ESOPs FABLES

HARSHU GHATE, CO-FOUNDER AND MD, ESOP DIRECT

A member of the Institute of Chartered Accountants of India, Mr. Harshu Ghate is also a licentiate member of the Institute of Company Secretaries of India. He developed ESOP software solutions for the first time in India, and devotes time to ESOP consulting, US GAAP and statutory compliance issues. Interview excerpts follow:

Q. What led to the introduction of ESOPs in India?
A. Over past two decades, emergence of India as a knowledge economy, globalisation of Indian workforce, and awareness about new compensation trends led to the birth of ESOPs.

Q. How has the concept evolved since then?
A. I will answer this from the perspectives of the three stakeholders: investors, promoters/management, and employees. *For investors,* companies with ESOPs are rated higher than those without; higher dilutions for ESOPs are not objected to; and, accounting cost of ESOPs is usually ignored by analysts since it does not impact cash earnings. *For promoters/management,* dilution is no longer taboo; need for retention and attraction of talent overpowers the sacrifice of dilution; ESOPs is an integral part of any compensation discussion during CXO recruitment; and, accounting implications will become crucial, going forward. *For employees,* ESOPs are preferred despite market fluctuations; introduction of tax has not impacted attractiveness; and, many success stories are created for first-generation entrepreneurs.

Q. How do ESOPs make a difference to a company's compensation policy?
A. ESOPs are still an add-on, barring a few companies which provide them in lieu of variable pay. Here, the trend is performance-based options.

Q. What is the accounting treatment?
A. Introduction of IFRS (*International Financial Reporting Standards*) will require mandatory expensing of options. Currently, if the company grants ESOPs at market price, there is no charge to P&L. However, inspite of these changes, expensing will still be a notional charge as no liability is created. This charge is in appropriation of profits, leaving net worth unchanged.

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Q. Factors to evaluate before offering ESOPs?
A. The key points are: why we should grant ESOPs and to whom; what message/behaviour do we want to drive; how ESOPs fit in the compensation startegy; and, how much can we dilute (*in case of unlisted companies, how can employees encash since shares are not tradeable*). The objectives of all three stakeholders have to be considered and optimised.

Q. What trends do you anticipate in ESOPs?
A. I see companies who have been using ESOPs for some time modifying the option features; a relook at employee coverage, pricing, quantum of grant, etc. Companies that have diluted 8 to 10 per cent will face pressure to reduce incremental dilution, forcing them to look at new instruments. Introduction of IFRS may drive companies to design instruments that will optimise the accounting charge. Given the huge benefits, ESOPs' use will only increase in the days to come. In our recent survey, 95 per cent of the companies said that their ESOP plans had achieved the objectives, while 96 per cent said that ESOPs helped them in retention of key talent. We see wider acceptability of ESOPs in newer sectors, while the listed PSUs are mandated to pay between 10 to 25 per cent of variable pay through ESOPs. Public sector banks are also expected to follow, given the huge success in private sector banks. thf

Alankrita Srivastava