
CLIENT NOTE

**SO, YOU WANT TO KEEP THE BEST FRUITS, HUH?
See what ESOP can do for you!**



OVERVIEW

It's a constant struggle out there. The struggle is not only about rolling out the most competitive products or cutting the biggest market share but also about hiring and keeping the best and brightest of them all. That's right. Employees. This Note is not about the most sensible hiring, retaining, training and promoting strategies. We will leave that to HR professionals. We will talk

The Employee Share Option Plan is a tool that one can use to attract, motivate and retain the best team. Before jumping the fence and introducing such a plan though, businesses have to give much thought about how is the best way to set up a plan and stick to it. This Note tries to lay out some of the strategies and issues worth giving some thought.

though about Employee Share Option Plans or ESOPs and see how those can help businesses keep the keepers.

FIRING THE BRAINPOWER



Employee brainpower intensive companies when become mature, start thinking about ways in which they can retain the best and the brightest. One of the ways in which they can do that is through putting together an ESOP. Thanks to various good policies in certain sectors of the economy such as data sciences, engineering, financial, agriculture, etc., some Armenian enterprises are taking steps to integrate some of their employees into their shareholding structures.

Bringing in key employees as equity participants has number of advantages and gives the enterprise a competitive edge vis-à-vis its peers:

- Have employees work for results and value creation;
- Mitigate the brain drain towards competitors;
- Keep the talent at home and not lose those beautiful minds to foreign markets (one or two decades ago this was a risk for the Armenian government mainly, but nowadays and for the past years this is a serious risk also for local private enterprises);
- Motivate those in rank and file to climb the ladder;
- Keep the cash in business.

AFTER ALL, WHAT'S ESOP ANYWAY?

An ESOP is basically a plan or a program, based on which the company gives options to the employees to buy the company's shares at a predetermined price (called the strike price), which is usually considerably lower than the share price of the same company in the future. One has to remember though that an OPTION to purchase company shares is the RIGHT of the employee and not an obligation. Of course, the distributed options are binding upon the issuing company.

Not to complicate things, we have to mention that there are three major option types:

- The Classic Stock Option, which gives employees the right to buy ordinary shares at the "strike" price in the future;

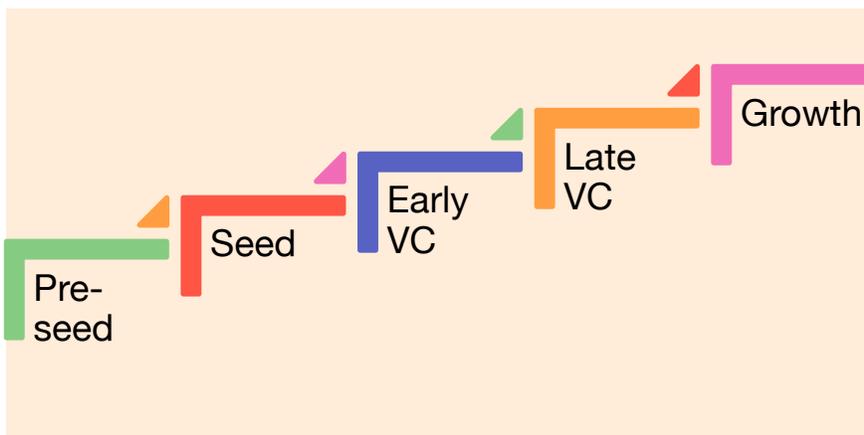
- Top Dog Option (or Restricted Stock), which gives the TOP employees to buy the ordinary shares at the “strike” price;
- The Promise Option (or the Restricted Stock Units), which basically is a promise by the company to issue the ordinary shares at a future date (basically when the company is really doing good).

WHO IS ESOP FOR?

Does the above mean that an ESOP is a corporate policy primarily worthy of mature companies? No, not at all. We would certainly argue that an ESO plan can be set and used by companies at all stages of developments. Actually, the earlier the founders of an enterprise set up such a plan, the better. See below for yourself. In all the bellow stages of company development from pre-



seed to growth, founders can set up the plan. Of course, we have to understand that during pre-seed, the founders are worried with and busy tuning up other aspects of the product or the company and an ESOP is usually not the first thing that comes to their minds. Who said they shouldn't though?



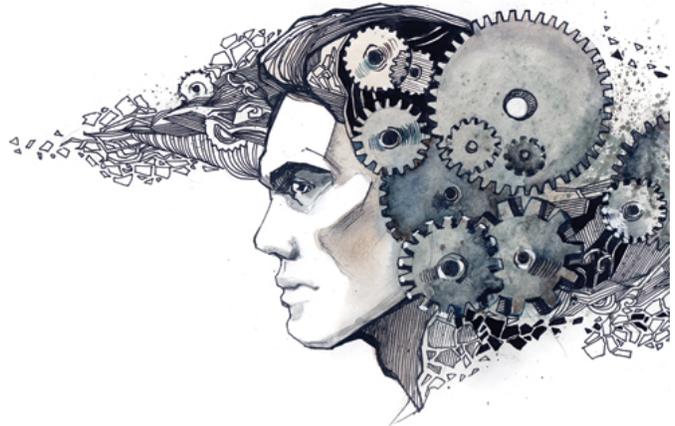
Actually, at the VC (sorry, got carried away. It stands for Venture Capital) stage the venture investors would probably look for a well thought plan to be in place and if it's not, then they probably would ask for one to be set up. Why? For two reasons:

- 1) To attract top talent into the venture-backed enterprise,
- 2) To avoid burning the valuable cash for the hired talent (Greedy, huh? Not really. Efficiency is the name of the game!).

Simple as that!

CONSIDERATIONS

All convinced that introducing an ESOP plan is the right thing to do? Easy tiger! There are many aspects that one should consider and think through before setting up a program.



Now let us see what is there to think about.

- **Jurisdiction**

Where do you want to set up your ESOP? Is that jurisdiction favorable to ESOPs? Sorry to say that Armenia is NOT a favorable destination (anyone from the Armenian government/parliament reading this?). Don't worry though. If your business is set up in Armenia, you can still have an ESOP plan in a favorable jurisdiction.

- **Taxation**

Tax is a very big consideration. What would be the taxes that might be levied in any stage of the plan? Is there a specific language in the tax law of jurisdiction of choice that favors one ESOP scheme to the other?

- **VC origin**

Where do your VCs come from? What's familiar to them?

- **HR policy integration**

How would you integrate your ESOP with your HR policies? Who would get into the plan? When? Who's next?

- **Law of Wills (inheritance)**

How will the options or shares be inherited? What would be the restrictions if any?

- **Divorces and prenuptial agreements**

How will the options or shares stay with the divorced employee? Will those be transferred to the spouse? What if there is a prenuptial agreement? What would be the restrictions if any?

- **Early termination of employment**

What would happen to the options or shares if the employee quits prematurely? What if you fire the employee? What if the employee terminates the employment because of an accident at work or physical/mental disability?

- **Retirement plan**

How would your ESOP work with your retirement plan? What about early retirement?

Well, this list can be extended based on industry, maturity, jurisdiction, holding structure, etc.

HOW CAN WE HELP?

Our team has extensive experience in helping both true startups and mature companies set up programs that either introduce share options or some other form of employee equity participation. So please, do get in touch when you want to get sophisticated advice.

NOTE: This material is for general information only and is not intended to provide legal advice

Varoujan Avedikian, Managing Partner

vavedikian@tk.partners

