ESOP implementation in India - Challenges faced by Start-ups and Unicorn Journey

Pay Nearby
Zidd aage badhne ki

ESOP

29 Aug 2024

Content

- Why ESOP is relevant for start-ups?
- ESOP Design Aspects
- Key challenges

ESOP BUYBACKS/PAYOUTS SINCE 2020

Number of startups: **80+**

ESOP worth: **$1.45 Bn**

Top 5 buyers:
- Flipkart
- Razorpay
- Browserstack
- Swiggy
- Zerodha

Unicorns participated: **25+**

Top segments:
- E-commerce
- Fintech
- SaaS
- Edtech
- Logistics

As of 15th July 2023

Source : **Fintrackr**

FINTRACKR

Startup Unicorns 2021: Size of ESOP Pools (2021 data)

Start-up Co	ESOP Pool Size (in Crores)	Valuation (in Crores)	% of ESOP pool
CRED	3750	30075	12.5%
Unacademy	3000	25800	11.6%
Oyo	7569	75000	10.1%
PolicyBazaar	3836	45000	8.5%
Flipkart	17000	282000	6.0%
Zomato	5639	97500	5.8%
Spinny	336	6000	5.6%
Paytm	4571	82500	5.5%
Ola	3000	54750	5.5%
Upgrad	427	9000	4.7%
Nykaa	4280	93975	4.6%
Swiggy	1589	41250	3.9%
Sharechat	513	14625	3.5%
Byju’s	3092	135000	2.3%
PharmEasy	592	45000	1.3%
Total	**59194**	**1037475**	**5.7%**

Reference – https://indiatech.substack.com

CRED Launches 4th ‘Accelerated Wealth Programme (Mar’24)

CRED Records Lifetime ESOP Buyback Of INR 250 Cr

Edtech startup **Adda247** facilitates first ever Esop buyback for 130 employees (buyback price 40x of original purchase price)

Agritech startup **DeHaat** completes its first ESOP buyback for 10 cr. for 153 employees

AiDash, an enterprise software as a service (SaaS) company, said on Friday it had rolled out its first Employee Stock Ownership Plan (ESOP) buyback

Zomato seeks approval from shareholders for creation of new ESOP pool

Why ESOP’s

- Wealth creation
- Retention or lower attrition
- Attracting talent through stock options
- Increases chances of success for start-up
- Growth focus / strategy
- Cash conservation or Deferred compensation
- A sense of ownership in the company
- Align colleagues in driving the purpose of the company
- PE backed companies drives people towards IPO listing
- Any other?

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ESOPs: Design Considerations

ESOP Designing: What it entails?

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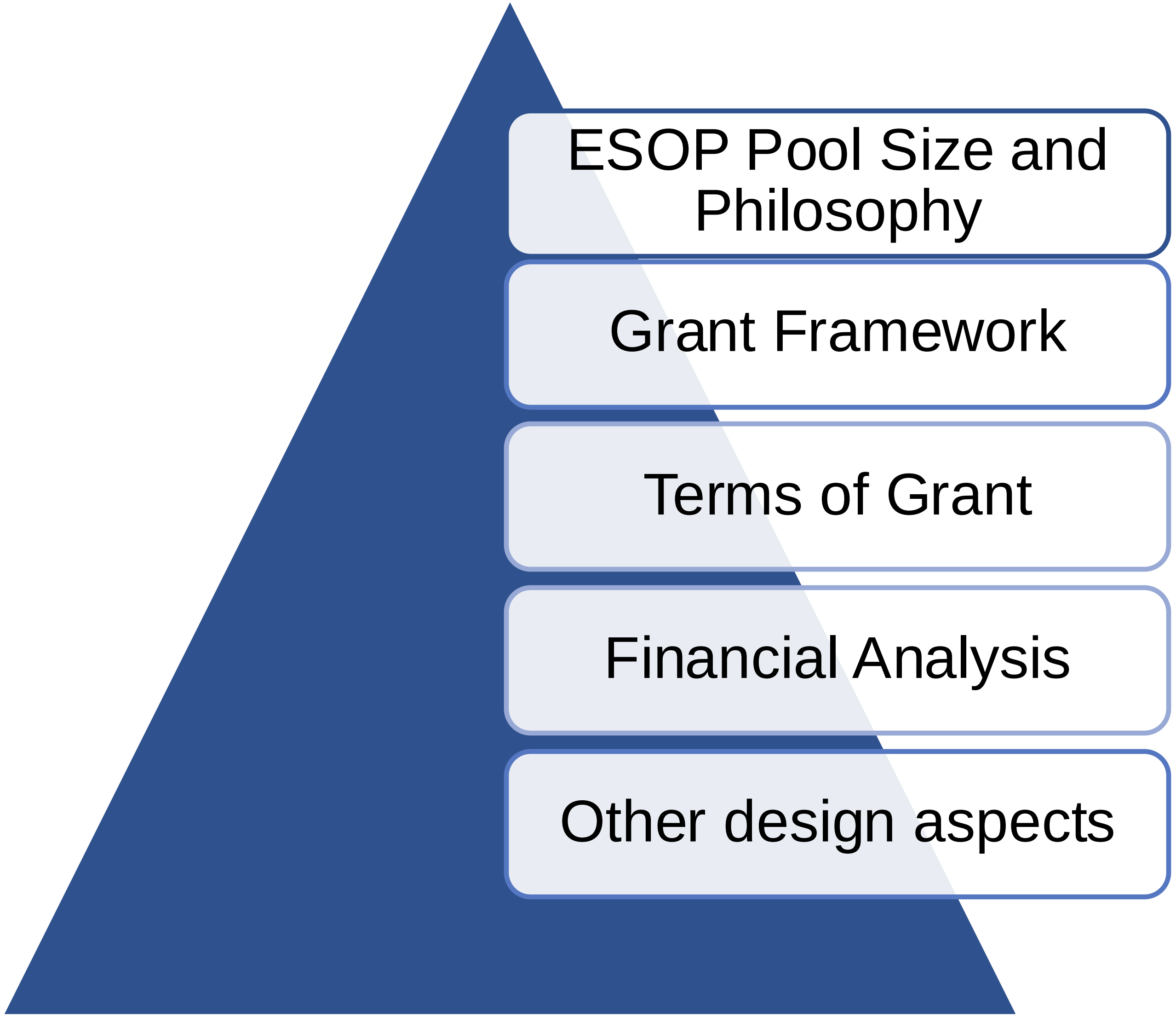

ESOP Pool Size and Timing

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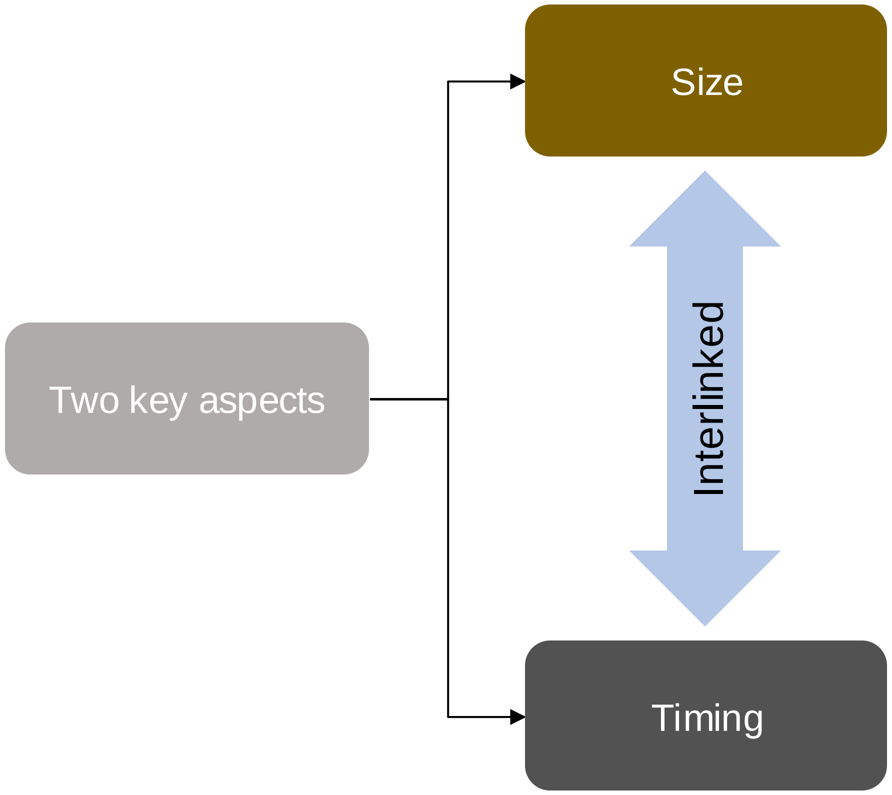

Large enough to potentially create sufficient wealth for employees

Small enough to ensure shareholder dilution is within limits

Need to be smart and get the math right! Do not rely on external benchmarks!

Immediate enough to cater to immediate needs of current employees and grants

Deferred enough to limit dilution of existing shareholders & to leave enough for future grants

Grant Framework

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Employee Level Grants

Who?

- Eligibility criteria – **broad based vs selective?**
- Senior Management or founding team only
- Middle management employees to be considered?
- Any **past tenure or performance criteria?**

How?

- **Methodology** for grants basis compensation philosophy
  - CTC Replacement
  - Future wealth creation approach
  - CTC Multiple approach

When?

- **Triggers** for future grants
- Promotions, milestones, etc
- Criteria for grants to new joinees, if needed

Terms of Grant

KPAC

Terms of Grant

Vesting Criteria

- **Performance or service based** or both
- Graded or bullet vesting
- Uniform, front-ended, back-ended
- Performance criteria recommended for senior employees
- Distinction for different divisions / departments

Exercise Price

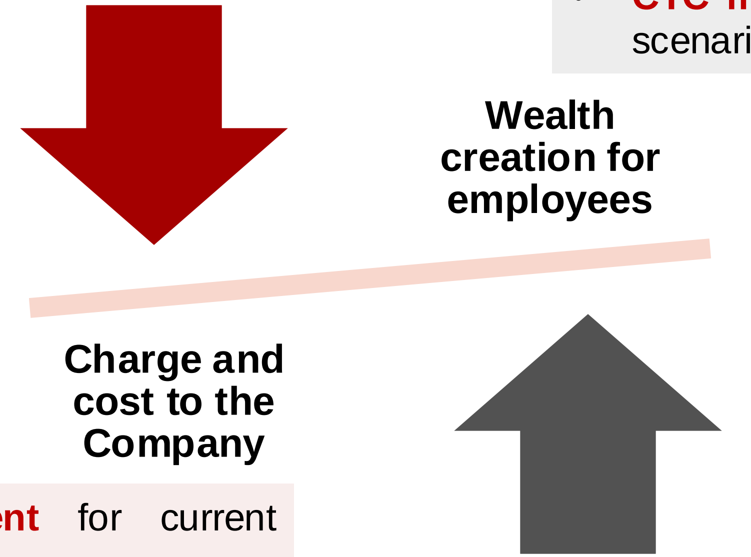
- **Current share price vis-à-vis discount** to be offered
- Impact on cost to company and wealth creation

Exercise Conditions

- Length of exercise period
- **Linkage or not to happening of corporate event**
- Flexibility to Board for buy back (including implications)
- Flexibilities to board to enable early exits / liquidity

Pricing and Financial Analysis

- **Expected wealth creation** basis business plan projections of Company
- **CTC multiples** for various share price scenarios



- **Cost to Income statement** for current employees and key hires
- **Fair market value** - more dilution, no / less accounting charge
- **Discount** - less dilution, benefit buffer with accounting charge

Various **scenarios / simulations** for different options will be presented

Optimizing cost to Company for given level of wealth creation

Other design considerations

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Minimising Cash-flow strain for Employees	• Choose scheme rules which aim to **match cash inflow & cash outflow** for employees • Consider **linking exercise only with Liquidity Event**
How will your cap-table look over time?	• View of **level of dilution expected over time** • Preference for having **individual employees on cap-table** as shareholders?
Treatment of vested options of ex-employees	• **Compulsory exercise of options** in a short period; or • Allowing employees to **continue holding vested options** post leaving
Other Scheme Rules	• **Flexibility to Board** to decide exact terms of Exercise at a later date depending upon how the Company grows • **Accelerate vesting for key employees**, if needed • **Listing** considerations

Key Challenges

1. EBITDA impact due to ESOP costs and also dilution impact on shareholders
2. Vesting Schedule – Performance based, Time based or a combination
3. Accurate valuation method
4. Legal and regulatory compliance
5. Alignment of ESOP scheme based on company and individual metrics

Thank you