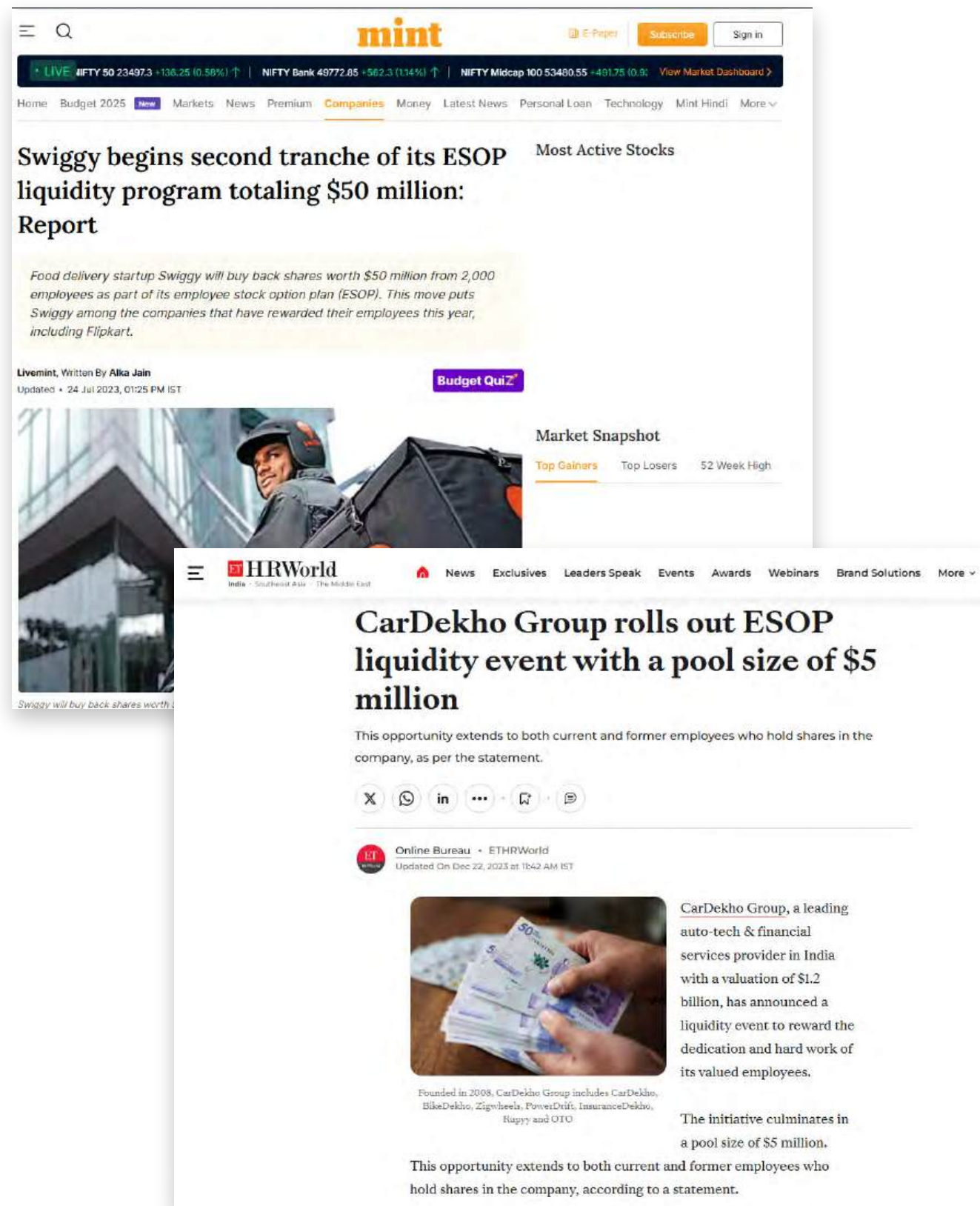


From Grant To Liquidity

The Full ESOP Journey
Explained

A complete guide to ESOPs, right from granting and vesting to liquidity events and their impact on employee's wealth.





You've probably come across these headlines before, haven't you? To help you understand ESOPs, we'll break it down into key aspects – what liquidity means, its types, benefits, and more.



“

I completely back implementing Employee Stock Ownership Plans (ESOPs) for employee wealth creation. ESOPs not only align the interests of employees with organizational success but also serve as a powerful retention tool.

I've noticed that granting employees a stake in the company helps inspire a shared commitment to excellence, driving both individual and collective prosperity.

Through my extensive professional experience, I have witnessed firsthand the transformative impact of ESOPs in enhancing employee morale, loyalty, and financial well-being, making them an indispensable aspect of strategic financial planning for any forward-thinking enterprise.

Manish Panwar

Business Head | Finance SME



”

Foreword

Employee Stock Ownership Plans (ESOPs) offer a unique ownership structure where employees receive shares as part of their compensation. This promotes loyalty among the workforce and helps shape a collaborative and inclusive workplace culture.

But how do employees turn their ESOPs into real wealth? **Through ESOP Liquidity.**

ESOP liquidity refers to the ability of employees to convert their ESOPs holdings into cash or tradable assets. Liquidity events, such as a company going public or being acquired, enable employees to sell their ESOP shares and realize the value they've accumulated.

In this guide, explore everything related to ESOPs – how they work, their benefits, challenges, and of course, ESOP liquidation.



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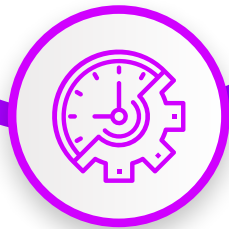
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From Employee to Owner

What if your employees thought & acted like owners?

Imagine a workforce where every team member is deeply invested in your company's success, thinks strategically, and contributes like a true partner.

**Enhanced
Productivity**



**Improved
Retention**



**Sustainable
Growth**



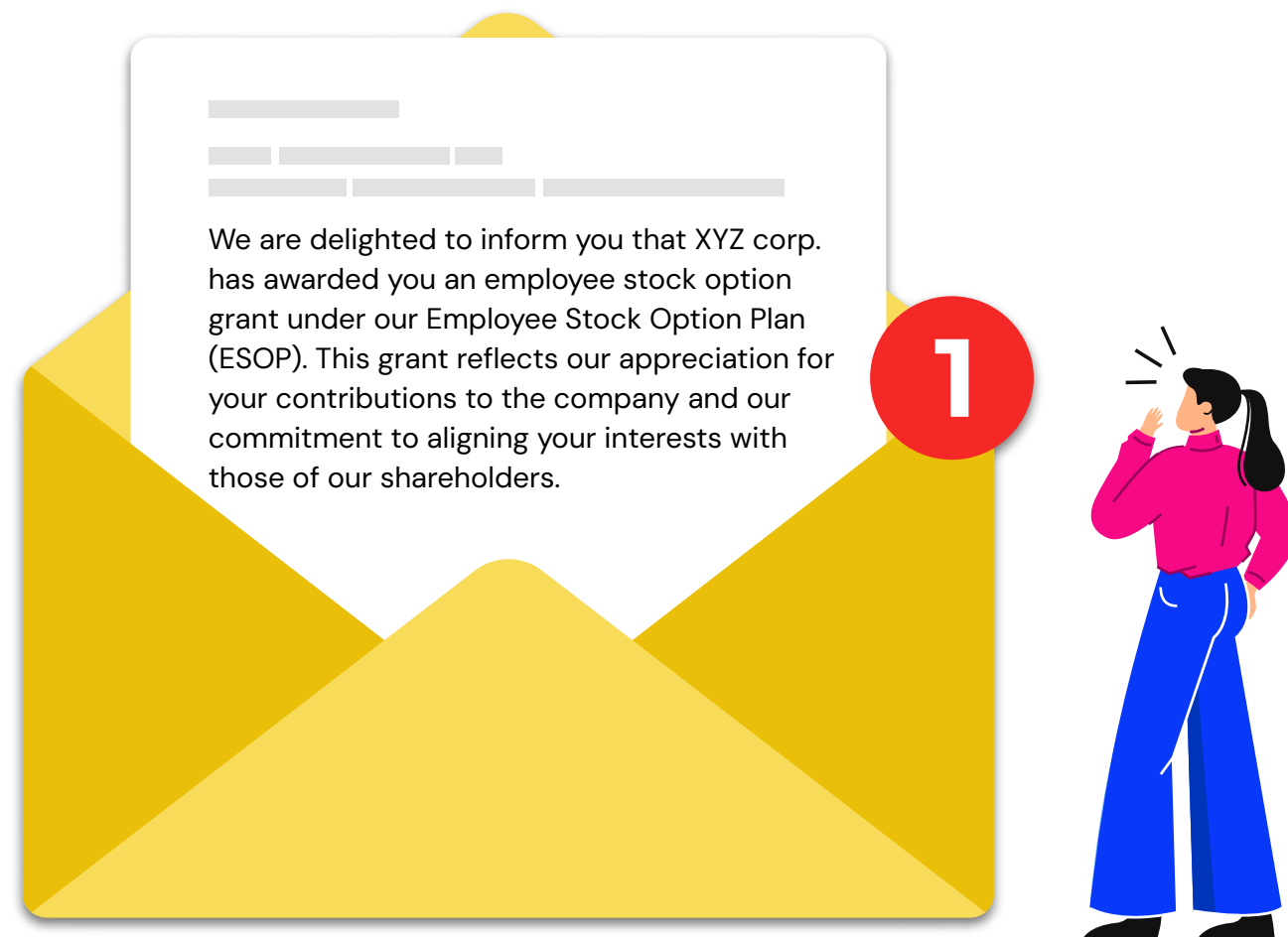
Understanding ESOPs is
the first step to turning
this vision into reality.

Let's explore how it works.



Understanding how ESOPs work

Employee Stock Option Plans (ESOPs) empower employees to become stakeholders in the companies they work for. Let's dive into the basics of how ESOPs work.



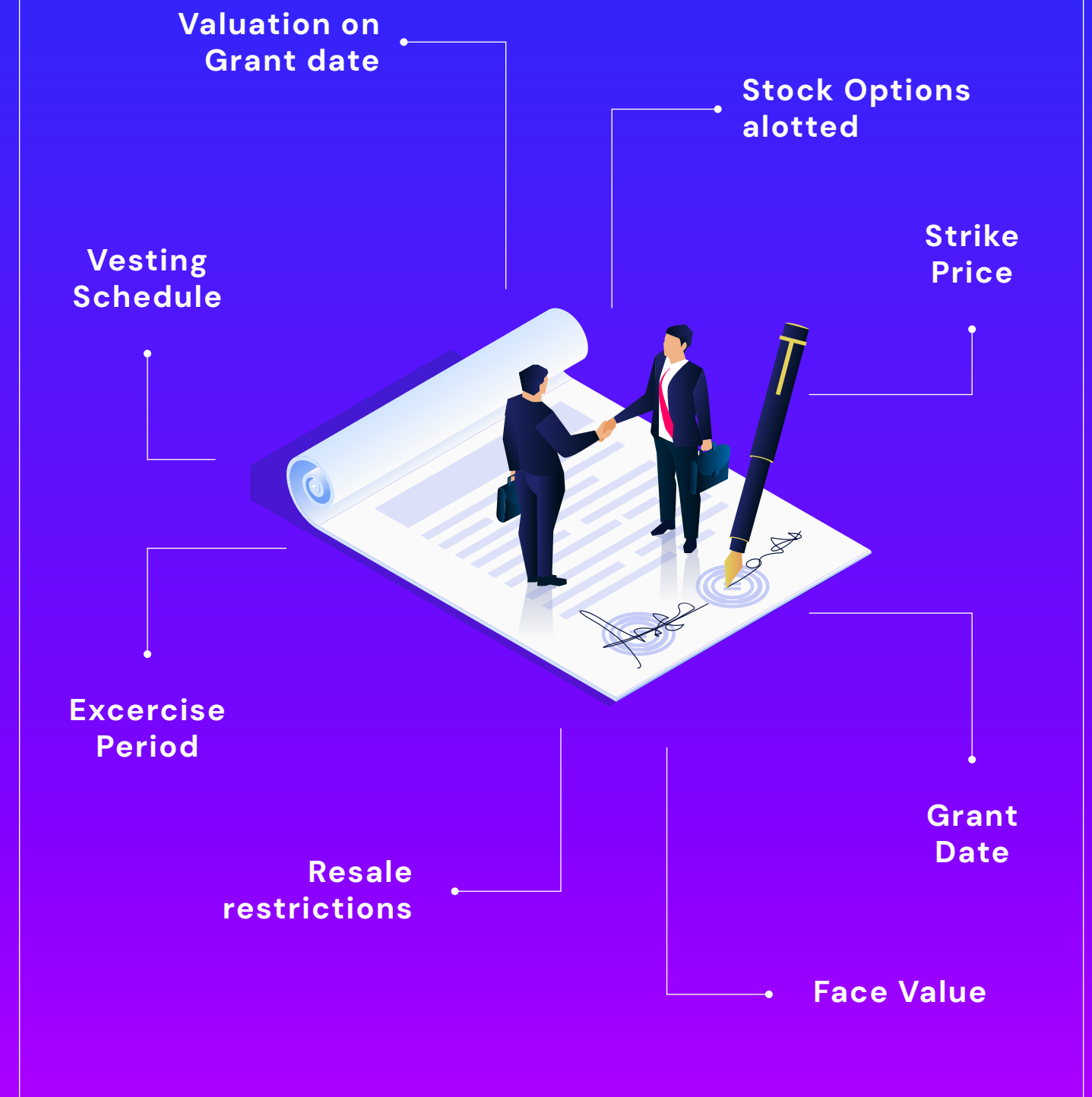
Sounds familiar?
Perhaps you've read something
like this in your grant letter.

→ That's the starting point
of an ESOP journey – **A
Formal Grant Letter.**

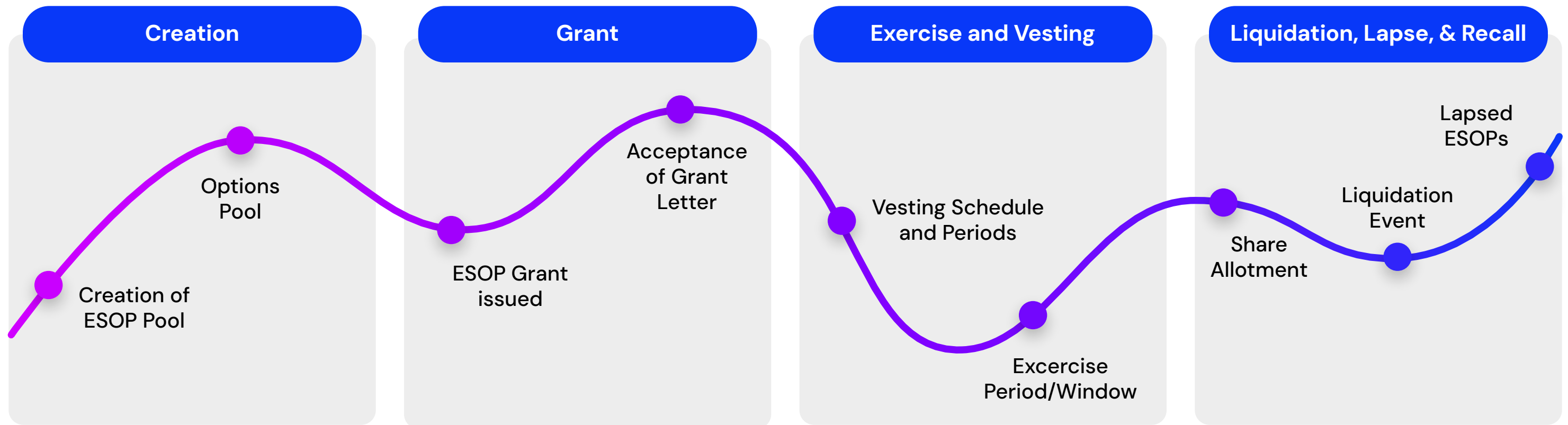
A grant letter is more than just an acknowledgment. The letter outlines key terms of your ESOP compensation package. These may include the vesting timeline, schedule, and the type of ESOP granted to you. Understanding these terms is crucial for maximizing the benefits of your ESOPs.

Next, we'll take a look at some of these grant letter terms and what they mean for you.

Key terms in your ESOP Grant Letter



The ESOP Timeline



Employees acquire ownership through Employee Stock Ownership Plans (ESOPs) by receiving company shares as part of their compensation. Over time, as employees stay with the company, they accumulate a vested interest in the shares. When employees leave or retire, they can cash in or sell their vested shares.

However, this process begins only after completing the vesting journey. So, what exactly is vesting?

Let's explore that next! →



Vesting Schedules & Eligibility in ESOPs

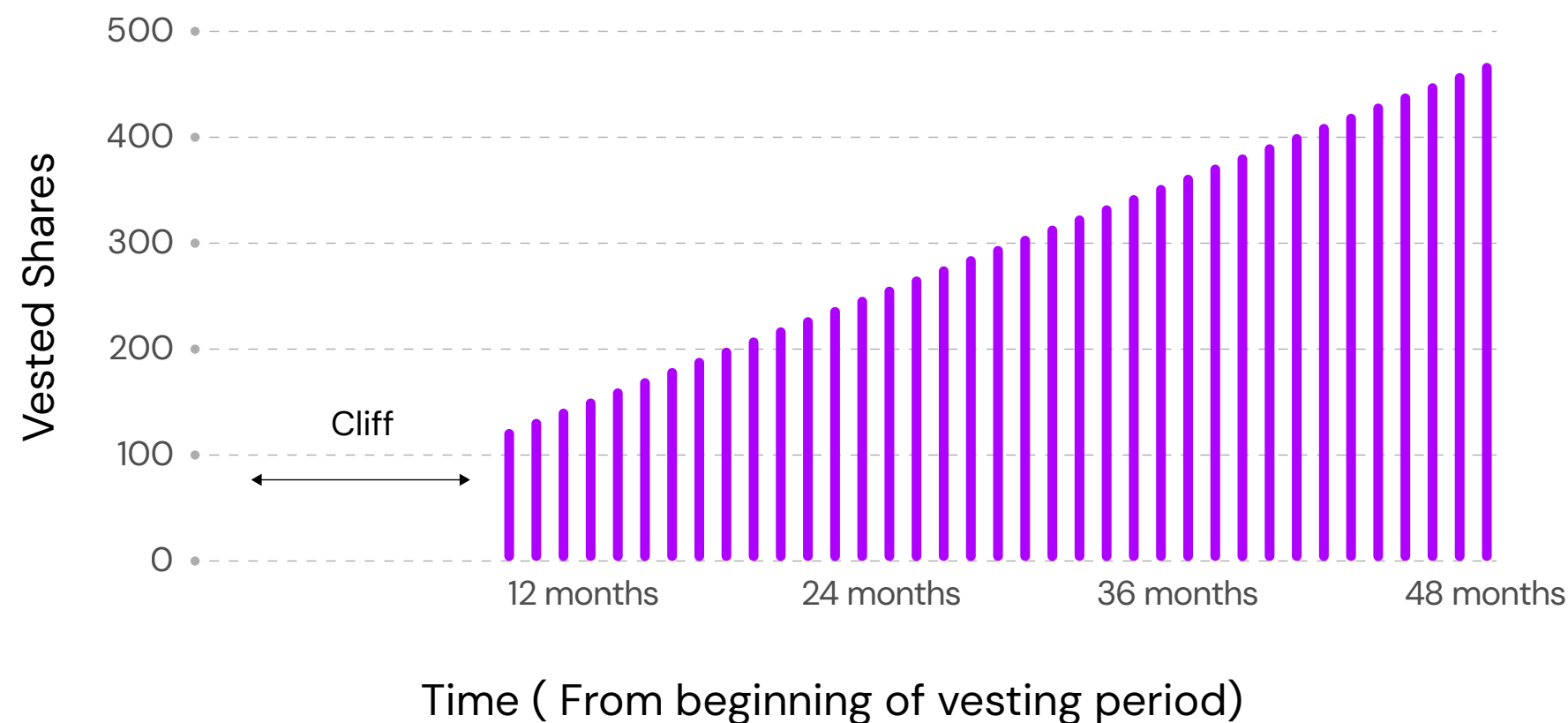
DID YOU KNOW



In India, the mandatory minimum vesting period for ESOPs is **1 Year (Cliff Period)**

ESOPs come with vesting schedules that help determine when employees gain ownership rights. Vesting is gradual, usually occurring over a set period, motivating long-term commitment. Eligibility criteria for ESOPs may vary, often requiring a minimum tenure before they can participate in the plan or begin vesting.

4-Year vesting with 1-year cliff



Did you **know** ?

Employees can exercise their ESOPs even after they leave the company (provided they have vested).

Key Differences Among Phantom Stocks, Restricted Stock Units, and Stock Appreciation Rights

	Phantom Stock	RSUs	SARs
Key Factors			
Ownership Rights	No actual stock ownership	Actual stock ownership upon vesting	No actual stock ownership
Dividend Payments	No dividends	Receives dividends when RSUs vest	No dividends
Vesting Period	Typically has a vesting period with conditions	Has a vesting schedule over time	Dependent on a vesting period with conditions
Payout Mechanism	Cash upon triggering event (e.g., sale)	Company stock upon vesting	Cash upon triggering event
Tax Implications	Taxed as ordinary income upon payout	Taxed as ordinary income upon vesting	Taxed as ordinary income upon payout
Conversion to Shares	Doesn't convert to actual shares	Converts to actual shares upon vesting	May result in cash or stock settlement
Liquidity for Holder	Cash settlement provides immediate liquidity	RSUs may be sold after vesting, providing liquidity	Cash settlement provides immediate liquidity

Let's now understand the liquidity of **SARs**,
Phantom Stocks, and **RSUs** in simple terms:

Stock Appreciation Rights (SARs):

How Liquidity Occurs:

SARs provide employees with the opportunity to receive cash or company stock based on the appreciation of the company's stock price over a specific period. When the SARs vest (become available to the employee), they can typically be exercised, meaning the employee can choose to receive either cash or company stock equal to the value of the appreciation in the stock price since the grant date.

Liquidity Mechanism:

Once SARs are vested and exercised, liquidity occurs through the company's processes. If the employee opts for cash settlement, the company pays out the equivalent amount. If the employee chooses stock settlement, they may receive shares, which they can then sell on the open market for liquidity.



Phantom Stocks:

How Liquidity Occurs: Phantom stocks are essentially a promise by the company to pay out a bonus based on the performance of the company's stock. Unlike SARs, employees do not receive actual shares but rather the cash equivalent of the appreciation in the company's stock price.

Liquidity Mechanism: When phantom stocks vest or when the predetermined performance targets are met, the company pays out the cash equivalent to the employee. This liquidity typically occurs within the company's compensation cycle, often through payroll or bonus payment processes.

Restricted Stock Units (RSUs):

How Liquidity Occurs: RSUs are actual shares of company stock granted to employees, subject to a vesting schedule. The key difference from SARs and phantom stocks is that RSUs grant ownership of company stock directly, albeit with restrictions until they vest.

Liquidity Mechanism: When RSUs vest, the employee gains ownership of the shares, which they can then sell on the open market for liquidity. Alternatively, some companies may offer a cash settlement option upon RSU vesting, providing immediate liquidity to employees without requiring them to sell the shares.

The liquidity of SARs, phantom stocks, and RSUs occurs through different mechanisms but ultimately provides employees with the opportunity to realize the value of their equity compensation. SARs and phantom stocks offer cash or stock equivalents based on the performance of the company's stock, while RSUs grant actual ownership of company shares, which can be sold for liquidity upon vesting or through cash settlement options.



Key Benefits of ESOPs

For Employer

- Minimized attrition with additional reward
- Attract and retain high-quality employees
- Provide incentives without monetary compensations
- Align employees with your company's mission

Quick Stats



Companies claim tax benefits of ₹500-700 crore annually. (KPMG)

For Employee

- Stock monetization exceeds the regular remuneration
- Enhance job security and stability
- Direct ownership opportunities by acquiring the shares
- Significant retirement benefits at no monetary cost

Quick Stats



On average, employees accumulate ₹50-75 lakhs in wealth from ESOPs. (EY)

Did you know

ESOP-issued companies have **25%** higher retention than non-ESOP companies and they have enabled **17%** higher performance compared with non-ESOP companies.

Source: Nasscom



Companies with Massive ESOP Buybacks in 2024

You might have noticed recent headlines highlighting how Indian startup employees earned over INR 1,250 Cr through ESOP buybacks in 2024. But what does this actually mean? It means that employees were rewarded for their contributions and dedication.

A buyback is one type of liquidity event but it's not the only one. Before diving deeper into other types of liquidity events, let's revisit the basics.



DeHaat
Seeds to Market

Adda247

SWIGGY

UC Urban
Company

WINZO

whatfix

Classplus

Pocket FM

**leverage
edu**

propelld

meesho

mygate

purplle

**THE SLEEP
COMPANY**

XY | XX

What Does ESOP Liquidity Mean?

The liquidity event for ESOPs occurs when the options become exercisable and the employee can convert them into actual shares of company stock.

This liquidity event can happen through several scenarios, primarily:



Buyback Programs

In 2023, Razorpay conducted a major ESOP buyback worth ₹486 crore. Similarly, many companies run buyback programs, repurchasing employee shares at set intervals to provide liquidity. However, it's crucial to assess buyback price carefully.



Mergers/acquisitions

In the event of the company's merger, acquisition or liquidation for any reason, you will receive the value of your vested ESOPs in the form of cash or equity in the acquiring company.



ESOP Trust Pre-IPO

Numerous private companies employ an ESOP Trust to facilitate employee exits before an IPO. While this approach may pose certain tax-related obstacles for the company, it is increasingly being implemented effectively.



Initial Public Offerings (IPOs)

This practice is gaining momentum. It represents an optimal scenario where one can exercise and sell ESOPs in a single transaction without concerns about perquisite taxes.

- These events offer employees the opportunity to realize the value of their equity, providing liquidity for their vested shares.

When's the Right Time for ESOP Liquidity?

Timing your ESOP liquidity depends on a mix of factors!

1 Check Your Company's Growth Story:

Has the company been growing consistently? If the stock's value is at a promising level and future growth seems strong, it might be a good time to consider liquidity. For example, if your company recently announced record-breaking revenues or a high-profile acquisition, it could indicate strong performance.

2 Look at Market Trends:

If your company is involved in the AI sector and there is high investor interest, it might be the ideal time to capitalize on this and hold on to your ESOPs. However, if you feel the market is experiencing uncertainty, it might be a wise decision to sell off your ESOPs.

Note

Also, check out point 4 to make an informed decision based on your needs.

3 Conduct Scenario Analysis:

Evaluate your cash inflow versus cash outflow for different timelines. For example, evaluate how the potential returns if you sell your ESOPs now versus after 1 year or 2 years. Also, consider the **tax implications**. Compare the difference in gains between short-term capital gains tax (if you sell within a year) versus long-term capital gains tax (if you hold for longer). Analysing these factors will help you understand the financial impact of your ESOP liquidity decision

4 Think About Your Own Goals:

Do you have a big expense coming up – like buying a house or funding a major milestone? Or maybe you just want to diversify your portfolio. Personal financial goals play a big role here.

5 Know the Rules:

Check if there are any restrictions, like lock-in/blackout periods, on selling your shares. Also, many companies have graded vesting schedules which means 25% of your ESOPs are vested each year, enabling you to only sell the vested portion of your ESOPs.



PRO TIP!

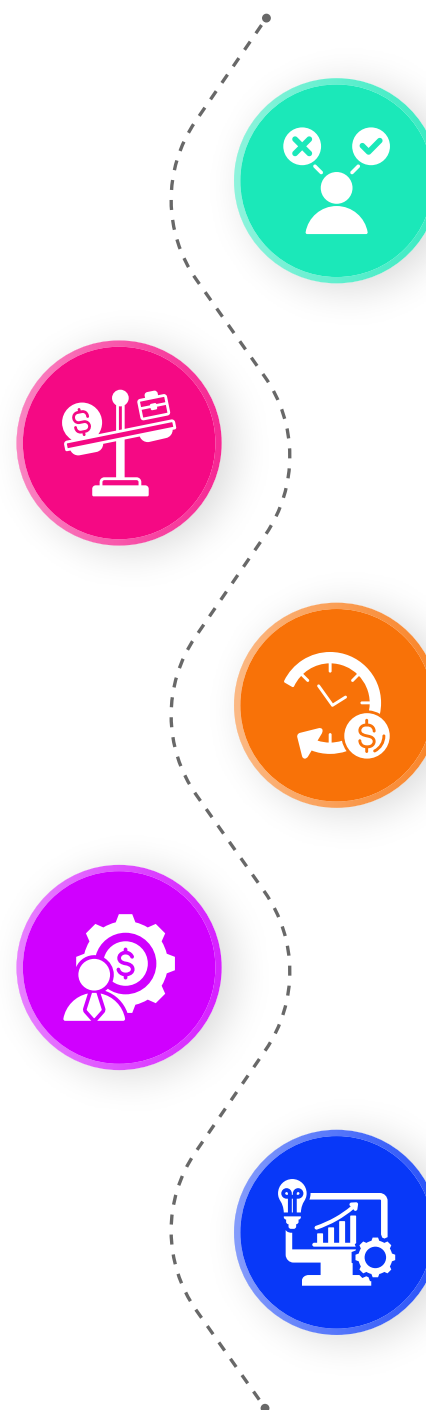
Always consult with a financial advisor or tax expert before making a decision.

The right time to sell isn't just about numbers – it's about aligning your company's growth, market conditions, and personal goals to make the most of your ESOPs!



Impact of Liquidity Events on Employee Wealth & How to Maximize It?

Employees can realize liquidity from ESOP holdings and diversify their investment portfolios. They can optimize the benefits of ESOP liquidity events through strategic planning, such as:



Keeping Ahead:

Staying informed about the company's financial health and market trends enables timely decision-making.

Broadening Investment:

Consider how Vaibhav Gupta, founder of Udaan, may have expanded his investments at Flipkart to transition from being an employee to building his own venture.

Patience Pays Off:

Exercising patience can be key. Look at how employees of companies like Zomato and Delhivery benefitted from bumper listing gains.

Expert Guidance:

Seeking professional financial advice aids in navigating complex decisions, such as whether to sell, hold, or reinvest proceeds.

ESOP Education:

Finally, actively engaging in ESOP education programs fosters a deeper understanding of the option plan to make informed choices. This helps maximize the long-term impact of liquidity events on their financial well-being.

NOTE

Market volatility can impact stock valuations, influencing the overall proceeds for employees. Thus, timing is crucial. Also, tax implications require careful consideration, as improper planning may lead to substantial liabilities.

What Xumane Can Do For You

Allocating, monitoring, and managing ESOPs for employees can be challenging as your company expands. As the organization scales, so does the number of employees participating in the ESOP plan.

Imagine effortlessly overseeing every aspect, from seamlessly granting ESOPs to redistributing them and streamlining the centralized management of company-wide options. Wouldn't that make your management tasks much more efficient?

Xumane can help!

Our expert advisory services and an end-to-end ESOP management platform enables you to:



Since our launch in **2022**,

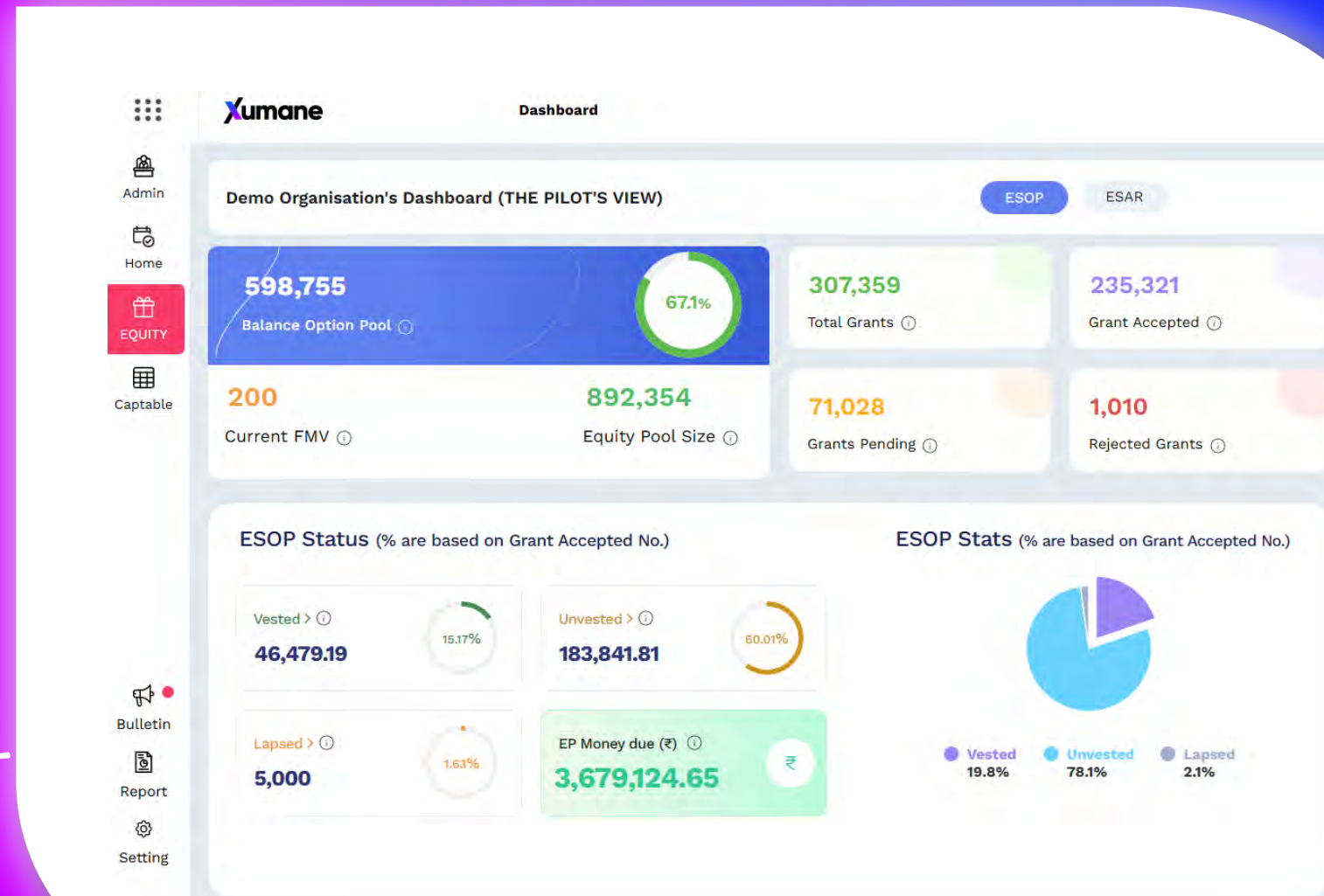
Xumane has worked with over **100+ clients** such as ECOM EXPRESS, V- MART, Trade India and Zaggle, among others. With a repeat customer rate of **99%**, we take pride in the trust and loyalty of our clients.

1

48-hr.
Onboarding

2

Customizable
ESOP Dashboards



3

Simple yet
Intuitive Interface

4

Scenario
Visualization

5

Quick Support
& Services



Xumane

Using a tool like Xumane can help you streamline your ESOP operations to maximize your financial wealth via ESOP liquidity.

Ready to Simplify ESOP Management?

Schedule A Demo!

Contact Us Today