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INTRODUCTION TO SHARE-BASED PAYMENTS

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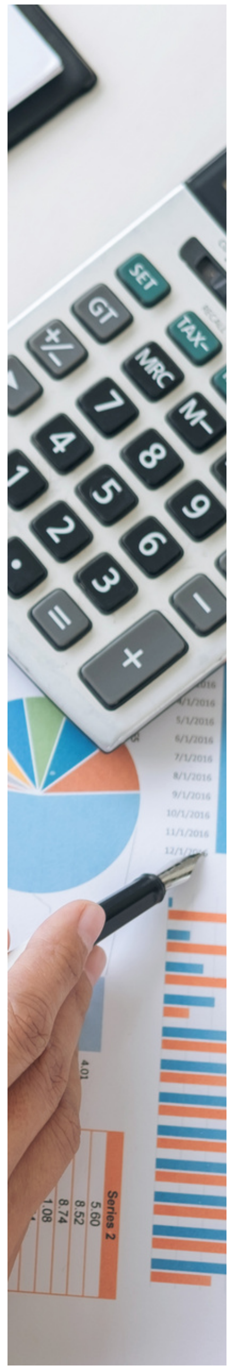
CONTEXT

In today's competitive job market, companies are constantly seeking innovative ways to attract and retain top talent. For a workforce motivated by immediate gratification and potentially significant rewards, share-based benefits have emerged as an effective option for companies.

Over the years, the Indian market has seen a consistent increase in the number of companies adopting share-based benefits as an approach to reward employees. It is evident that this trend has coincided with the rising number of start-ups and their exponential growth. Given the issues that start-ups usually face with regards to cashflow crunch and employee retention, share-based payments provide the best of both worlds for these companies. They enable start-ups to reward employees for their loyalty, based on certain conditions of growth and success being met, while offering a work-around to navigate through the afore-mentioned challenges.

However, the benefits of share-based payments are manifold and well-established and listed companies are also turning their attention towards these benefits. In this article, we give a generic overview of share-based payments and discuss how they work.



WHAT ARE SHARE-BASED PAYMENTS?

Share-based payments are plans under which employees are entitled to rewards based on movements in the price of an underlying stock. These underlying stocks are usually the company's own shares or those of a group/parent company. The benefits are granted in the form of options, giving an employee the freedom to utilize the options in a scenario where the stock price movements have been favorable between the time of granting and exercising of the option. Since these benefits are linked to share price movements, there is a huge potential for employees to obtain large financial rewards if the share price increases significantly. There is also an opportunity for further rewards from capital gains after the share has been acquired and if share price movements are favorable during the lock-in period (if any), after which the employee can sell the share at a potentially higher price. Therefore, by providing share-based benefits, the company aligns the interests of the employee with that of the shareholders and top-level management, leading to a more driven and outcome-focused workforce.

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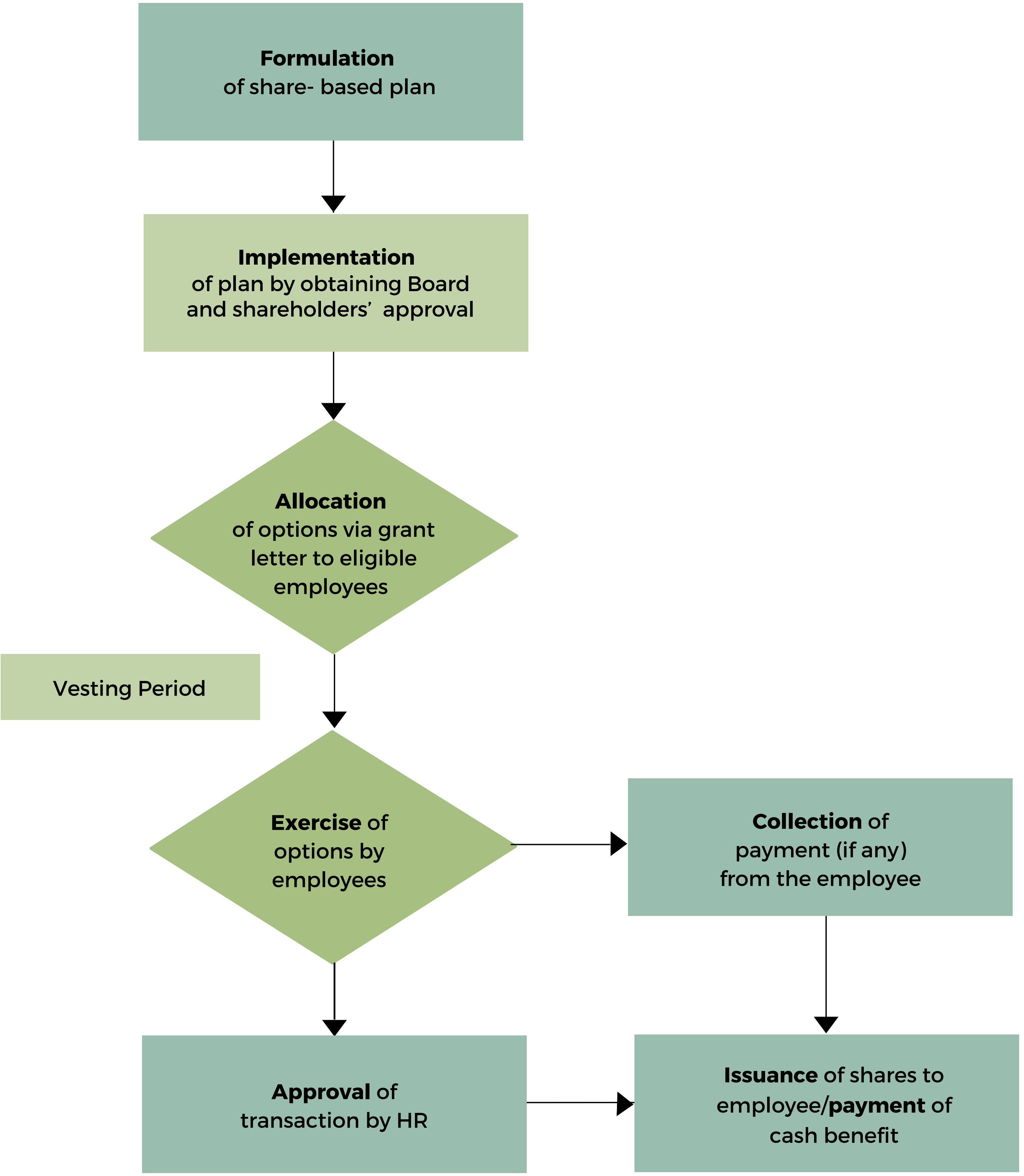
HOW DO SHARE-BASED PLANS WORK?

The most common form of share-based benefits are Employee Stock Option Plans or ESOPs as they are commonly known. Other frequently used share-based plans are Stock Appreciation Rights (SARs), Restricted Stock Units (RSUs), Phantom stocks and many more. The type of plan selected depends on the exact goals that the company wishes to achieve and the targeted workforce for these plans. Different groups of employees value different things and have varied objectives. As a result, it is not uncommon to customize specific plans for the C-suite, top level management, and other employees.

However, regardless of the form of the share-based plan, there are a few common aspects about how all these different types of plans function. Once a plan has been formulated and approved, it is offered to the relevant employees in the form of a grant. The grant letter not only intimates employees that this benefit has been granted to them but also specifies the terms and conditions of the plan.

There is typically a vesting period over which options get vested. Vesting can also be done in tranches, where a proportion of options gets vested at various pre-designated time points. Depending on the objectives of the share-based plan, companies can also choose to have performance-based vesting criteria i.e. vesting that is based on performance of the employee or the company based on certain metrics. Once the vesting period and vesting conditions are satisfied, an employee becomes eligible to exercise the options. This could be in the form of the underlying shares or a cash pay-out based on the price of the stock at the time of exercising the option. Usually, employees are given a specific time period after the vesting date during which they can exercise the options.

LIFE CYCLE OF A SHARE-BASED PLAN



CONCLUSION

There are various nuances surrounding share-based payments which give companies the flexibility to alter share-based plans to meet targeted objectives. While it is important to formulate and design these plans keeping these specific objectives in mind, they can prove to be a powerful resource for employers and a valued benefit for employees. As we move ahead, the functionalities and allure of share-based payments will continue to grow and these plans will gradually turn into a crucial component of employee compensation packages.

In order to learn more about the different types of share-based benefits and how to design a plan which aligns with the strategic objectives of your company or value their liabilities and account for them on your books, please get in touch with us.

CONTACT US

Swagatam, 1st Floor, S. V. Road, Mumbai 400052

actuaries@thanawalaconsultancy.com

+91 22 66943311 / 22 | +91 9820616964

www.thanawalaconsultancy.com