S.C.SHARADA & ASSOCIATES
COMPANY SECRETARIES

Unveiling the Differences: ESOP vs SAR

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This presentation explores the distinction between Employee Stock Option Plan (ESOPs) and Stock Appreciation Rights (SARs), providing a comprehensive analysis of their structure, benefits and implications.

Stock Based Compensation

In today's competitive environment, companies are increasingly offering stock-based compensation. Such two most popular compensation tools are

- ❑ **ESOP (Employee Stock Option Plan)**
- ❑ **SAR (Stock Appreciation Rights)**

The above two are majorly popular among startups and mid sized companies looking for an alternative compensations as a way to incentivize and retain the top talent thereby helping in cash outflow management and equity dilution.

Features:

- ✓ **Incentivize and retain the top talent**: Draw in and retain top talented and skilled employees.
- ✓ **Cash Flow Management**: Manage cash flow effectively without immediate payouts.
- ✓ **Equity Dilution:** Limits the equity dilution while still providing valuable incentives.

EMPLOYEE STOCK OPTION PLAN (ESOP)

Section 2(37) of the Companies Act, 2013 defines “employees' stock option” to mean the option given to the directors, officers or employees of a company which enables such directors, officers or employee, the benefit or right to purchase or subscribe to the shares of the company at a pre-determined price.

Further, Section 62(1)(b) governs the issuance of shares through ESOP mode. It states that such shares shall be offered to employees under a scheme of employees’ stock option, subject to approval of shareholders by way of special resolution and subject to such conditions as prescribed in Rule 12 of The Companies (Share Capital and Debentures) Rules, 2014.

STOCK APPRECIATION RIGHTS (SAR)

Stock Appreciation rights are a form of employee compensation that allows employees to benefit from the increase in the value of a company's stock over a specified period. In case of unlisted companies, this is not governed by Companies Act, 2013 but is implemented based on mutual agreement between the company and the grantee whereas the Securities and Exchange Board of India (SEBI) regulates Stock Appreciation Rights for listed companies through the SEBI (Share Based Employee Benefits) Regulation, 2014.

Unlike ESOPs, neither any shares are allotted to the grantee nor is there a payout required from the grantee's side.

A Comparative Insight….

Particulars	ESOP	SAR
Definitive	Allow employees to purchase shares of the company at predetermined prices typically lower than market value	Allow employees to receive cash payment based on appreciation of the company's stock
Ownership	Employee becomes owners of the shares	No such ownership granted
Financial Gains	Share comes as capital asset of the employees	Cash payments are received allowing employees to share the company's success
Employee Turnover	Bears Significant impact thereby reducing the same	Bears Significant impact thereby reducing the same
Company's Performance	Indirectly linked to Company's performance	Directly linked to Company's performance

Stock based compensation offers multiple benefits	ESOP	SAR
	Motivates employees when they hold stake in company	Avoids equity dilution
	Reduces employee turnover	Streamline compensation management reducing administrative burden
	Provides tax deferral benefits	Involves less regulatory compliances making them more accessible to implement
	Employee offers long term commitment	Attractive to employees and advisors
	Company conserve liquidity	Employees receive equivalent cash payouts based on stock appreciation bringing more liquidity to funds availability with employees

	ESOP	SAR
Every PROS comes with its own CONS	Equity is diluted	At times employees may feel little dissatisfied as unlike ESOP, SAR does not provide ownership and a future asset
	ESOP policy may be complex to set up and manage	Payment of SAR may for a time being impact the cash outflows of the company providing strain on financial resources
	Potential funds that might have been generated had the shares been issued to outsiders	Financial payout may put effect on operational capacity of the entity

Conclusion

In conclusion, both Employee Stock Option Plan (ESOP) and Stock Appreciation Rights (SAR) serve as effective tools for employee ownership and incentivization.

ESOPs provide employees with an actual stake in the company, offering long-term benefits through stock ownership and aligning their interests with the company's success. On the other hand, **SARs** allow employees to benefit from stock price appreciation without having to purchase the shares, providing flexibility and reducing the financial burden to purchase the share.

While each plan offers distinct advantages, both are powerful mechanisms for fostering employee engagement, improving retention, and driving organizational growth, ultimately benefiting both employees and the company as a whole.

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THANK YOU

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