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SPOT ON

Employee Share Purchase Plans in Switzerland

ESPPs increase employee engagement, identification of employees with the company and align the interests of employees with those of shareholders

The positive effects of turning employees into shareholders through direct or indirect participation have been proven on numerous occasions. Employee share purchase plans (ESPPs) offer employees the opportunity to participate in the company's profitability over time. The company's owners also benefit, as they increase the risk sensitivity and engagement of employees, thereby increasing the company's long-term performance.

The following SPOT ON provides an overview of Swiss market practice with regard to the use of ESPPs, highlights the challenges associated with their design and implementation and illustrates their practical application.

Every company, independent of its legal form, industry or size, can implement an ESPP and profit from it. Such plans can (and should) be designed in a way that they address the individual needs of the company and fit to the company's culture.

While almost all listed and many unlisted Swiss companies operate plans for their senior executives, broad-based ESPPs are less common despite their obvious benefits. In general, they are more common among large multinational corporations than in small and medium-sized enterprises (SMEs). One reason for this may be a lack of awareness with regard to possibilities regarding the design and implementation of this instrument and a perception that the development efforts are overly high. This, however, does not need to be the case provided that an appropriate design is chosen.

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In Switzerland, with its large number of SMEs, there exists a large untapped potential for increasing corporate performance and employee engagement by using some form of employee participation.

Benefits of ESPPs

Corporate practice at companies that use employee participation has demonstrated the positive effects of ESPPs on employee motivation and corporate performance. In addition, there are also a number of academic studies that have confirmed the positive impact, including the following:

- **Sustainable decision making and entrepreneurship**
  Employees that own a share of their employer make more sustainable and long-term oriented decisions. Because of their co-ownership status employees may also be more entrepreneurial and innovative. At the same time their risk awareness increases as their personal wealth is directly linked to the company's performance. In short, employees behave more like owners.

Equity	Mezzanine	Loan
▪ Employee owns company equity ▪ Possible with or without an investment by the employee ▪ Employee benefits from increase in share price and dividend payments	▪ Mix between equity and loan ▪ Requires an investment by the employee ▪ Employee has no participation rights	▪ Employee grants a loan to the company ▪ Employee benefits from interest payments ▪ Employee has no participation rights
▪ For example: Share matching plans, discounted share plans	▪ For example: participation rights, participation certificate	▪ For example: loan, bond

Figure 1: Common forms of employee participation

- **Employee engagement, motivation and identification with the company**
  Employees who own a stake in a company feel more appreciated and are more engaged and motivated. Therefore, employee participation also leads to stronger identification with the company, its strategy and goals. This, together with the effect described above, increases company performance.
- **Employee retention**
  Increased engagement, motivation and identification with the company leads to increased employee loyalty and hence supports retention. Strong employee loyalty facilitates the retention of talented employees, which is a competitive advantage and crucial for a company's success.
- **Savings and wealth**
  ESPPs facilitate asset building by employees. Assuming that the company's risk of default is low, ESPPs also serve as an attractive investment opportunity – even for risk sensitive and more junior employees. If they are operated over a longer period of time they can play a complementary role to pension plans.

Common Plan Types

Employee participation can be achieved in different ways, depending on companies' needs – ranging from those of unlisted SMEs to listed corporations.

For stock exchange listed companies, equity plans – in form of discounted share plans, matching share plans, free shares or a combination of them – are by far the most common forms of employee participation. In discounted share plans the company grants an upfront discount for the purchase of shares, i.e. employees receive shares at a preferential price. In share matching plans the company grants free matching shares at a certain ratio for every share purchased by the employee. The shares purchased by the employee must be held for a predefined period for the matching shares to vest.

Less common and more exotic plans include mezzanine capital or virtual models. Mezzanine models are hybrids between equity- and liability based (loans) plan types and can take on various forms, such as participation rights. In general, for mezzanine models capital is brought in by the employee without granting direct voting rights to the employee.

One important difference between the ESPP models is the varying degree of participation rights that employees enjoy. Generally, these are more significant for equity based models, such as shares, which provide unrestricted participation in the company's value, including dividend payments and voting rights. Debt plans do not usually provide direct influence due to the lack of voting rights and participation is in a more indirect manner through interest payments on a loan.

SMI & SMIM Market Practice

Approximately one half of the companies listed on the SMI and around a quarter of the companies listed on the SMIM operate a global ESPP. In addition, there are plans operated in one country only. In Switzerland (as in the rest of Europe), the number of plans with global coverage is increasing and hence the number of employees who have access to an ESPP also increases.

In line with European market practice, the majority of ESPPs in Swiss companies are share discount plans, followed by share matching plans. However, larger and more global companies are more likely to use matching share plans as they are easier to implement and operate across countries. Free shares are often used for specific situations, e.g. on an IPO or for work anniversaries.

On average, employee shares granted by Swiss companies have a two to three year vesting or holding period. In comparison, US companies tend to have significantly shorter vesting periods.

The matching rates of share matching plans range from 3:1 to 2:1. The discount rates of discount share plans have a wider range, varying between 15% to 50%. On average, the benefit that employees receive under plans operated by Swiss companies lies around 30%. In comparison, in the US most companies use share discount plans with a discount of up to 20%. European companies apply higher discount rates with one-third of them granting discounts of between 20% and 60%.

Designing ESPPs

The development of ESPPs typically involves not only its design, but also tax and legal, operational and communication considerations.

1. Design

The design of an appropriate employee participation program needs to be suitable for the company's needs, resources and culture. There should be clarity of how the plan fits within the company's overall employee value preposition and compensation & benefits mix.

Main design parameters include the choice of an appropriate vehicle (e.g. shares, loans, cash or options), minimum and maximum amount of investment by the employee, timing of share purchases, grant and vesting, length of vesting or blocking period etc. When designing a new plan consideration should also be given to the operational implications, e.g. with regard to the interaction with local payrolls, handling of dividends or the use of fractional shares, and communication.

2. Tax & legal

Legal implementation not only depends on the design of the plan, but also on how the new plan is funded, the number and location of expected participants and other factors. In addition, the tax implications should be reviewed in all countries to which the plan is rolled out.

The tax treatment needs to be reviewed on a country-by-country basis and, if applicable, a tax ruling be obtained from the competent authorities. In general:

- discounted shares are often taxed at the time of acquisition by the employee,
- matching and free shares are usually taxed at the time they are transferred to the employee,
- options are taxed at exercise, and
- plans under which cash is paid to the employee are taxed at the time when the cash is paid.

Features such as blocking periods can lead to a different tax treatment in some countries and forfeiture provisions can also impact the tax treatment.

3. Implementation

Together with the design and communication, the way in which plans are implemented is a major factor, which determines if a plan is successful or not. Successful implementation ensures that processes are both efficient and compliant. This is the reason why implementation and decisions, such as the choice of an appropriate administrator, should be considered as early as possible in the process.

Internal and external operational processes should be scalable and able to accommodate changing circumstances, including possible future corporate transactions, and take the entire lifecycle of the plan into account.

In addition to factors, such as how centralized or decentralized a company operates, the number of payrolls and type of HR IT systems, the design of plans strongly impacts operational complexity. In general, the more complex the design of the ESPP, the higher the cost of administration and the more difficult it is to communicate it to employees.

The same generally applies to global reach. However, it should not be assumed that more countries necessarily means more complexities or proportionally higher costs. Operational complexity and costs primarily depend on the decisions made regarding plan design and how the plan is rolled out, including the interaction between internal and external parties.

4. Communication

Communication is of utmost importance for the success of an ESPP. An ESPP can only achieve acceptance and a high participation rate (and hence benefit employees and the company) if the employees understand the value of the plan. For this, a targeted and flexible communication approach, which is aligned to the needs of various target groups, while enabling management to control the corporate messages delivered, is required.

Figure 2: Areas of consideration when implementing ESPPs

Conclusion

Offering employees the opportunity to participate in the company's success via participation in an ESPP can have a fundamentally positive effect on the company. For it to be a success, the design, implementation and communication are crucial elements which have to be considered. The company's culture, legal form, strategy, stakeholder interests and geographic spread have to be taken into consideration.

A well designed ESPP that is aligned with the company's strategy and culture will not only motivate its employees, increase the company's performance and improve employee retention, but will also turn employees into shareholders that think and act in the long-term interest of the company and its shareholders.

hkp/// group experts can provide support during all the steps from design to implementation and communication of an ESPP, including

- the design of an ESPP that meets the company's needs,
- arranging for tax and legal reviews to be undertaken,
- provide support during implementation and ongoing maintenance, and
- the communication of the plan.

hkp/// group experts

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About hkp/// group

The hkp/// group is an independent and partner-led international consulting firm specializing in performance management, talent management and compensation.
The hkp/// approach to performance management integrates the requirements of financial and HR strategies with management
concepts. At the same time it aligns the performance management criteria and processes at the corporate level with those at individual level. Based consistently on a value- and values-oriented implementation, this approach helps our clients achieve sustainable long-term success. The hkp/// partners possess many years of international consulting experience. They are recognized experts in the market for compensation, talent, financial and risk management. In these focus areas; our clients – supervisory boards, top managers and management boards, as well as specialists – rely on us as a competent partner for value-enhancing, innovative, results-oriented solutions

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