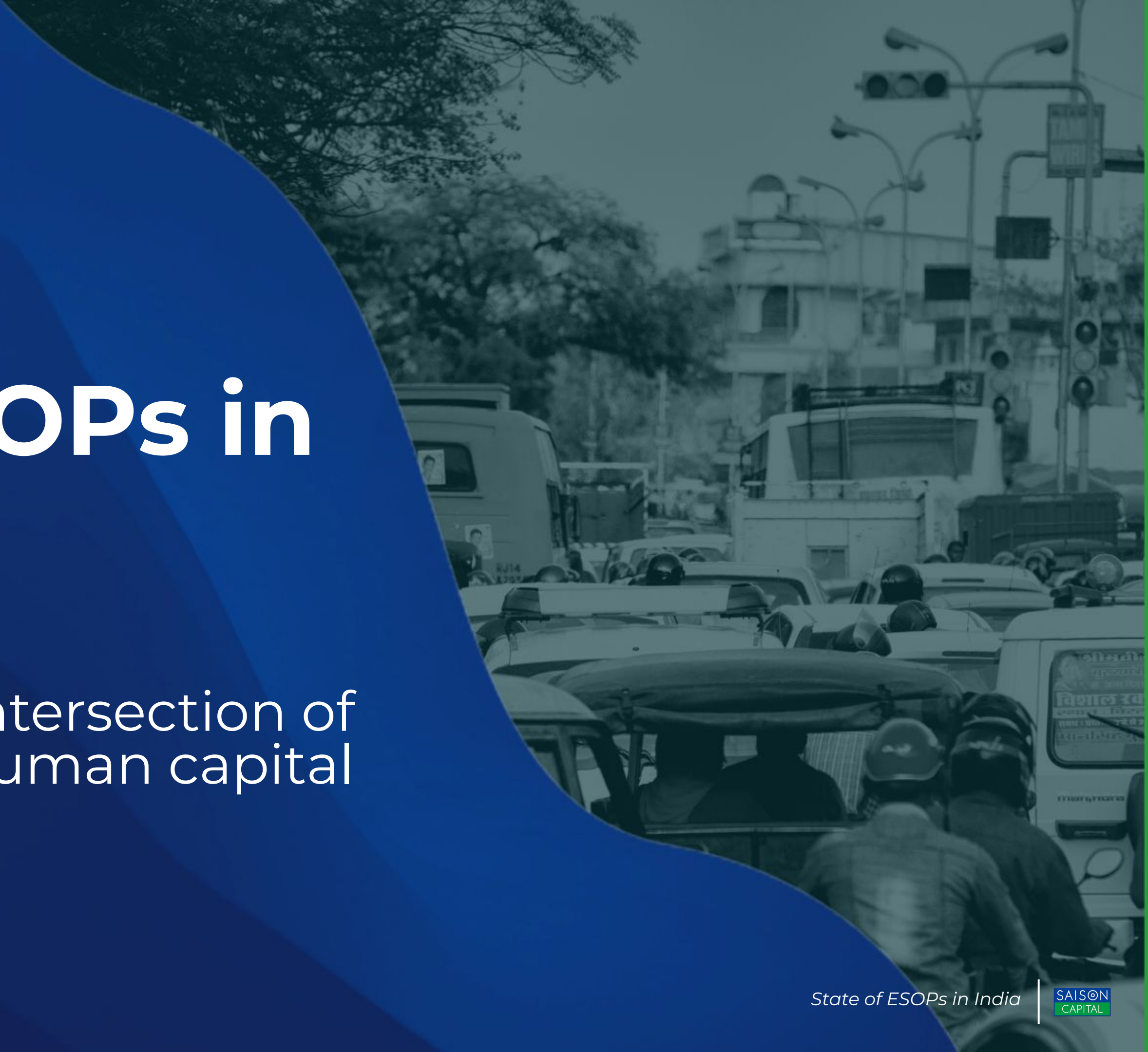
SAISON CAPITAL

State of ESOPs in India

A deep dive on the intersection of startup equity and human capital

2022 Findings



Foreword

The Emergence of ESOP Conversations

With a record-breaking US$63B invested in Indian startups in 2021, the technology ecosystem of the second largest population in the world has matured and a new era has arrived - one where opportunities are created at unprecedented pace.

Powering this accelerated growth are talent who are increasingly savvy on what is available to them, coupled with a growing desire to share in the risks and rewards of new venture creation. Cash-based compensation is no longer sufficient to attract and retain talent in high-growth technology companies, yet we often hear from founders challenges on how to structure effective employee stock option plans (ESOPs).

Inspired by the positive feedback and enthusiasm we saw from **The State of ESOPs in Southeast Asia** report, Saison Capital is excited to release a deep-dive landscape study focusing on India. We have seen the power of conversations to drive greater transparency and alignment between employers and talent, and are excited to once again engage with founders to understand the current state of ESOPs.

Companies that leverage ESOPs effectively will find themselves defining and leading a new generation's workplace expectations. But there's a little more to ESOPs than that.

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About Saison Capital

Saison Capital is an early-stage venture capital fund (pre-seed to Series B) with a focus on emerging markets.

We back ambitious founders solving big problems, including embedded finance - non fintech companies expanding into fintech, web3, e-commerce and more

Each individual in our team comes from an operating background, and we are unafraid to roll up our sleeves to support our founders.

We are backed by Credit Saison, a Tokyo-listed 30b AUM consumer finance company with extensive financial services across Asia.

Find out more at www.saisoncapital.com

About the Survey

1. Online survey of 45 questions; responses accepted 15 Nov 21 to 23 Feb 22.
2. Saison Capital portfolio companies and made up less than 5% of respondents.
3. 268 responses[1] from startups. 48 in the first 48 hours alone; reached 80+ responses within a week.
4. All survey results were solely evaluated on an aggregated, anonymous basis - we did not analyse individual companies.

Svested

Saison Capital would like to thank Svested, our collaboration partner, for their invaluable contribution and support to this report.

Svested is one of Southeast Asia's leading ESOP specialists. They advise founders in the planning and setting up of their startup equity strategy, and enable founders and employees to manage their ESOPs easily through a user-friendly digital platform.

Find out more at www.svested.com

[1] There are ~9,000 technology companies in India according to PitchBook
A sample size of 107 companies translates to a 95% confidence level at a 6% margin of error.
Confidence level is the percentage of confidence that the target population would select an answer within a certain range.
Margin of error is a percentage that the survey results would reflect the views of the overall population.

There is cause to celebrate...

This initial report offers a strong starting point to survey the state of employee stock option plans (ESOPs) in India. We are encouraged by several positive observations:

ESOPs are available from the start: Most founders that offer ESOPs implemented them at an early stage (seed or earlier).

ESOPs are not exclusive to executives: 4 out of 5 companies surveyed offer ESOPs to non-senior management employees.

ESOPs are fairly awarded to employees - even when they leave: Only a slim minority of startups dissolve all options (vested or unvested) on an employee's departure.

Employees are kept in-the-know from the start: Most startups explain ESOPs to their employees before the contract is signed. Encouragingly, this is driven by the majority of leaders who personally explain ESOPs to their prospective hires.

...and areas to work on

There are a few surprising insights that we think demand attention:

ESOP pools remain **relatively stagnant, even as companies progress through later stages of fundraising**. This may be due to founders being unfamiliar with ESOP top-ups.

Only **2 in 5 companies have defined good/bad leaver policies**, creating potential grounds for disagreement when an employee leaves the company.

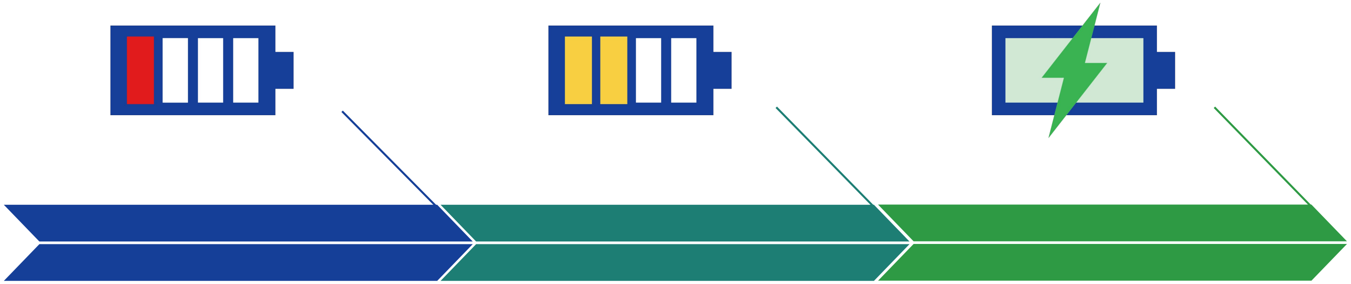
A **quarter of companies surveyed still rely on physical documents to manage their ESOPs**, not leveraging digital tools to simplify management and employee communication.

It's not all bad news: **leaders at startups want to improve**. For those without ESOPs, an overwhelming majority said they would implement ESOPs if the process was easier, and if guidance was available to them.

We hope this report serves to inform and educate - and if you're still struggling to wrap your head around ESOPs, fear not. We have our handy cheat sheet summarising the key takeaways at page 42.

Note on Findings

Of the 21 observations from this study, we identified more positive practices to keep up, and several opportunities for improvement



Opportunities for improvement

7

OBSERVATIONS

For example (page 14):
ESOP pools remain stagnant, even at later stages

Neutral

4

OBSERVATIONS

For example (page 18):
Most companies follow the 1 year cliff and 4 year vesting period.

Positive practices to keep up

10

OBSERVATIONS

For example (page 25):
More than 8 out of 10 leaders make the effort to explain ESOPs to their prospective hires.

Two regions in contrast: ESOPs maturity in Southeast Asia is evolving but India's a few steps ahead

The State of ESOPs in Southeast Asia

Launched in December 2021, The State of ESOPs in Southeast Asia has become the definitive guide to ESOPs for startups in Southeast Asia.

Download the report here

While both regions share more similarities than differences, we found that India is slightly ahead in the ESOPs maturity curve when compared to Southeast Asia. Notably:

	India	Southeast Asia
Founders who say they understand the risks of ESOPs well.	1 in 2 Founders	1 in 3 Founders
Startups that offer more than 12 months to exercise options, which allows employees sufficient time to shore up capital.	Nearly 50%	37%
Startups that dissolve all options (vested or unvested) when employees leave.	6%	20%
Startups that explain ESOPs to employees during the interview or at the point of the job offer.	9 out of 10	7.5 out of 10

ESOPs buyback activity is high among mature startups in India: a total of US$440M in 2021 (as reported here).

Table of contents

How founders in India understand ESOPs

Chapter 1

Culture, ownership and retention are key motivators for founders to implement ESOPs.

Reasons founders implement ESOP:

92%
To build culture and create a sense of ownership

87%
To retain talent

83%
To attract talent

25%
To save costs to increase liquidity

Founders are more likely to implement ESOPs to retain and attract talent, or to build a rewarding culture with a sense of ownership.

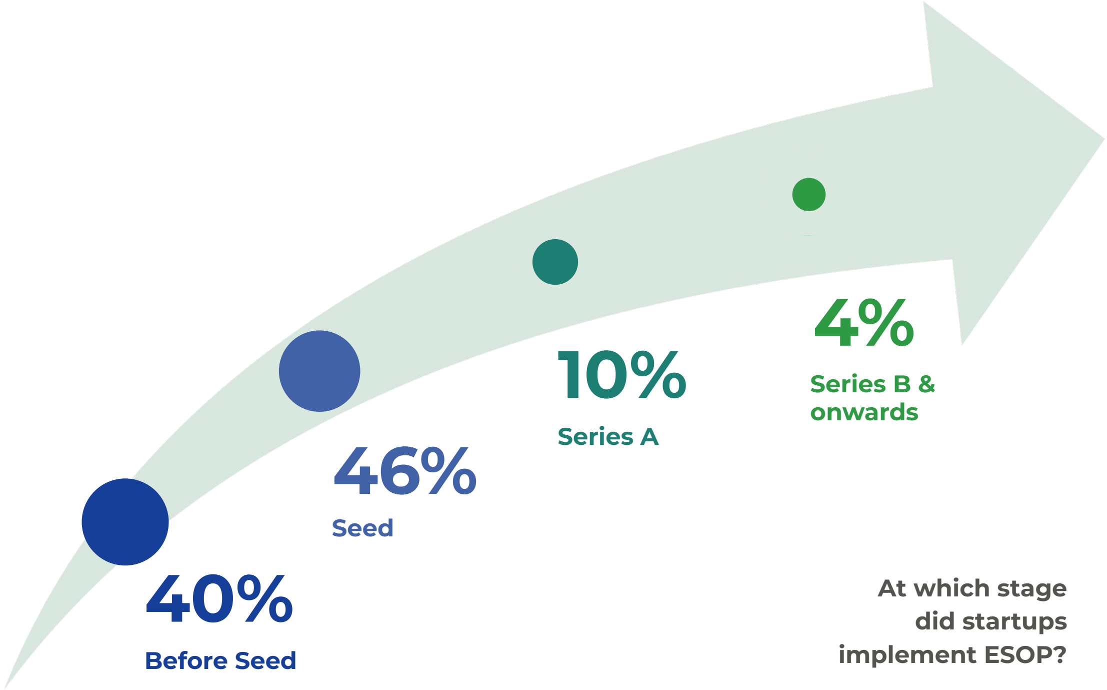
Only a minority of founders view ESOPs as a cost-saving device to reduce overheads spent on salary and other benefits. While ESOPs can reduce the initial cash spent on compensation, it is by no means a "cheap" fix - especially considering how it dilutes stock pools for future fundraising.

Most startups that set up ESOPs do so at **seed stage or earlier.**

- ESOPs help align incentives between investors, founders and employees. The earlier this happens, the more likely it will generate value for all parties involved.

- Early-stage companies often struggle to compete for talent with more established, well-funded peers.

- Offering ESOPs enhances a startup's value proposition; early employees can reap significant financial rewards when the company succeeds.

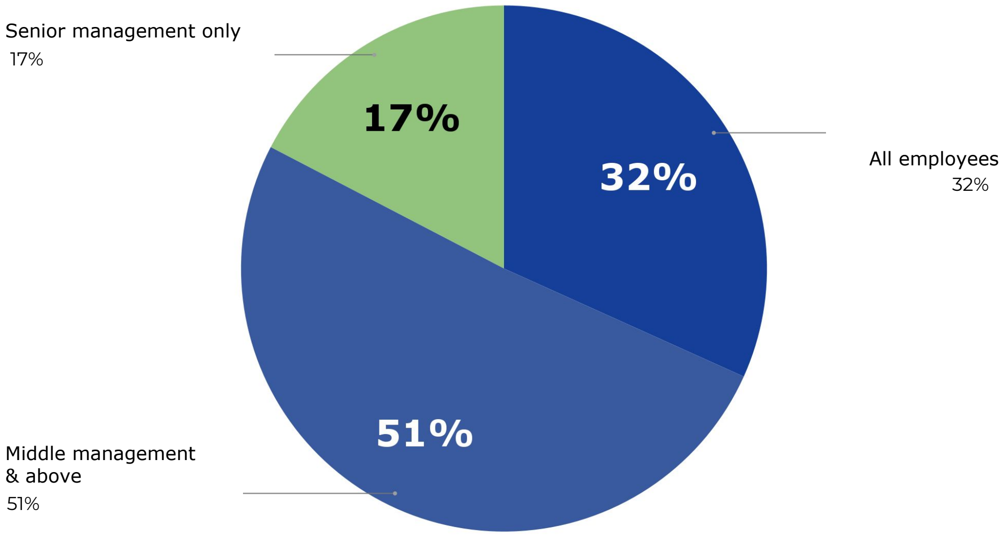


ESOPs for all: 4 out of 5 companies offer stock options to non-senior management employees

- The majority of Indian startups offer ESOPs to employees beyond the senior management team. Nearly 1 in 3 offer ESOPs to all employees, regardless of rank.

- This approach aligns incentives and motivations across the organisation and nourishes a culture of ownership.

Which employees do you issue ESOPs to?



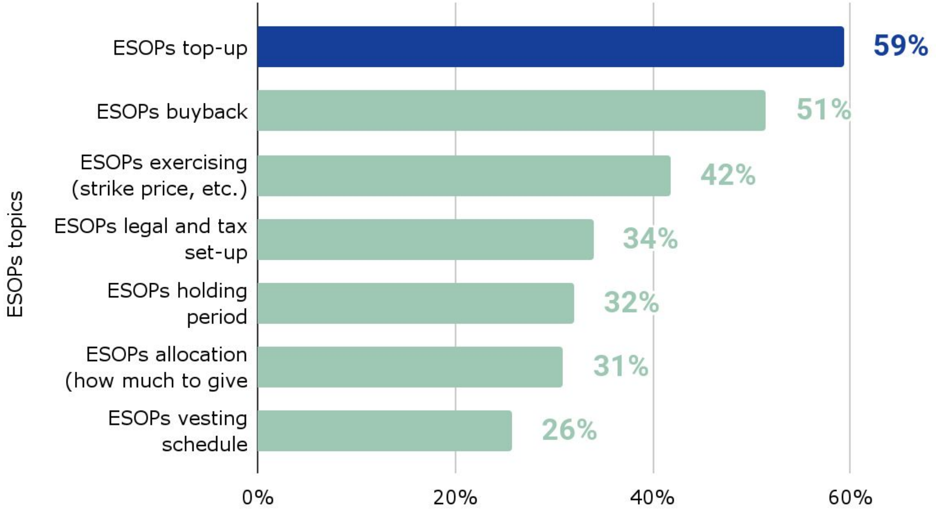
ESOPs top-up and buyback are the least understood topics among founders

While most founders understand ESOPs' vesting schedules, the majority do not understand **how to top-up ESOPs.** ESOP top-ups increase the pool of unallocated shares for future employee attraction and retention

This explains why ESOPs do not grow across subsequent rounds of funding (continued on p. 14).

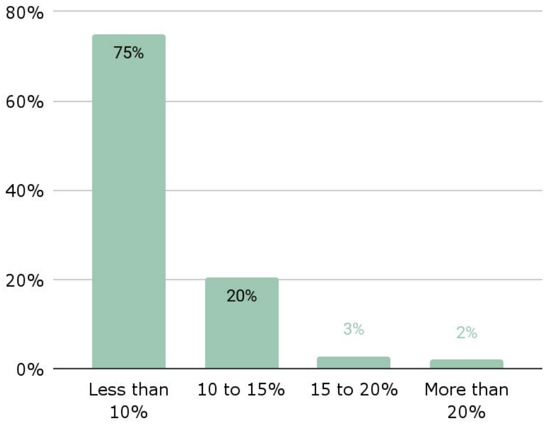
It is also concerning that 1 in 2 founders **do not understand how to translate ESOPs into cash** through buybacks. However, we are **starting to see an uptick in buybacks from mature startups in India**, which hopefully sets precedence for burgeoning startups.

Founders say they do not understand the following ESOPs topics:

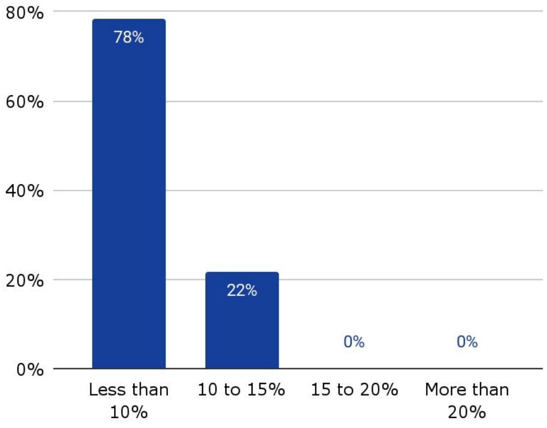


As a result, ESOP pools remain stagnant **even at later stages.**

Size of ESOP pool at Seed funding



Size of ESOP pool at Series A & beyond



- At Seed stage, 3 out of 4 companies have ESOPs of 10% or less.
- While the number of employees grow at Series A and beyond, ESOPs are not growing accordingly.
- This could impact attracting talent in future if there are not enough stock options to offer a competitive compensation plan.

While ESOP buy backs are less understood, an uptick in buybacks from mature startups has begun.

Top ESOP Buybacks in 2021

Flipkart	$80.5 Mn
Browserstack	$50 Mn
Swiggy	$40 Mn
UpGrad	$29.5 Mn
Zerodha	$27 Mn
Udaan	$23 Mn
CRED	$19.3 Mn
Sharechat	$19 Mn
PhonePe	$18 Mn
Healthyfyme	$12 Mn
Unacademy	$10.5 Mn
Chalo	$10 Mn
Khatabook	$10 Mn
Razorpay	$10 Mn
Zetwerk	$8.3 Mn
Urban Company	$7.3 Mn
Simplilearn	$6.4 Mn
Meesho	$5.5 Mn

- According to Fintrackr, more than 40 startups based out of India facilitated or announced ESOP buyback programs worth approximately $440 million in 2021.
- This represents an 8x increase in ESOP buyback compared to 2020.
- Many of these startups are unicorns or prominent industry leaders, setting an example for others to follow.

Source: Research collated by Entrackr, data sourced from Fintrackr and media reports

While 3 in 10 founders understand risks very well, 1 out of 2 have a limited understanding

Any financial instrument involves risk for both parties, so it is alarming to see how many founders have limited awareness of the risks associated with ESOPs.

20%
I do not understand well

32%
I have a rough idea

18%
I understand well

30%
I understand very well

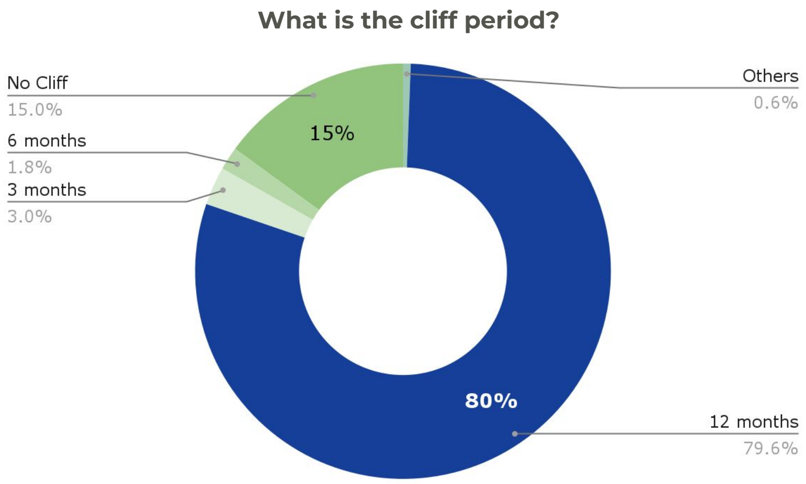
Potential risks include:

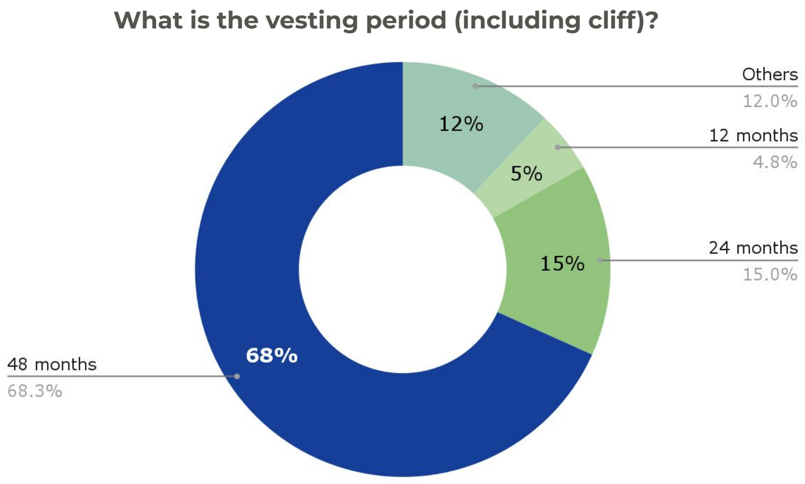
- Over- or under-capitalising ESOPs, which can impact talent attraction and retention.
- Legal implications of stock ownership can differ by the country that the company or employees are based.
- Tax implications on the company and employees, especially during exercise, buyback or liquidation.

The mechanics of ESOPs in India

Chapter 2

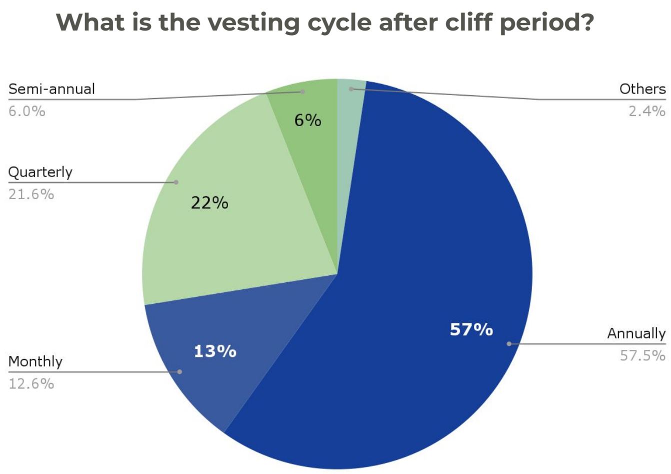
Most companies follow the standard ESOP structure - 4 year vesting period with a 1-year cliff.

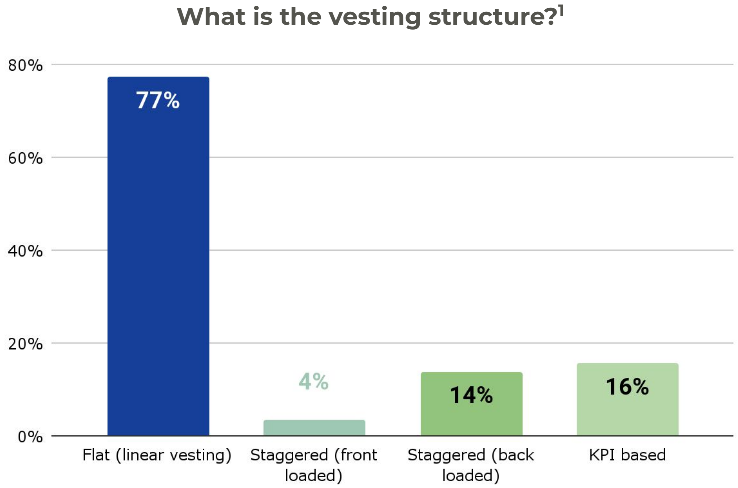




This aligns with the global industry standard in tech, including Southeast Asia (refer to The State of ESOPs in Southeast Asia).

Most founders adopt annual, linear vesting structures.





While annual vesting is the norm, monthly vesting may reduce the risk of mass attrition at the end of the financial year - when stock options typically vest, in the case of annual vesting. This surge may strain a startup's human capital strategy. Monthly vesting allows employees to be fairly compensated for their effort - one who works 11 calendar months before leaving should be entitled to a prorated reward.

Linear vesting structures are simpler to communicate and administer, compared to other forms. It creates predictability for both founders, employees, and administrators such as accountants and auditors.

[1] Founders were allowed to select more than one option, hence responses do not add up to 100%

Less than 1 in 2 founders offer a low or negligible strike price, a practice more founders could consider.

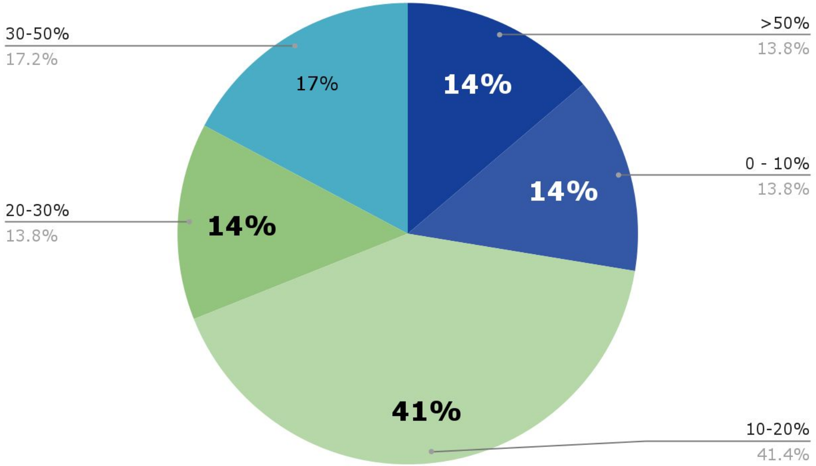
How do you set the strike price?

43% Low or negligible strike price

41% Based on the price per share for the latest fundraising round

16% A discount off the price per share for the latest fundraising round

Discount % for those who set a discounted strike price.

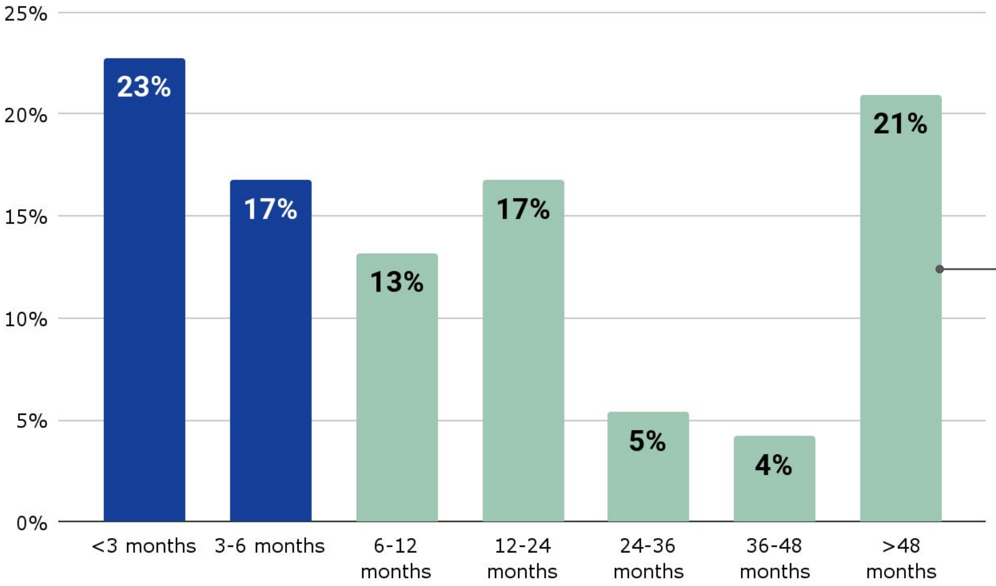


4 in 10 founders set strike prices in line with valuations at the last round, which means employees may not be able to afford the strike price, especially at later stages of funding. If employees cannot afford to exercise their stock options, their ESOPs are worthless to them.

The majority of startups offer limited discounts of 20% or less, which means employees still have to shore up sufficient funds to exercise ESOPs.

2 in 5 of startups give employees 6 months or less to exercise their options.

If a departing employee can exercise their options within a set period of time, what is that period?



We recognize **1 in 5 startups** offer **>48 months** to exercise options, and this should be celebrated and encouraged

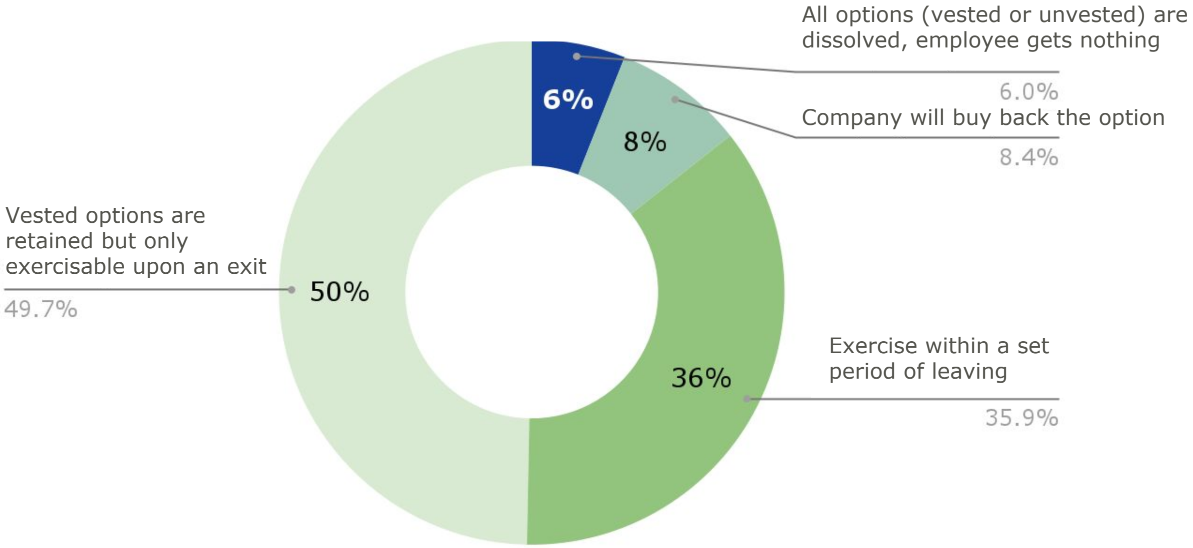
If an employee is leaving, they may struggle to acquire sufficient capital to exercise their stock options, meaning they risk losing them.

Furthermore, there are tax implications to exercise ESOPs. In India, gains from the exercise of ESOPs are taxable even when these gains are not realised in cash.

This can result in a 'double-whammy' for employees, who need cash to both exercise ESOPs and pay taxes on them.

Most startups **preserve vested options** when an employee leaves, which is a positive practice.

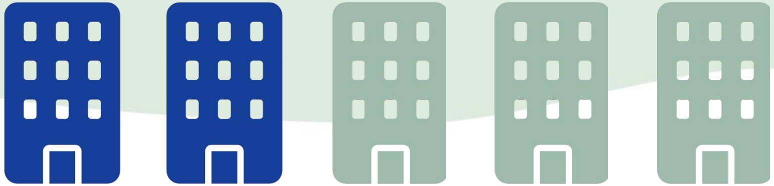
What happens to vested stock options when an employee leaves?



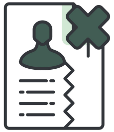
The practice of dissolving all options (vested or unvested) is detrimental as it means that employees who leave a startup **lose all of their ESOP benefits,** even vested options. This acts as golden handcuffs: employees must stay in their role to realise the value of their ESOPs once the company succeeds.

It is cause for celebration that most startups in India preserve vested options; **only a slim minority dissolve options.**

Only 2 in 5 startups operate good/bad leaver policies for ESOPs.



But those who define bad leavers tend to do so fairly.



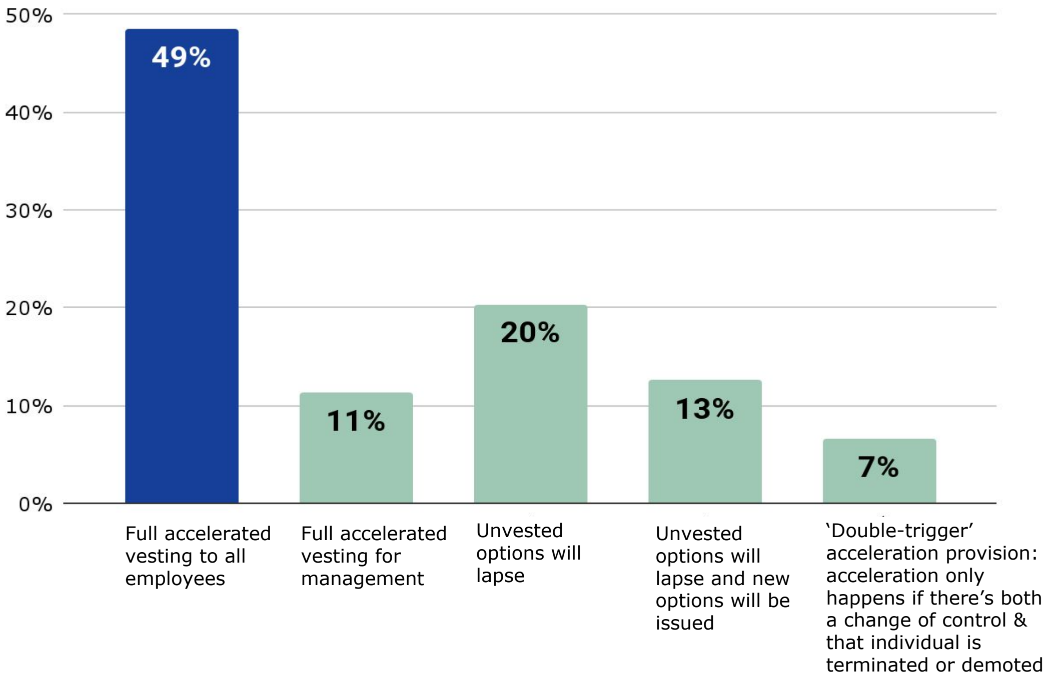
According to startups, a bad leaver is an employee involved in fraud, negligence or in breach of confidentiality (91%) or fired for major disciplinary breaches (76%).

All startups surveyed do not consider employees who choose to leave as bad leavers.

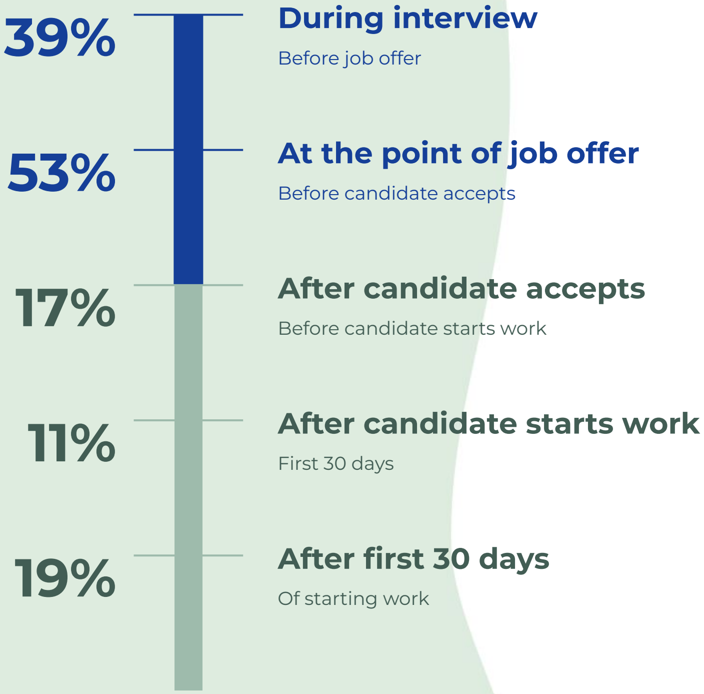
However, 1 in 3 startups consider employees terminated for poor performance to be bad leavers, which could create conflict. A good/bad leaver policy ensures all employees understand how leaving may impact their ESOPs.

Only 1 in 2 companies offer accelerated vesting to all employees in a liquidity event.

- A liquidity event should offer the whole team a chance to reap the rewards of their ESOPs, even if only partially.
- 11% of startups only offer accelerated vesting to senior management; excluding the rest of the company from the benefits of a liquidity event.
- A shocking 1 in 3 companies let unvested options lapse. For those who issue new options, employees risk losing potential financial upside, as the clock for cliffs and vesting "restarts."



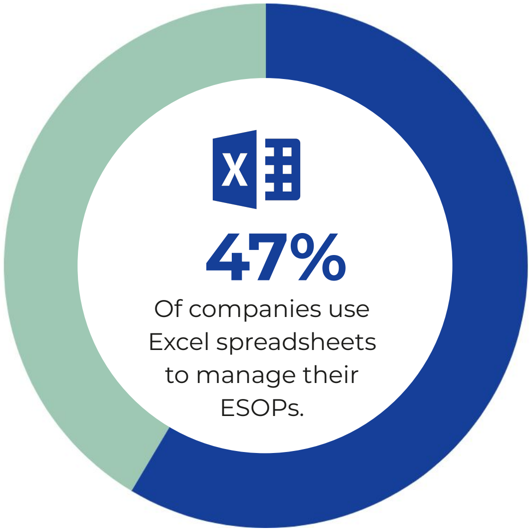
Most startups explain ESOPs to their employees before the candidate accepts the job.

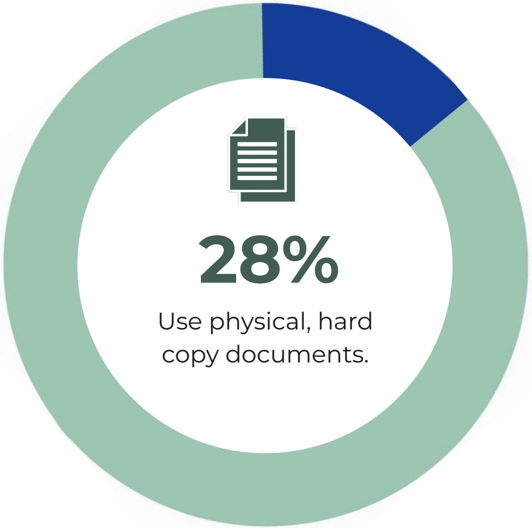


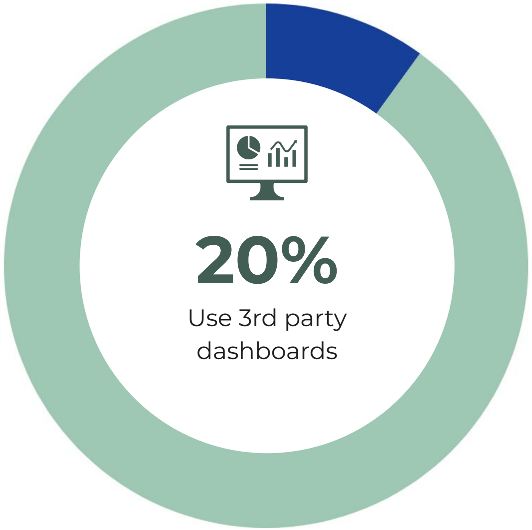
More than 8 out of 10 leaders personally invest time to explain ESOPs to their prospective employees.

Founders were allowed to select more than one option, hence responses do not add up to 100%

Startups are still using **outdated methods to manage ESOPs.**



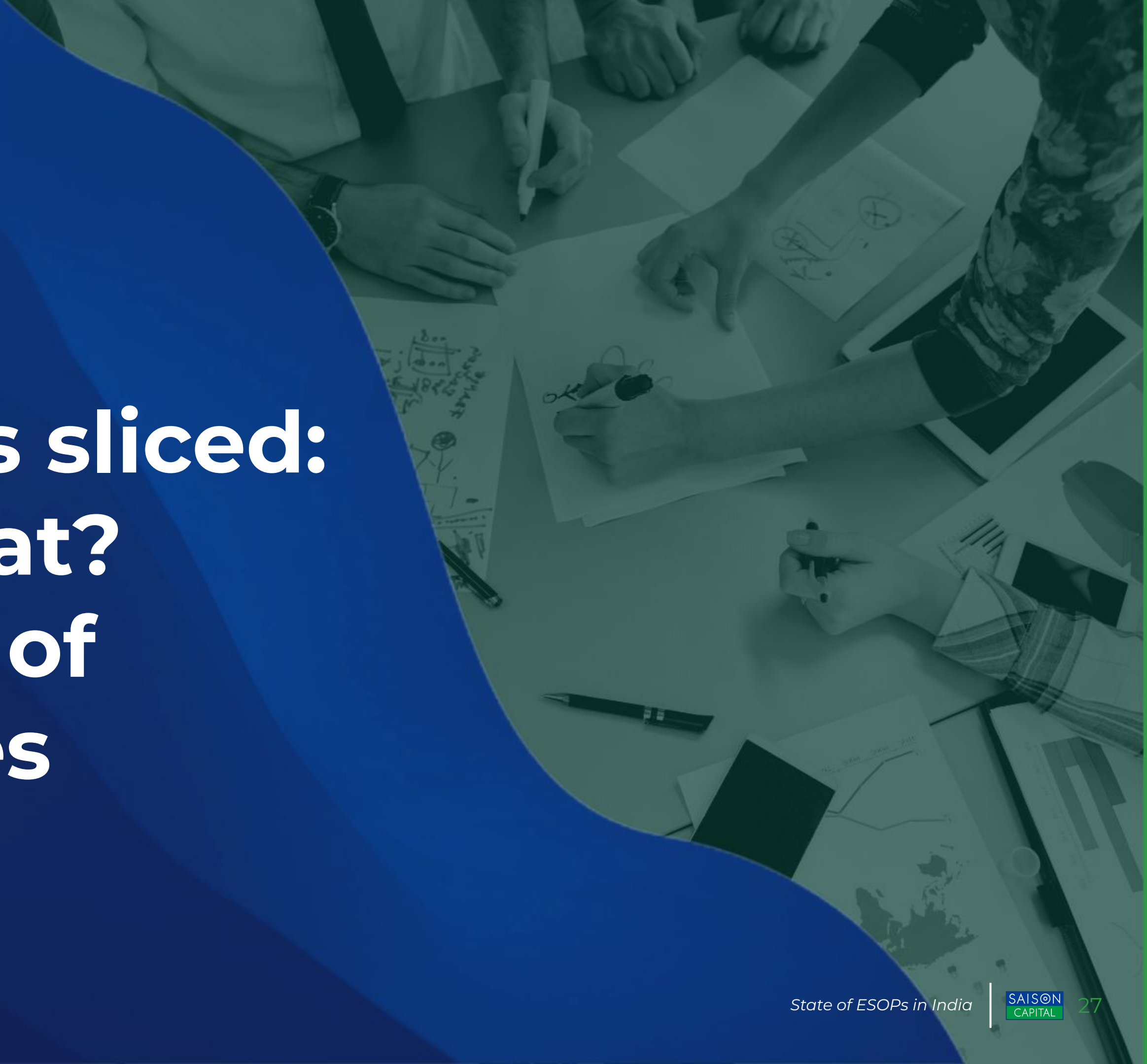




Only 1 in 5 startups use a purpose-built dashboard to manage ESOPs.

Dashboards allow employees to see and manage their own ESOPs. This should become more common to promote greater transparency and awareness among founders and employees. As ESOPs update frequently, dashboards keep employees informed and reminds them of the value of their ESOPs.

How the pie is sliced: Who gets what? A breakdown of ESOPs by roles



Chapter 3

Overview of ESOPs awarded across the organisation

Median ESOPs as a % of company shares:

1-3%
Leadership

0.25-0.5%
Senior Technical

0.25-0.5%
Senior Non-technical

0-0.1%
Junior Technical

0-0.1%
Junior Non-technical

Median ESOPs as a % of annual cash compensation[1]:

40-60%
Leadership

20-40%
Senior Technical

20-40%
Senior Non-technical

0-20%
Junior Technical

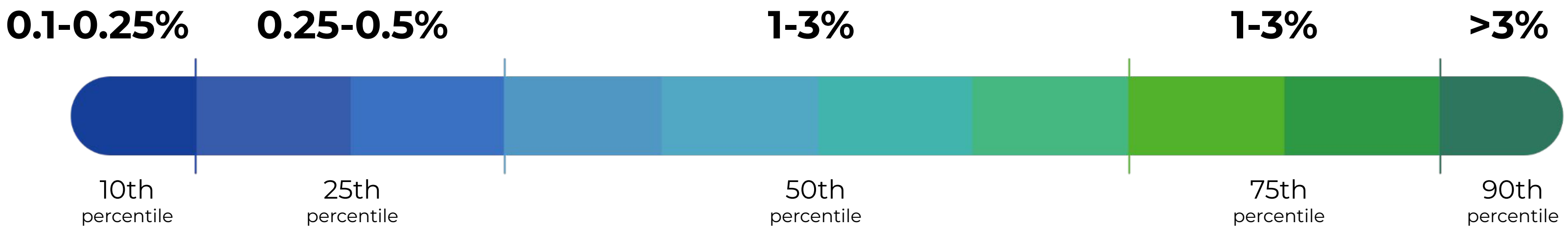
0-20%
Junior Non-technical

[1] For example, if a leadership employee has an annual cash compensation of $100K, they receive $40-60K in ESOPs on top of cash compensation (40%-60%)

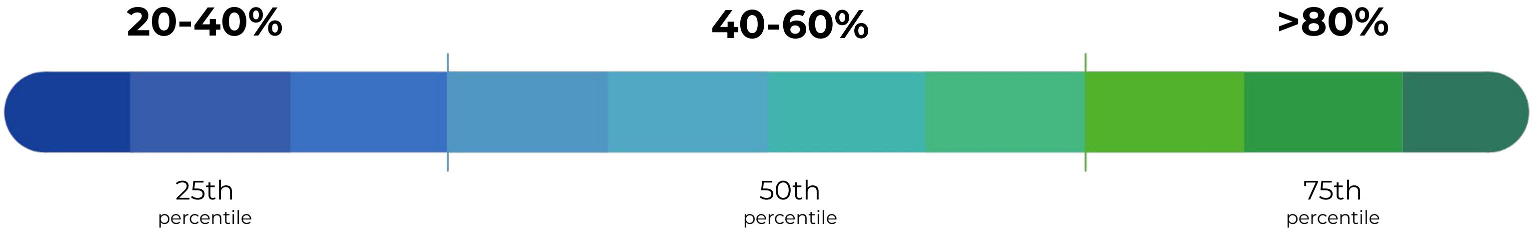
Leadership

This is the senior management team: Directors; the C-Suite; Executives.

ESOPs Received (as a % of total company shares):



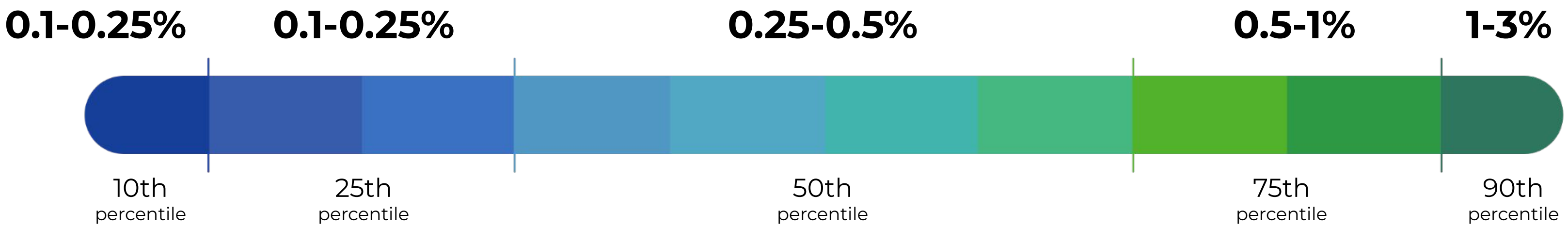
ESOPs Received (as a % of annual cash compensation):



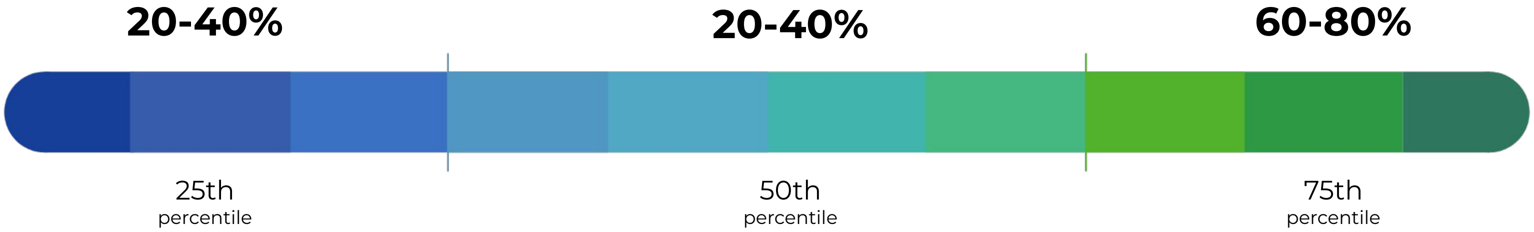
Senior Technical

Technical team members work in the product and technology side of the business.

ESOPs Received (as a % of total company shares):



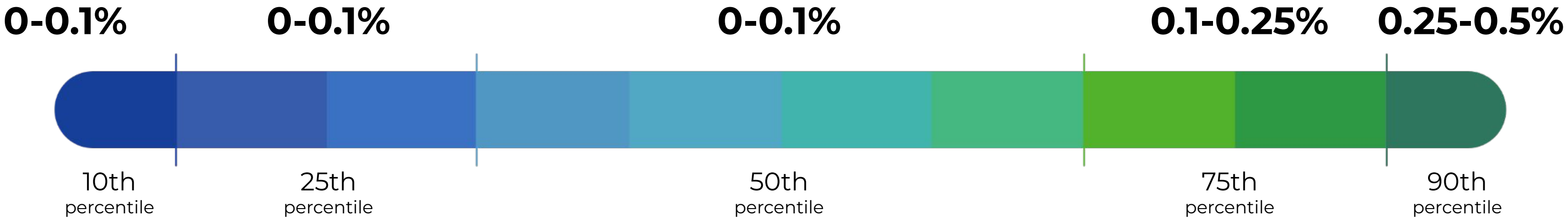
ESOPs Received (as a % of annual cash compensation):



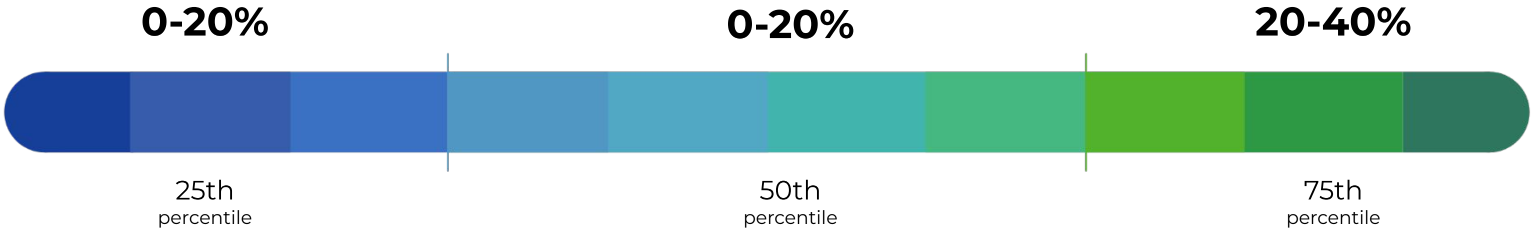
Junior Technical

Technical team members work in the product and technology side of the business.

ESOPs Received (as a % of total company shares):



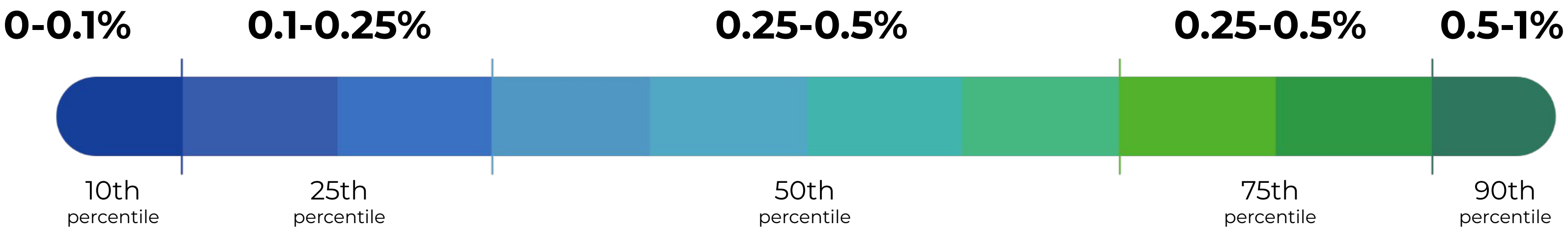
ESOPs Received (as a % of annual cash compensation):



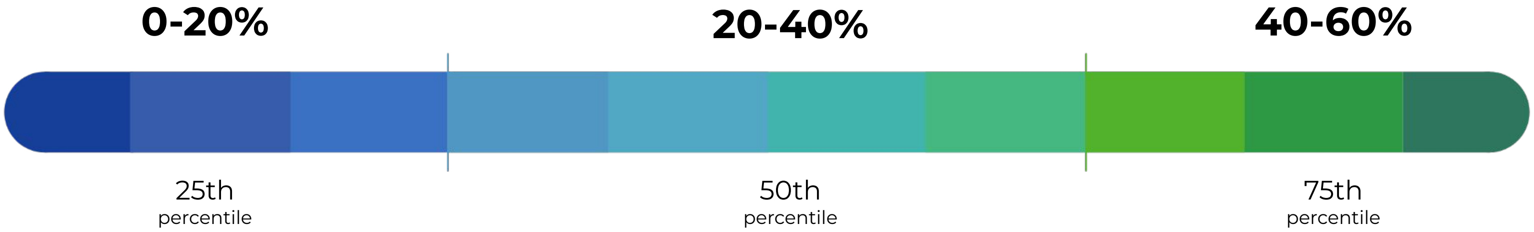
Senior Non-Technical

This includes Operations, HR, Marketing and Sales team members.

ESOPs Received (as a % of total company shares):



ESOPs Received (as a % of annual cash compensation):



Junior Non-Technical

This includes Operations, HR, Marketing and Sales team members.

ESOPs Received (as a % of total company shares):

10th percentile	25th percentile	50th percentile	75th percentile	90th percentile
0-0.1%	0-0.1%	0-0.1%	0.1-0.25%	0.25-0.5%

ESOPs Received (as a % of annual cash compensation):

25th percentile	50th percentile	75th percentile
0-20%	0-20%	20-40%

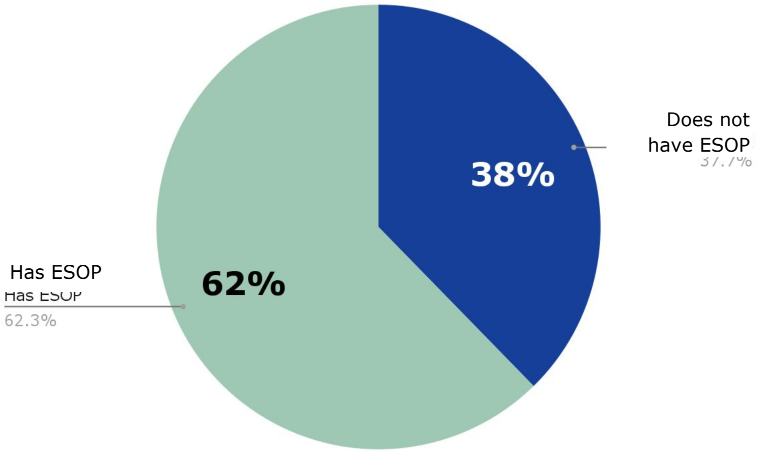
ESOP FOMO* in India

Chapter 4

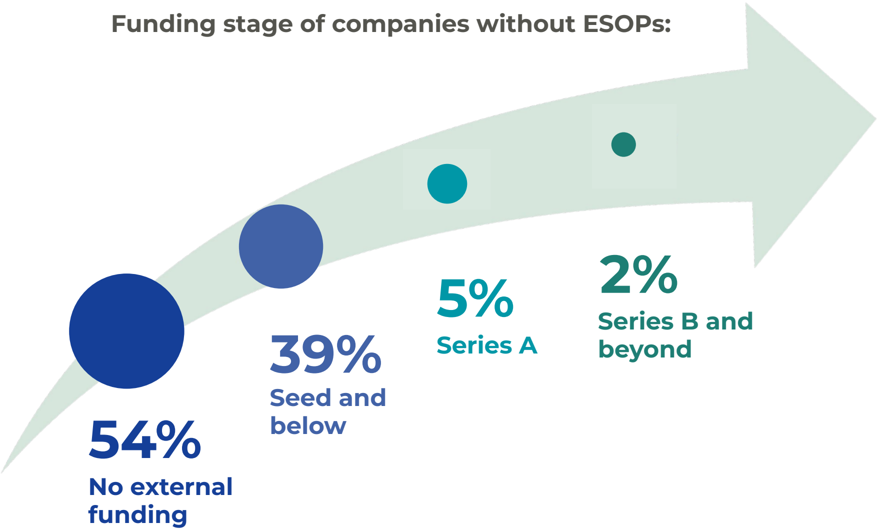
*FOMO: Fear of missing out

2 out of 5 startups in India do not use ESOPs.

Does your company have ESOPs in place?

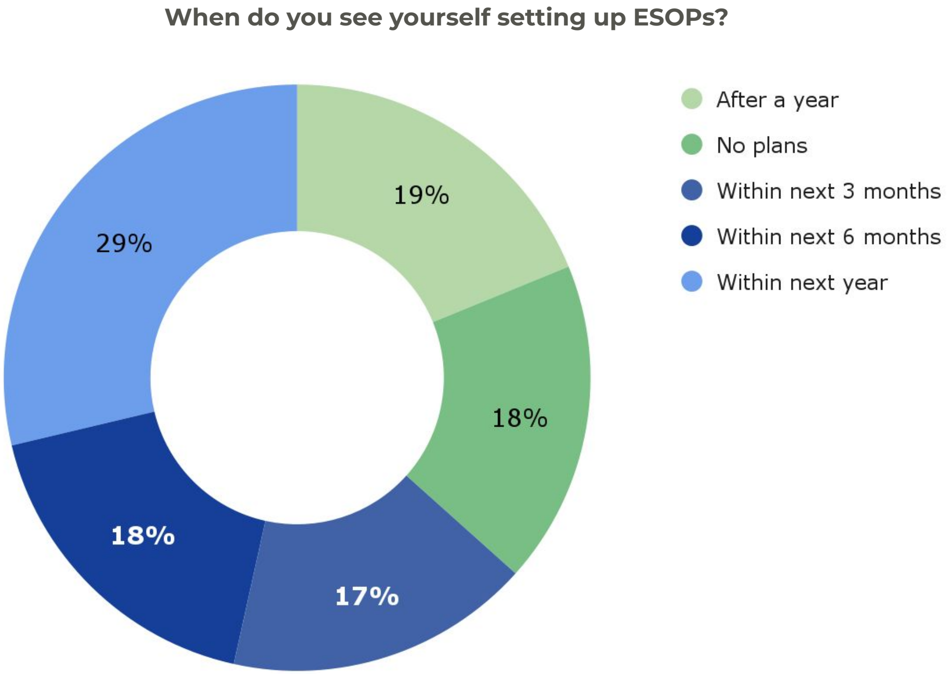


Funding stage of companies without ESOPs:



The majority of companies that do not have ESOPs are seed stage (or earlier) or have grown without external funding.

1 in 3 of these companies intend to set up ESOPs in the next 6 months.



Around 2 in 10 startups who do not have ESOPs have no plans to set them up. There is a clear need to improve awareness of and education around ESOPs and their benefits for startups and talent alike.

The greatest hurdles to ESOP adoption are doubts over their efficacy or setup process, and tax implications.

The top 3 reasons that companies without ESOPs do not use them:

- **48%** Uncertainty around how effective ESOPs are in attracting (and retaining) talent
- **38%** Tax implications of ESOPs
- **37%** Unsure how to set ESOPs up

- **34%** Not enough information about ESOP
- **32%** Accounting and audit implications
- **30%** Legal implications
- **20%** Ownership dilution
- **20%** Complicated administrative process
- **17%** Not sure what is ESOPs or how it works
- **12%** Majority of employees do not want it

While India has started taxation reforms on ESOP, challenges still exist - especially for employees

2020

Taxation on ESOPs was removed for selected startups

(under Section 191 of the Income Tax Act, 1961)

Selected criteria:

1. Startups incorporated after April 1, 2016
2. Registered with the Department for Promotion of Industry and Internal Trade (DPIIT) under the Startup India initiative;
3. Annual revenue of less than Rs 100 crore.

0.5% of startups in India eligible for tax waiver

(source)

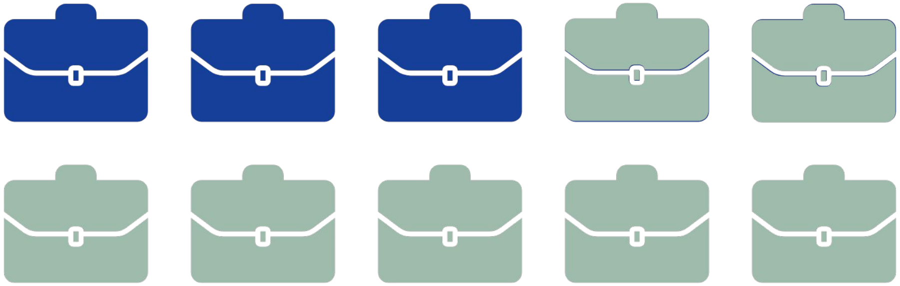
Other challenges include

- Double taxation on exercise and liquidation:
  Tax 1: when ESOPs are exercised based on the Fair Market Value (FMV)
  Tax 2: at the time of buyback or secondary sale of shares, if the selling price is higher than FMV
- Tax is applicable once employees leave the startup and exercise the ESOPs, meaning employees have to pay a hefty tax bill before receiving any up-side.

Investors and talent play a key role in motivating leaders to **adopt ESOPs.**

3 in 10 founders

who are setting up ESOPs in the next 6 months were asked to do so by investors and/or employees, revealing the critical role these stakeholders have in establishing an ESOPs infrastructure.

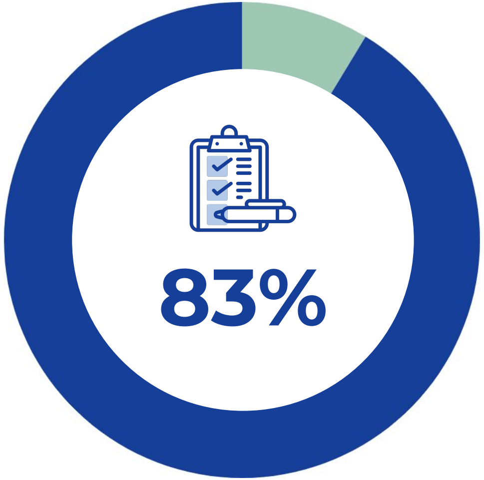


In contrast…

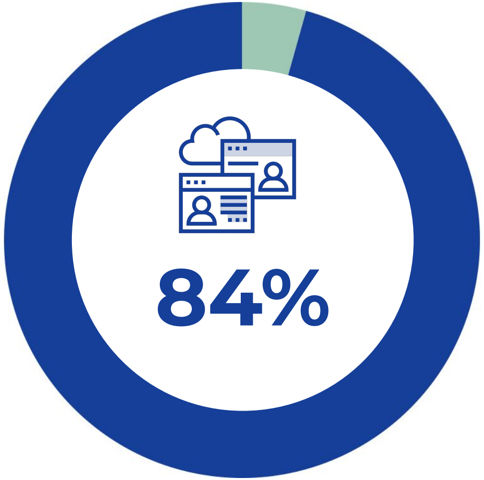
- Those not planning to set up ESOPs within the next 6 months had less pressure from investors and employees:
- Only 8% of these founders said investors had asked them to set up ESOPs.
- Only 5% of these founders said employees had asked them to set up ESOPs.

Simplifying the process is key to encourage higher ESOP adoption among founders.

93% of founders would be willing to implement an ESOPs strategy if there was **someone to guide them through the structuring and setup process.**



95% of founders would be willing to implement an ESOPs strategy if there was a **platform that made the administration process easy.**



Could this be an emerging niche of Startup Service as a Service startups?

The three stages to ESOPs success

Chapter 5

Three stages to ESOPs success.

1. Plan

Understand:
Invest the time to understand ESOPs, from setup and structure to management and risks

Strategise:
Be clear on what purpose ESOPs serve, and be transparent to the team

Start Early:
Implement ESOPs at seed-stage or earlier (e.g. angel, friends/family)

Standardise First, Iterate Later:
4-years vesting + 1-year cliff

Vest More Frequently:
Vest shares monthly

2. Include

ESOPs For All:
Offer the whole team ESOPs, not just senior management

Make ESOP Strike Prices Accessible:
Offer generous discounts or set a negligible strike price to make ESOPs affordable

Make ESOP Exercise Periods Accessible:
Offer a longer exercise period to allow employees who leave to remain connected with the company

No Golden Handcuffs:
Establish good leaver / bad leaver policies; be fair and transparent around them. Then, uphold good leaver policies, such as not dissolving employees vested options on departure.

Reward:
Accelerate vesting upon liquidity events

Educate:
Explain ESOPs to employees before they accept the job offer

Engage:
Founders / senior leaders should do the explaining.

3. Scale

Grow:
Plan to grow your ESOPs as you fundraise subsequent rounds

Educate:
Explain ESOPs to employees before they accept the job offer

Engage:
Founders / senior leaders should do the explaining

Manage:
Figure out the right tools to manage ESOPs for your company - Excel might not be the best

Realisation:
Consider introducing or facilitating a buyback or sale of ESOP

Conversation:
Talk more about it - facilitate industry conversation

Appendix

Demographics of survey respondents: Vintage

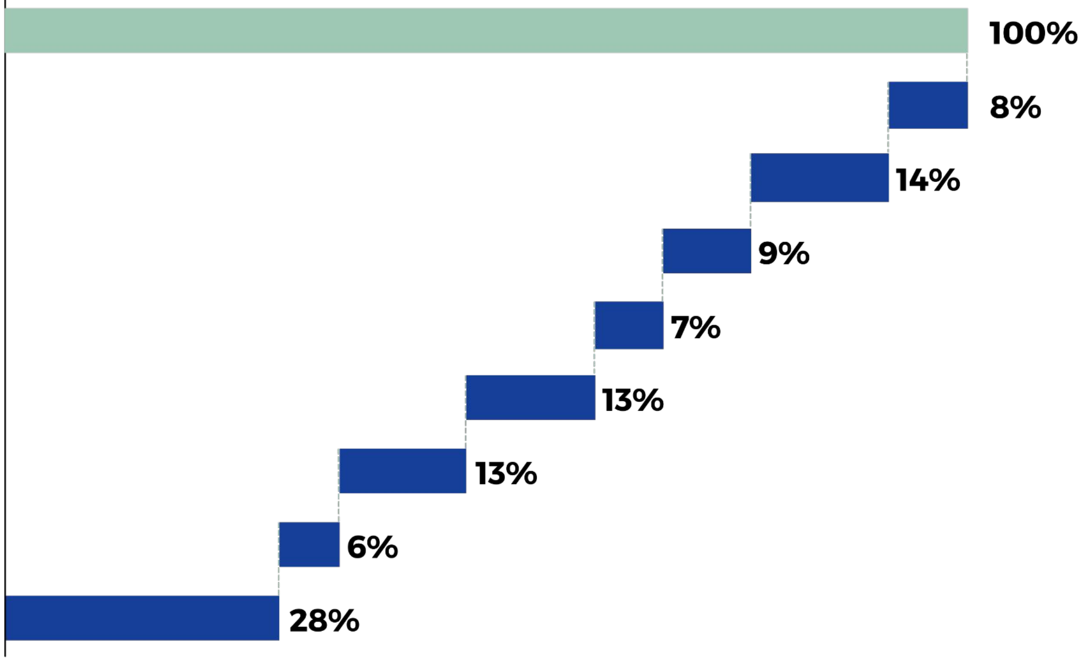
A total of

268

Companies took part in the survey.

This table reflects the year the companies were founded:

Year of founding	#
Total	268
2021	22
2020	38
2019	23
2018	20
2017	36
2016	36
2015	17
2014 or earlier	76



Demographics of survey respondents: Industries

Demographics of survey respondents: funding and team size

Stage of funding:

%	Stage	Companies
27%	**No external funding**	72 companies
48%	**Seed and below**	130 companies
15%	**Series A**	40 companies
5%	**Series B**	13 company
5%	**Series C and beyond**	13 companies

Team size:

Team size	%	Companies
51-100	20%	53 companies
26-50	15%	40 companies
11-25	18%	48 companies
201 & ABOVE	18%	48 companies
101-200	12%	32 companies
1-10	17%	47 companies

Glossary

Buyback	The process where the company may choose to buy back an employee's stock options before a liquidation event at a mutually agreeable price, so that employees can realise value.
Cliff Period	The lock-in period before employees are entitled to their vested stock options.
ESOP	Employee Stock Option Plan
Exercise	The process of converting a stock option to a share.
Exercise / Strike Price	The amount to be paid by the employee to convert a stock option to a share.
Exercise Period	The time period which the employee can convert the stock option to a share.

Liquidity Event	An event, usually involving an external party, where the valuation of the company is re-assessed and additional capital is injected into the company or to shareholders. Usual liquidation events include IPO or an acquisition / investment in which the incoming owner becomes a majority shareholder.
Secondary Markets	A market where employees sell stock options to other investors, rather than to the company (buyback).
Stock Option	A stock option gives employee the right, but not an obligation, to purchase shares in the company.
Top Up	Increasing the number of available stock options for current and future employees.
Vesting	The process where employees earn their stock options over time. Vested stock options refer to stock options that have been earned by the employee.
Vesting period	The time period for the awarded stock options to be distributed across.

Thank you

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