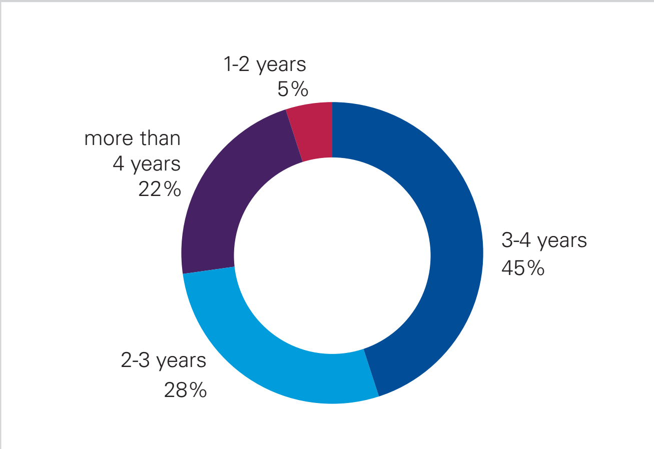
© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

Vesting

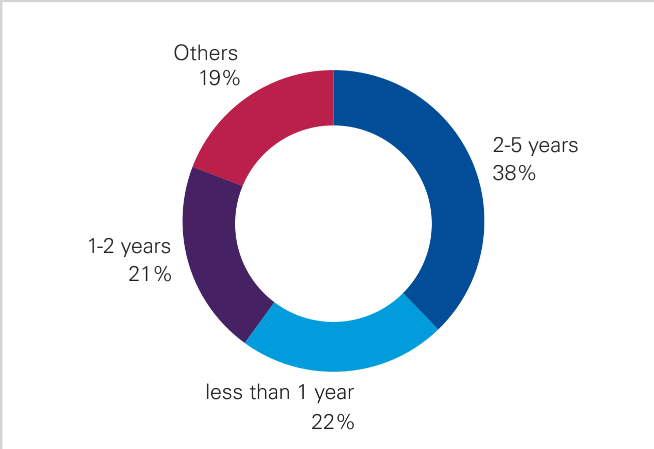
About 45 percent of the respondents prefer a vesting period of about three to four years with vesting occurring annually and equally over the vesting schedule. As vesting schedule is synonymous to the amount of time an employee must work before acquiring a non-forfeitable entitlement to his or her benefit, setting an appropriate vesting schedule is of paramount importance.

Exercise

Approx. 38 percent of the respondents prefer an exercise schedule ranging from two to five years, preferably, without any lock-in period. As the vesting schedule and exercise window collectively determine the longevity of the employee with the company, it is appropriate to ensure such schedule is set accurately to match the company's growth objectives.



Source: 'KPMG in India's ESOP Survey 2021'



Source: 'KPMG in India's ESOP Survey 2021'

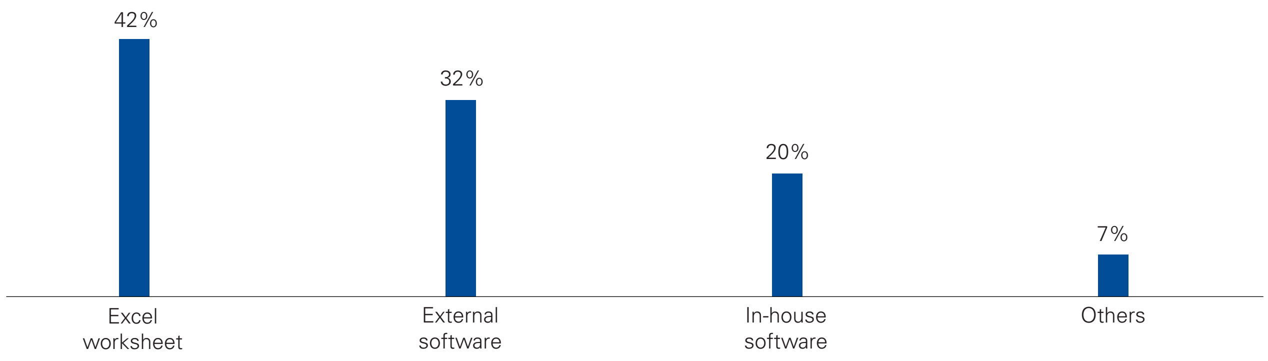
Nearly 59 percent of the respondents would have time-based vesting while 36 percent of the respondents favour a combination of time and performance-based vesting. Further, companies could choose either cliff vesting or graded vesting depending upon their requirement.

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

4. Post Implementation

Administering the Plan

Approximately 42 percent of the respondents use simple tools such as excel spreadsheets to administer the day-to-day activities under the Plan. If the Plan involves large number of participants, companies could consider adopting external tools / professional guidance to administer the Plan in order to ensure proper administration and regulatory compliance.



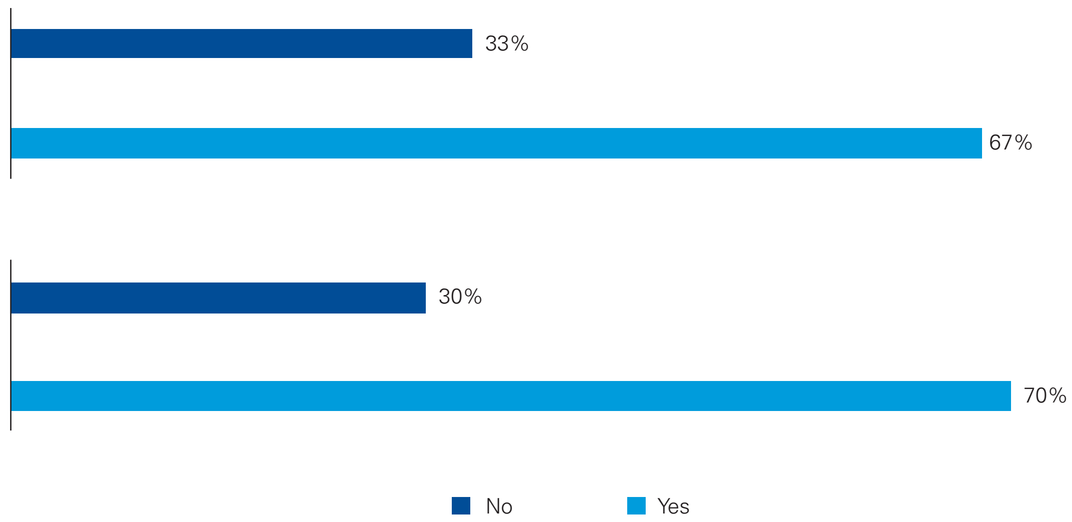
Source: 'KPMG in India's ESOP Survey 2021'

Impact assessment and review from regulatory compliance perspective

Companies will also have to periodically assess impact vis-à-vis objectives to ensure that the intent of the plan is being met. While 63 percent of the respondents conduct such assessments annually, some companies schedule such tests and checks with a longer time gap. A periodic analysis would help companies to identify and plug loopholes, if any, to safeguard their interest.

Periodic review of tax and regulatory aspects is also imperative. With constant changes in law and related provisions, companies will need to undertake catch-up reviews of their existing plans to ensure they are compliant.

The Survey indicates that in light of the provisions of the Companies Act and the SEBI Regulations, nearly 67 percent and 70 percent of the respondents respectively analyse / re-evaluate their stock ownership plans.



Source: 'KPMG in India's ESOP Survey 2021'

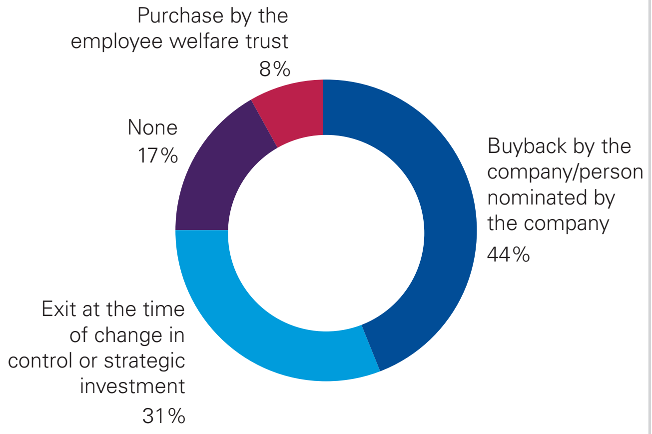
© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

5. Exit mechanism

Liquidity is a critical step in the entire process of ESOPs. While listed companies do not face any issue, with the stock markets providing an exit mechanism, employees of private limited companies are often posed with challenges of providing ways and means to encash the benefit arising from exercising of stock options.

Unlisted companies will have to evaluate alternatives to provide exit mechanism to the employees in case it does not intend to be listed. Buy-back of shares seems to be the most preferred option, with 44 percent of the respondents opting to buy-back shares from the employees while 31 percent believe that a strategic investment by an investor would serve as an exit mechanism.

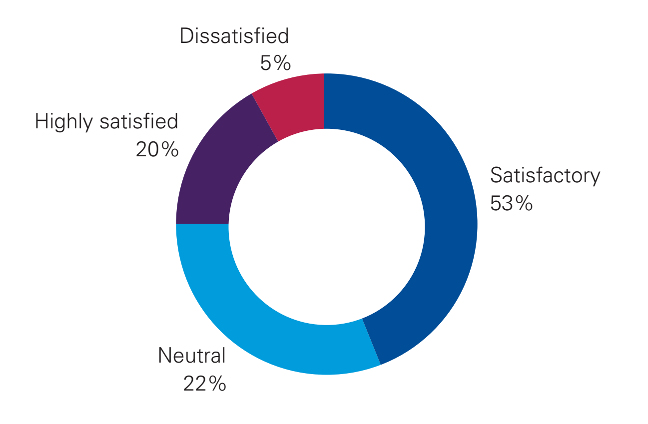
It is important for the employee to gauge the purpose and the timing of the exit and for the employer to evaluate the regulatory and compliance requirements before providing an exit mechanism.



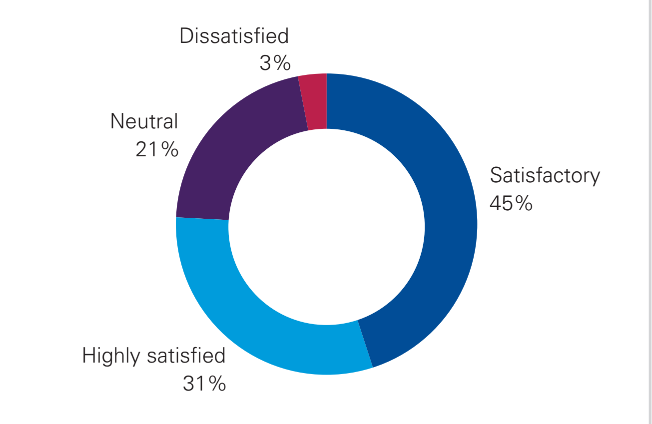
Source: 'KPMG in India's ESOP Survey 2021'

6. Overall perspective

Over 45 percent of the employer and employee participants believe that their experience vis-à-vis any stock ownership plan implemented by the company has been satisfactory.



Source: 'KPMG in India's ESOP Survey 2021'



Source: 'KPMG in India's ESOP Survey 2021'

EIPs can work well as their value can far exceed the employee's annual income over a period. In case of senior executives, the value of ESOPs could be much more than the other salary components put together over a period. The freedom to exercise at will and cash flow linked to exercise would mean that it's an employee-driven compensation incentive mechanism.

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

Conclusion

The Survey results indicate that more and more companies, especially private companies and start-ups are now considering equity-linked incentive plans as an avenue to incentivise their employees. The tax incentives proposed to be provided to selected start-ups should also encourage them to roll out EIPs as a part of compensation strategy if not done already.

Most companies are of the view that ESOPs tend to align with the interests and goals of the management with the shareholders.

Generally, listed companies consider ESOPs for the following key reasons:

- The market pays the upside to its employees
- There is no cash outflow for the company
- Helps in retaining and attracting talent
- Provides sense of ownership to employees
- Facilitates wealth creation for the employees.

There is no universal formula for determining the eligibility criteria and basis of allocation to employees. Each company needs to assess / evaluate various parameters prior to conceptualising its incentive mechanism. This would be based on the company's business model and overall need to attract, retain, motivate and reward employees. Companies may also consider fine-tuning the mechanics of the plan based on their experience / specific requirements.

With several changes in the specific regulations governing ESOPs viz., Company law, SEBI Regulations, Foreign Exchange Regulations, etc., companies need to evaluate all relevant aspects therein, prior to designing and rolling out an ESOP.

Further, considering the current market situation owing to the COVID-19 pandemic, several economies and businesses are reeling under pressure caused by unprecedented volatility in stock markets globally. COVID–19, is impacting several companies, both private and public. While the uncertainty of the current economic conditions is evident from the stock market, the future impact cannot be easily ascertained currently.

Considering the current low valuations and cash flow issues, several companies, have started looking at EIPs as an alternative mode of remuneration. This would help achieve the two-fold objective of retention as well as remuneration in the long run, while balancing the pay scale in the current cash-strapped situation. As stocks of a few companies may currently be under-water, some of these companies are also evaluating re-pricing the options.

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Are you following the emerging trends?

As is evident from the Survey trends, companies could consider implementing ESOPs to attract and retain talent. Besides being lucrative, ESOPs help in imbibing a sense of ownership amongst employees.

Once companies can address key aspects such as dilution of share capital and facilitating exit mechanisms (in case of unlisted companies), ESOPs could yield the desired result that they have been implemented for.

The recent trends of multi-fold deals of management buy-outs and overall buoyancy in the stock market coupled with certain regulatory changes (SEBI ESOP Guidelines, Corporate law provisions and IFRS convergence) has been the driver for many companies to re-consider their reward strategy and existing ESOPs.

There could be situations where many large business houses have planned an aggressive growth strategy.

This has led to greater demand for talent particularly with professional expertise. Attracting and retaining competent professionals has been a challenging task faced by many organizations. Besides cash rewards, it is important for any organization to make their employees believe that their personal growth is linked to the growth of the organization. ESOPs can prove to be a catalyst in achieving this objective.

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

KPMG

KPMG josh IT SHOWS

IN OUR ABILITY TO TRIUMPH OVER ANYTHING
IN OUR SPIRIT OF UNDYING ENTHUSIASM
OUR DRIVE TO ACHIEVE THE EXTRAORDINARY
UNMOVED BY FEAR OR CONSTRAINT
WE'RE DRIVEN BY JOSH AND IT SHOWS

THIS ADVERTISEMENT FEATURES KPMG INDIA EMPLOYEES

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved

KPMG in India contacts:

Rajeev Dimri
National Head of Tax
E: rajeevdimri@kpmg.com

Ajay Mehra
Partner and Head
Tax Markets and Strategy
E: ajaymehra@kpmg.com

Parizad Sirwalla
Partner and Head
Global Mobility Services, Tax
E: psirwalla@kpmg.com

home.kpmg/in

#KPMG josh

Follow us on:
home.kpmg/in/socialmedia

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011 Phone: +91 22 3989 6000, Fax: +91 22 3983 6000.

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

KPMG (Registered) (a partnership firm with Registration No. BA- 62445) converted into KPMG Assurance and Consulting Services LLP (a Limited Liability partnership firm) with LLP Registration No. AAT-0367 with effect from July 23, 2020.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

This document is for e-communication only. (003_THL0521_RSG)