

ESOP: Paving hospitality growth

Express Hospitality October 16 - 31, 2007, Page No. 58-59

Employee Stock Option (ESOP) scheme is emerging as a great retention tool for the hospitality sector. But it has the potential to churn out a new chapter of progress for the sector. By **Sanjeev Bhar**

Of late, hotel companies have embarked on a journey to keep top officials glued to their existing positions within the organisation. Employee Stock Option (ESOP) has come to fore as a conservator of sorts and is being viewed (as per conventional think) to play a changing HR role in times to come in the Indian hospitality sector. But the obvious question that comes to mind is how the corporate culture of distributing shares to employees will be translated into hospitality, and whether it would play as h3 a retention role as it is expected to. Many in the industry believe that the expectation is inconsequential. ESOP's role should be viewed more rationally with a macro perspective as a contributor to the sector's growth and not merely as a defense mechanism to tackle HR issues.

Stock option as HR tool

Recently, with lot of focus veering towards ESOP, the Confederation of Indian Industry (CII) organised a meet in the Capital on "Employee Benefits and Long Term Incentives: Employee, Employer and Cost Perspective." It was understood that ESOP is not only a reward for employees; 'Total Employee Value Proposition' should be the key to retain the employees. This suggests ESOP has a larger perspective to it. Hospitality sector in many ways contradicts conventional industry rules. On whether ESOP would work as a retention tool in the hospitality sector or not, Tarun Gulati, vice president, ESOP Direct says, "ESOPs work in every sector so long as value is being created. It would be interesting to note that ESOPs are now being used extensively even in construction/real estate companies, which are figuratively, as well as literally, brick and mortar companies." "The basic principle of stock options is to share value, and remains the same, irrespective of the sector," he adds. Agreeing with that fact, Rahul Pandit - vice president (operations & people), Lemon Tree Hotels explains, "ESOPs should be seen as a h3 HR tool for sure but not restricted to retention needs. We can boast of the fact that our company made 11 millionaires, in least time ever imagined, due to the fact that we believe in making employees empowered."

At a time when the industry is thriving, ESOP serves as a lucrative incentive for employees to push them towards maximising effort. Arif Khan, director, corporate HR for Berggruen Holdings, India's Keys hotel chain reckons, "It is a mode to acknowledge their hard work for taking the company in the right direction. It definitely works as a retention tool in a scenario where people are looking at long term benefits." Speaking at the CII meet, Gulati said, "Option value is the amount for which the option can be exchanged between knowledgeable and willing parties in an arm length transaction." He is of the opinion that the 'fair value' increases with the increase of market price, volatility, expected term and risk free rate. The 'fair value' decreases with the increase of dividend, yield income and exercise price. The fact is hotel companies are increasingly trying to align the aim of senior "designated" employees with that of 'organisations'.

Talking of characteristics that govern the fundamentals of ESOPs, the need to be designed with precision is an important one especially in the hospitality segment, which is a new entrant per se. "An ESOP Scheme has to be designed carefully to ensure that it addresses the basic objectives for which it is being implemented. It needs to consider the type of industry requisite, profile of concerned people, growth cycle of the company, potential to create value and so on. The factors should ensure that the scheme that is designed fits best for that particular company," remarks Gulati. The success of ESOPs in different industries relies on its design. If the design is faulty, even in the best value-creating scenarios, an ESOP Scheme is bound to fail, feel experts.

Looking beyond retention



A couple of years back stock options in the hotel sector was unheard of. Lemon Tree Hotel came into the limelight with a new outlook towards hospitality business offering stocks to its employees. The country's economy (and tourism) was already spinning giving momentum to hotel developments. This led businesses to turn towards the budget and no-frill segment, where manpower-to-room ratio was less vis-a-vis the luxury segment. Less employees, limited tier management and financial security turned out to be the success mantra. Pandit elaborates, "In our company, which operates in the budget and no-frill hotel segment, we have four tiers of employees each at hotel and corporate level. Only the entry level tier in hotel, i.e. the associates, is not covered under the stock options, which comprises merely 30 per cent of total manpower. This drives growth for the large talent pool we have, ESOP being the remuneration." Another hotel group that has joined the league is Keys. The first hotel will be opening up next year but the company has allocated 11 per cent of its equity for ESOPs, informs Khan. He says, "The philosophy of ESOP is to promote start up ventures."

The presentation of the annual budget 2007-08 hurt some hotel companies wishing to venture into ESOPs. Income tax issues were perceived as a dampener. Patu Keswani, CMD of Lemon Tree Hotels, then, had remarked, "The move to bring ESOPs under FBT is horrendous. ESOP is a tool where the company passes on the benefit to employees and offers them an opportunity to

become entrepreneurs." According to Gulati, the gains from ESOP are taxed as capital gains in the hands of the employee. Post FBT on ESOP, the employer might also pass on the FBT burden to the employee, since the profits are made by the employee."

Preparing entrepreneurs

In the current scenario, hotel companies are realising the potential of an entrepreneurial approach. The fundamental aim is to create future entrepreneurs and achieve it by increasing wealth creation. In that scenario, ESOPs are designed to create "wealth", which is normally not possible out of cash salaries. Gulati feels, "Companies are bullish about stock options despite FBT for a simple reason: the value that can be created out of stock options is huge so despite taxation, there is a lot of money to be made. And at growth stages, paying out huge cash bonuses is also difficult and might jeopardise growth itself. So, ESOP fits the bill perfectly."

Hotels are trying to evolve as h3 labour organisations reducing management layers to attract profitability. This allows for a smoother ESOP policy and therefore, small groups concentrating on budget segment are approaching ESOPs aggressively. Also, the prime facie hurdle of unlisted companies dishing out shares to employees turned out to be naught. Argues Gulati, "Umpteen number of unlisted companies are queuing up with ESOPs for employees as the potential value on listing is what attracts talent and also creates a target for people to drive the company to a certain stage from where it is today; liquidity happens only on going public (read IPO)." He adds, "Senior management today is shifting to growing unlisted companies with stock options as a significant portion of their compensation because they are confident that in the next three to four years, these options are going to turn their fortunes for good." Hence, the companies are putting a blocking period on shares being allocated and planning a smooth IPO transition. For example, Berggruen Holdings India and Lemon Tree are planning to go public by 2010 and 2011 respectively. There are a number of hotels planning to go public in the coming years but have not revealed their intentions on record and are reserving plans on ESOPs. In such a scenario, employees will definitely look to seize the opportunity to gain maximum benefit and therein lies the catch.

It is thought that the co-relation of employee attrition with pay packages is going to go downhill if ESOP is taken into consideration. "ESOP, today, plays a bigger role in building a venture and bringing more professionals into the entrepreneurial stream. We are aiming at bringing free hand ownership and ESOP turns that aim into reality. By the time we go public, Lemon Tree would have made 100 millionaires. We have kept a vesting period of four years for holding the stocks by employee; they can sell it to a company before that with certain percentage cap on it. Therefore, after IPO, employees would earn quantum benefit on their share price earning them financial security for the future," remarks Pandit. There is a clear indication that companies are paving the way to take the sector ahead with dual intention, i.e. wealth creation and communicating intention about how the company is distributing its wealth back to society. ESOP as a "reward and attraction HR tool" seems passe .

October 16, 2007

