SINGAPORE

Cake.

# Employee Stock Option Plans

A practical guide to sharing the Cake.

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A practical guide to sharing the Cake.

An Employee Stock Option Plan (ESOP) is best thought of as slicing up your company's equity. Giving pieces of the cake to employees to incentivise growth and foster team-focused culture.

But ESOPs aren't always easy to understand. We cut through the jargon and legal terminology, to get your head around standard terms for startup ESOPs, making every bite count.

At Cake, we've made it our business to research best-practice standards for ESOPs globally and in your country. We've done the hard work, so you can rest easy knowing our platform creates and delivers seamless ESOPs with tangible benefits.

At Cake, we are on a mission to make equity effortless. Say no to spreadsheets, and hello to a single source of truth.

Get started on your ESOP today.

For more helpful content, check out our blog, or get in touch.

*Cake Equity is a SaaS platform designed to make equity easy on a global scale but we are not a legal or accounting firm, so we can't give legal or tax advice. This guide summarises important (and sometimes tricky) concepts but shouldn't be relied upon as legal, financial or tax advice. If you need advice specific to your circumstances, reach out and we can connect you with our expert network of (very friendly) lawyers and accountants.

# Contents

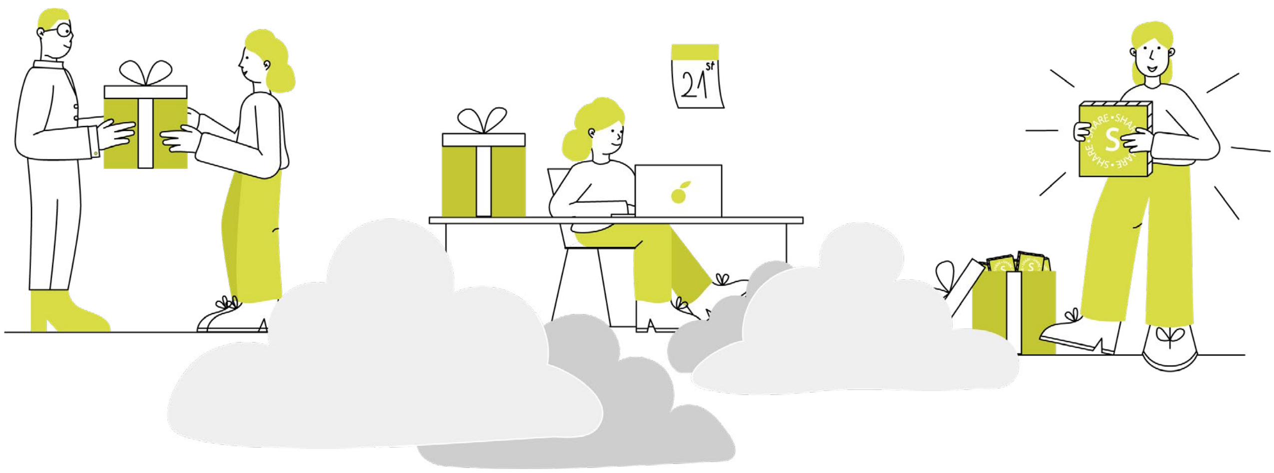
# The Basics - What is an ESOP?

An Employee Stock Option Plan (ESOP) is a way to give equity (or ownership) in your company to an employee or contractor. A slice of the cake, if you will.

An ESOP is a type of an Employee Stock Ownership (ESOW).

Let's break that down. Under an ESOW, stocks are offered. Under an ESOP Options to purchase stocks are offered. Because it's less of a mouthful, we just call these Options.

At a high level, an ESOP works like this:



### 1. Grant of Options

The employee or contractor receives Options (or rights)...

### 2. Vesting Period

...if the employee or contractor complies with the rules of the ESOP (Plan Rules)...

### 3. Exercise Options

...their Options can be Exercised to become stocks

ESOPs are the most popular way for startups and small businesses to slice up their equity cakes because it creates less paperwork for the business and better tax outcomes for the person receiving the Options.

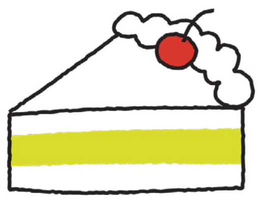
Investors usually require an ESOP is implemented before they inject cash into a startup because they know how effective it is for attracting and retaining talent. And, of course, they don't want to see their equity diluted down the track.

## A Piece of Cake.

Equity can be faster, simpler, and easier -- dare we say it, a piece of cake, with our end-to-end platform that allows you to plan, create, approve and manage your ESOP.

On average, our solution takes 85% less time and costs 90% less money than the average DIY equivalent, and you can get set up in minutes.

Cake works closely with expert start-up lawyers and accountants around the world. If you want some extra advice, we can put you in touch with one of our partners.



You can get started for free today.

# Glossary Terms

**ESOP** means Employee Stock Option Plan.

**ESOW** means employee stock ownership plan.

**Exercise** means the process of converting a Vested Option into an ordinary stock. An Option can be Exercised when the Option has Vested, and the Exercise Price is paid.

**Exercise Period** means the period in which an employee can Exercise Options. Often, an employee won't Exercise Options straight after Vesting, and will wait to Exercise them later on (for example, at an exit).

**Exercise Price** means the amount to be paid by the employee to Exercise the Option. In many countries, an approved valuation is required to determine this price. This is often also referred to as a Strike Price.

**Exit Event** means when the owners of a company "exit" the business by selling the business, for example by Initial Public Offering (listing) or acquisition by a third party.

**Grant Date** means the date the Options are Granted (or "issued") to the employee or contractor under the Offer.

**Lapse** means what happens to an Option when specific Vesting criteria is not met, and the Option can be transferred back into the Option pool for re-allocation.

**Offer** means an offer for Options made to an employee or contractor, made via an ESOP Offer Letter.

**Offer Letter** means the agreement setting out the number of Options being allocated, the Vesting conditions, and relevant Exercise and Options Price. In some jurisdictions this is referred to as an Award Agreement or an Option Agreement.

**Option** means an Option to purchase a stock. Until an Option has Vested and been purchased, it is not a stock. It is a legal right to purchase a stock at a later date, if certain conditions are met.

**Option-holder** means any employee or contractor who has been offered (and accepted such offer) options to purchase stocks under an ESOP.

**Option Price** means the price the employee pays to be Granted the Options. In most jurisdictions, this is usually set at $0.

**Start Date** means the date the Vesting Period starts ticking. This can be the Start Date of employment, or another date.

**Strike Price** has the same meaning as Exercise Price.

**Vesting** means the process by which the Option holder earns full rights to their Options, to allow them to be converted to stocks. This can happen by way of meeting certain time-based Vesting conditions, or other performance-based milestones. Only Vested Options can be Exercised to become stocks.

**Vesting Period** means the time from the Start Date, to the date the last Options will Vest under the Vesting conditions.

# Benefits of an ESOP.

Unleash a raft of benefits by implementing an Employee Stock Option Plan.

**Attracting Talent.**
It's no secret that cash can be tight for startups, which makes it hard to pay top dollar for talent. Using an ESOP, start-ups can offer tasty equity incentives to top-up slightly lower remuneration packages. The same applies for attracting experienced advisors and developers at an early stage. Knock their socks off with your idea, pay them in Options.

**Retaining Talent.**
It's hard to attract top talent and even harder to keep it. Options are usually subject to Vesting, which encourages sticking with a company until the Options Vest. That's why it's often called "sweat equity" – team members need to put in the blood, sweat and tears in order to eat their cake.

**Opportunity for significant employee financial gain.**
By taking a slice of the ESOP cake, an employee can benefit from the increase in value of the stocks over the company lifetime. It offers hungry employees the chance to generate real wealth.

**Salary Top-Ups.**
Tough times can often mean a company has to reduce staff salaries. To keep employee morale up (and the staff around), you can use an ESOP to 'top-up' pay cuts with proportionate equity.

**Incentivisation.**
Potential ownership of a slice of the company means employees start thinking like business owners. It's common to see a spike in collaboration, productivity, and innovation when ESOPs are incentivising the team. One cake, shared goals.

**Tax benefits.**
In many countries, start-ups and their employees are eligible to receive substantial tax concessions when implementing ESOPs. For more information about the tax benefits in your specific country, please get in touch with our expert legal partners and enjoy special Cake fixed-fees.

# The Nitty Gritty.

Below we answer the most common ESOP questions.
Got more queries? Just ask – we love talking Cake.

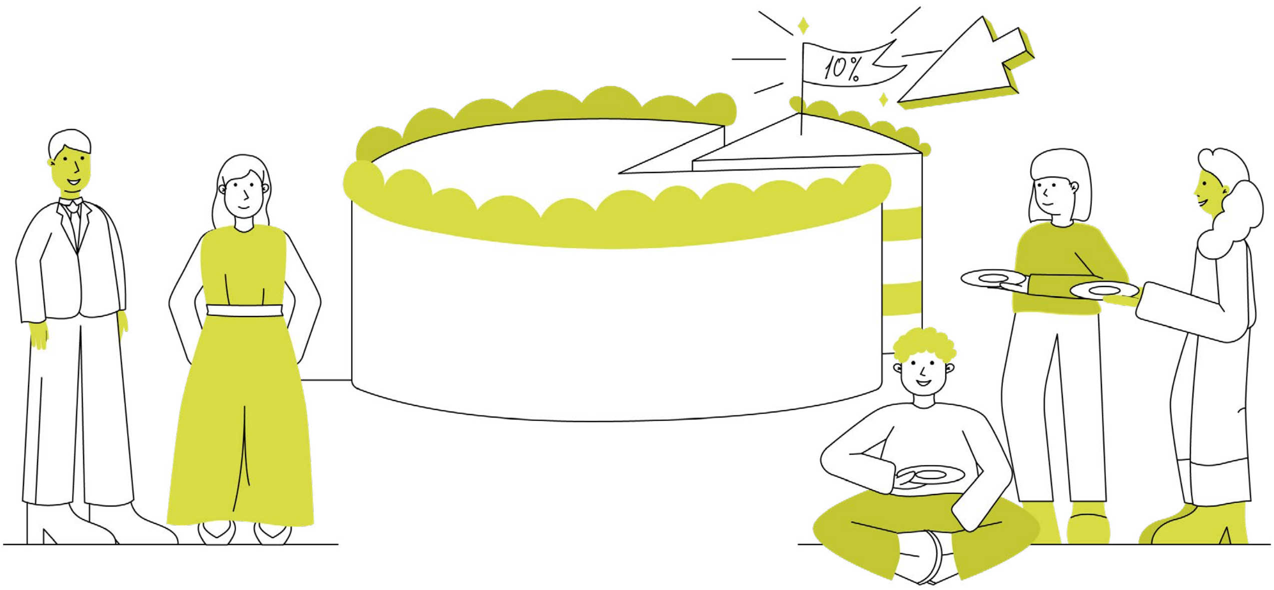
## How does an ESOP work?

The company creates an 'Option pool', setting aside Options that can be allocated to employees or contractors. Consider this one slice of cake, from which smaller nibbles are then allocated.

The standard Option pool size is 10% but it can vary between 5% to 30%. This is always a percentage of the 'fully diluted' capital in the Company.

**An Option pool can be created on your Cake account in minutes.**

The Option pool doesn't need to be allocated immediately. In fact, it's often better to leave unallocated Options to use for later hires or to top-up remuneration packages.



Granting an employee or contractor Options from your ESOP pool doesn't mean they immediately own stocks in your company.

Two things need to happen before they can eat their cake:

- the Options must Vest in accordance with the Vesting Rules; and
- they need to Exercise their Options to purchase their stocks.

The main documents you need to set up an ESOP are:

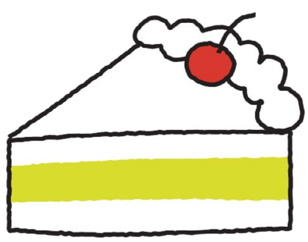
- The Plan Rules, and
- Individual Offer Letters

An ESOP also establishes the company's ESOP Committee. This is a group of directors and officers of the company, responsible for handling the ESOP pool and giving recommendations to the board of directors.

**Cake has all the template documents you need which can be sent for digital execution within the Cake platform.**

**Easy Right?**

*Our expert start-up legal partners can assist with any amendments, advice on approvals required (like Board or Member approval) or the terms of your Offer Letters and Plan Rules.*



# Vesting Demystified.

## How do the terms Exercise and Vest relate to one another?

Under an ESOP, an Option-Holder is not able to Exercise Options, until those Options have Vested.

Until the Option is Exercised, the Option-holder does not have any stockholder rights (like voting rights, for example).So, until Options have Vested, the Option-holder can't gain full rights to their slice of the cake.

## What's the purpose of Vesting?

Vesting is a little bit like dangling a carrot.

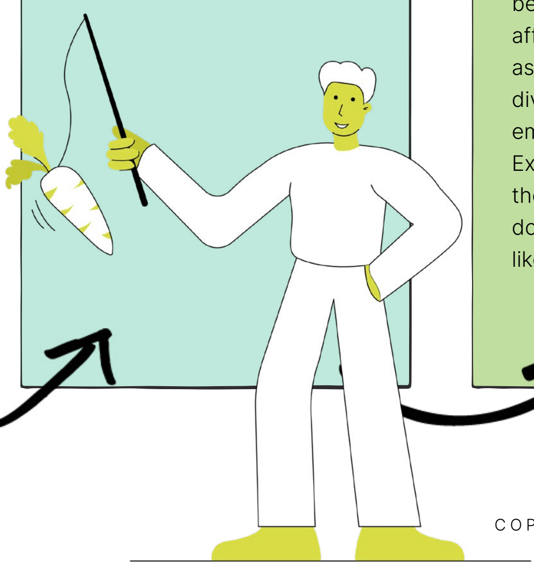
The purpose of Vesting conditions is to tie some obligation of performance (or time) to the Options. It's why ESOPs are such a powerful tool for incentivising your team to stay longer (and work smarter) towards the ultimate success of the company.

### Grant

Options are Granted to the employee or contractor under the ESOP Offer.
The Grant is made by the employee signing an Offer Letter through Cake, which is connected to the ESOP Plan Rules. The number of Options allocated, the Start Date, and all the Vesting Conditions for each employee will be in each Offer Letter. All other conditions will be in the Plan Rules.

### Vest

The Options Vest through time-based Vesting, Milestone Vesting, or a combination of both. Once the Options have Vested, they can be Exercised (or converted) into stocks.



### Excersise

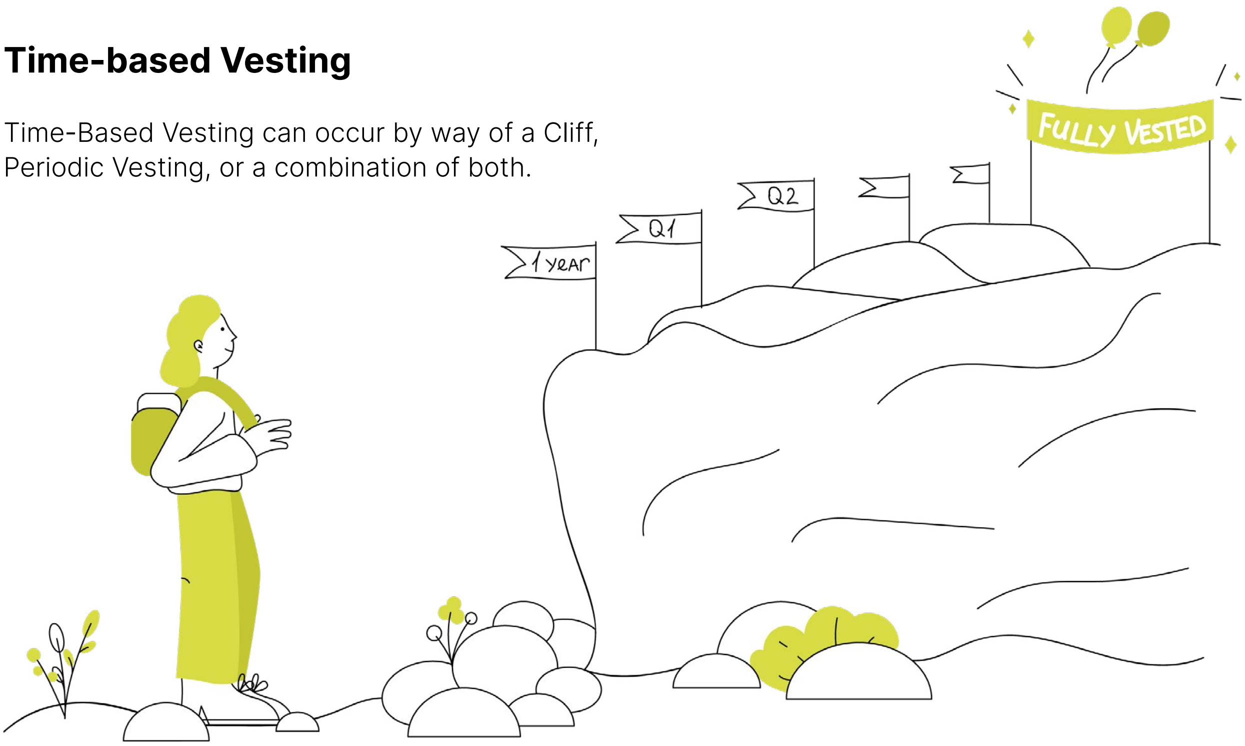
Vested Options can be Exercised (or converted) into stocks. To Exercise the Options, the employee must pay the Exercise Price. Once the Options become stocks, they are afforded all the same rights as the stockholders (voting, dividends etc). Generally, employees won't actually Exercise their Options, until there is immediate value in doing so – i.e. an Exit Event is likely to occur.

In an ESOP, Option Vesting happens by way of:

- Time-Based Vesting,
- Milestone Vesting, or
- a combination of both

## Time-based Vesting

Time-Based Vesting can occur by way of a Cliff, Periodic Vesting, or a combination of both.




### Cliff

Think of a Cliff as the probation period for equity. It's a period of time before any Options Vest. It's usually set at one year, which gives the company time to see how the Option-holder performs, before they receive any equity. For example, if Tracey has a 12 month Cliff, 25% of her Options would Vest 12 months after her Start Date.

### Periodic Vesting.

These are Options that Vest gradually over a period of time (what we call the Vesting Period). For example, if Tracey has a 4 year Vesting Period after Tracey's 12 month Cliff, the remaining 75% of her Options would Vest quarterly, over 3 years. So, at the end of month 15, another 6.25% of her Options would Vest.

The Vesting Period will usually start from the employee's Start Date. It can also be set retrospectively, so the employee is rewarded for any time spent in the business prior to the Grant of Options.

The Start Date can also be set to start at whatever other date the company likes. For example, a company can create an ESOP where the Start Date for Vesting is the same for all employees, regardless of when they started.

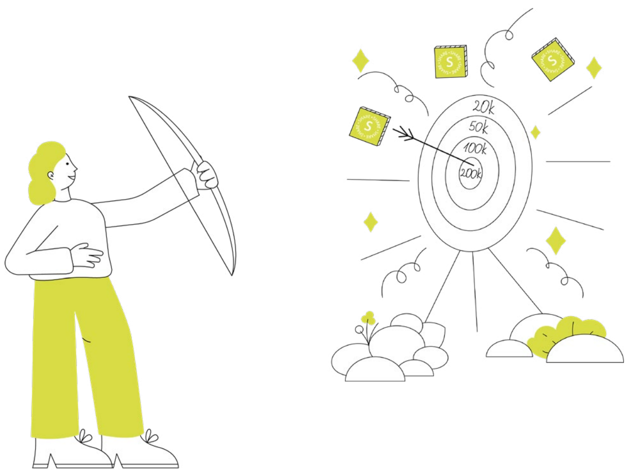
The Vesting Period will usually start from the team member's Start Date. It can also be set retrospectively, to reward for any time spent in the business prior to the Grant of Options.

The Start Date can also be set to start at whatever other date the company likes. For example, a company can create an ESOP where the Start Date for Vesting is the same for all employees, regardless of when they started.

### Milestone Vesting

Options will Vest on the achievement of some defined milestone or performance hurdle. For example, the remaining 25% of Tracey's Options could Vest on her 'recording $200k in sales for the company during 2021'.

Generally, Milestones are only appropriate when clear metrics can be defined. For example, a sales role where Vesting is tied to results.



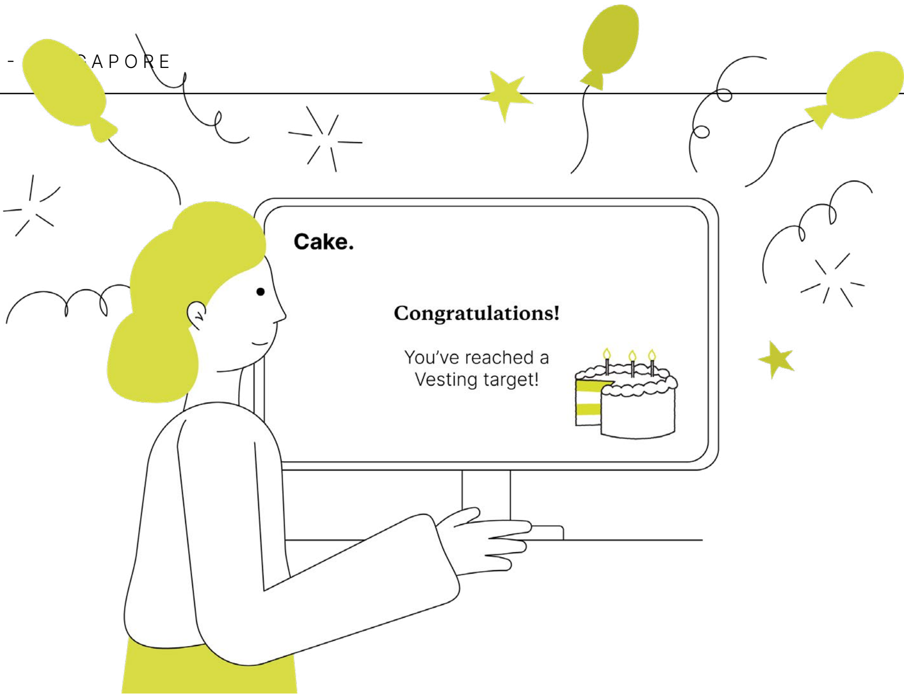

In Cake, Vesting Schedules are clearly set out in a visual format, for both the Option-holder and the company to understand at a glance. Without this tool, things can get a little messy.

## Most Common Vesting Arrangements

The most common Vesting conditions we see are:

- **25%** of Options Vest after a **12 month cliff**;
- The remaining **75%** of Options Vest quarterly, over **36 months after** the Cliff Date.

You can have default Vesting condition set up in your Cake account, or customise for each Option-holder.




## Keeping the team engaged

The Cake platform tracks Vesting, and automatically provides updates as Vesting events occur.

Cake also notifies the Company and Option-holders each time a Vesting event occurs, so they are always reminded of the Options they're accumulating. A neat way to keep equity top of mind for teams.

Transparency on the Cake platform makes the Options feel more tangible, and will avoid you needing to regularly provide updates to Option holders on their Vesting status (admin can really take the fun out of sweet treats).

## What is Accelerated Vesting?

The Plan Rules set out what happens to Unvested Options in the case of an Exit Event.

Most Plan Rules contain an 'Accelerated Vesting' provision, which provides that in an Exit Event, all unvested Options will automatically Vest.

The logic here is to disincentivise employees delaying an Exit Event, to make sure their Options have Vested first.

## What if the Options do not Vest?

If the Options do not Vest (eg, because an employee does not stay for the entire Vesting Period), they Lapse.

This means they can no longer Vest nor can be Exercised by that Option-holder.

The Lapsed Options can be recycled back into the Option pool and allocated to new employees, or top-up current employees. There is no need for a 'buy-back' for unvested Options. Cake does the heavy admin lifting for you, with the click of a button.

## Where will the Vesting Conditions for each Option-holder be located?

The Vesting conditions for an ESOP offer will be set out in each individual Offer Letter. This way, the Vesting Conditions for each Option-holder can be different, while the same general Plan Rules apply to all. Terms that can be specific to an Offer Letter include the Start Date and number of Options Allocated. Otherwise, it's normal for all other terms to be standardised.

# The Rules, explained.

## Why do we need Plan Rules?

The Plan Rules set out the rules and processes for Option-holders and stockholders. The Plan Rules and the Offer Letter should be read and understood together. You can think of the Plan Rules like an additional Stockholders Agreement, that only applies to the ESOP recipients.

Plan Rules provide full transparency, helps avoid disputes and gives the company peace of mind that it's protected in various scenarios.

Generally, the Plan Rules cover important issues such as:

- The right of the company to buy stocks back from Option-holders
- The price at which the company can buy the stocks back from the Option-holders
- What happens if an Exit Event is likely to occur
- Whether the Option-holder can transfer his or her Options or stocks, and the restriction periods on the transfers
- The company's right to take certain actions in the shoes of the Option-holder, where the Option-holder is not cooperating

The terms of any Offer that are specific to each employee (such as the number of Options allocated, the Vesting Rules, and the Start Date) will be set out in each Offer Letter.

*Cake has created Plan Rules using best-practice standards in Singapore. If you need to create Plan Rules specific to your ESOP, it's important they comply with Singapore's laws. If you need help, connect with our expert legal partners who are always ready to assist.*

## What if the employee leaves?

The Plan Rules may contain general 'buy-back' provisions, which give the company the right (but not the obligation) to buy stocks back from employees when they leave the company

The Plan Rules may set out the price which the Company must pay to buy-back stocks when the employee leaves. The price will be based on the circumstances in which the employee leaves - i.e. whether they are a Good Leaver, or a Bad Leaver.

The Plan Rules may also clarify what defines a Good Leaver and Bad Leaver, and how the 'Fair Market Value' is determined.

There's more to learn here.


*The treatment of employees when they leave the company will depend on the Plan Rules and Singapore's laws. Reach out to be connected with Cake's friendly and expert legal partners who can assist you.*

## What happens if the Company is sold or listed?

The Plan Rules will specify what happens to the Options if an Exit Event, like a takeover, occurs. Generally, the way the Options are handled will be left to the board's discretion.

Usually, the Option-holder will be provided an opportunity to Exercise their Options, to become part of the sale or listing as a stockholder.

Alternatively, if the Exit Event is an acquisition, the acquirer will often choose to cancel the Options instead and pay each Option-holder the same amount as if they were stockholders. This avoids the Option-holders needing to Exercise their Options, just to be bought out immediately after.

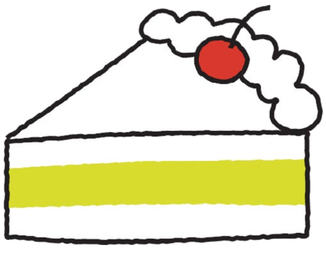
*The Plan Rules and Singapore's laws may affect the treatment of a sale or listing of a company. Cake's global legal partners can assist you in understanding the relevant provisions in Singapore.*

## Will the Options and stocks be diluted?

Just because an Option-holder might be offered Options equal to '3% ownership' of the Company at the time the ESOP offer is made, it does not mean they will always own 3%. Unless the ESOP includes anti-dilution rights (which is very rare), the percentage ownership will be 'diluted' each time more stocks or Options in the Company are issued.

For example, if after making the offer, the Company does a Capital Raise and offers new stocks for 20% ownership in the Company to an investor, the potential 3% ownership, has now become 2.4%, and so on.

But this isn't necessarily a bad thing. Investment generally means the company is on an upward trajectory. Would you rather own 1% of a $100m company or 5% of a $1m company?



## Does an Option-holder have to pay to Exercise their Options?

Usually, an Option-holder must pay the Exercise Price, to Exercise any Options. The Offer Letter will set out the Exercise Price.

The need to pay an Exercise Price can confuse ESOP recipients. For example, if an Option-holder received $25k worth of Options as a top-up on their remuneration package, it would not make sense for them to have to pay $25k cash to Exercise those Options once they've Vested.

However, it is rare that an Option-holder would ever need to do this.
Either

- the Exercise Price would be calculated by a valuation method which yields a nominal price per Option (i.e., $0.01 per Option), or
- Or, the Option-holder can hold off Exercising the Options until there is immediate value in doing so (i.e. at an Exit Event).

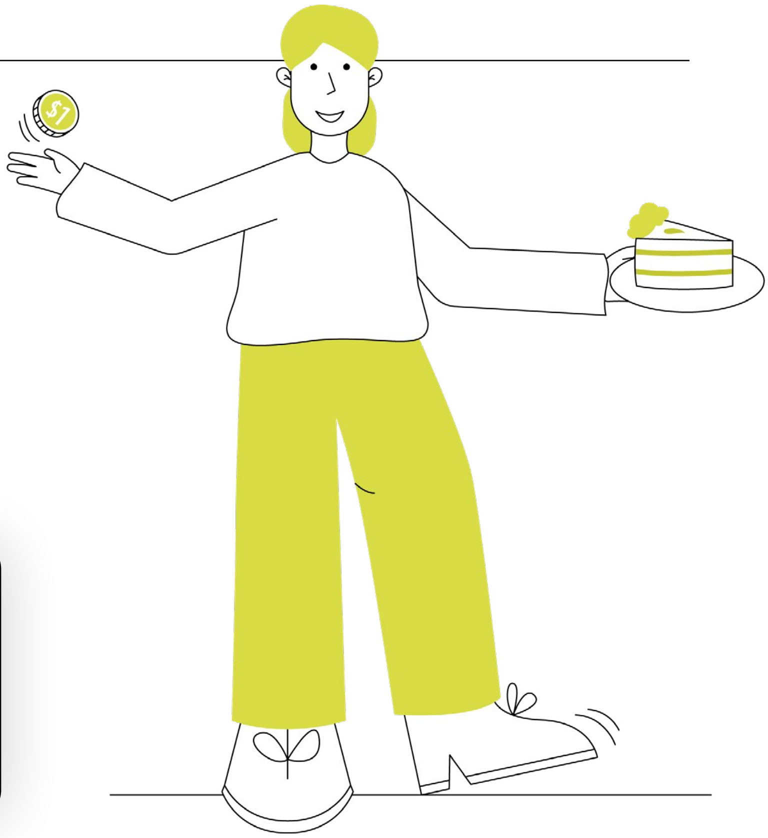
If the Exercise Price is high and the Option-holder wants to hold off on Exercising the Options, they could keep the Options as 'Vested Options', and not Exercise them until:

- an Exit Event is occurring, and they can be part of the sale or listing as a stockholder, or
- they will leave the company and the company elects to buy the Options back at the increased value. Owning a smaller part of a bigger Cake can be very sweet indeed.

## Can an Option-holder sell the Options or stocks?

The Plan Rules will set out all the rules relating to selling Options and stocks. The Plan Rules will often provide an exception to the rule for a disposal to an affiliate, for example, a direct family member, or a family trust.

*The Plan Rules and Singapore's laws may affect how Option-holders can deal with their options or stocks. Cake's expert legal partners can assist you in understanding these provisions in Singapore.*



# Big Decisions.

## Why would I do an ESOP instead of an ESOW?

ESOPs are the most popular method of granting employee ownership for start-up companies.

### Less Admin

They require much less admin. Under an ESOW, the employees are issued stocks up-front, which are then subject to vesting. If the employee does not satisfy the Vesting requirements, the company is able to buy those stocks back at a nominal value ($1).

However, if, for example, a company offers Stocks under an ESOW to 15 employees, and only 5 of those employees satisfy all of the

Vesting requirements, the company would be required to conduct Stock buy-backs for each of the 10 employees where the Vesting criteria was not met.

This can be a time consuming process, as it will require members resolutions, buy-back agreements, and updates to your country's regulator (if any).

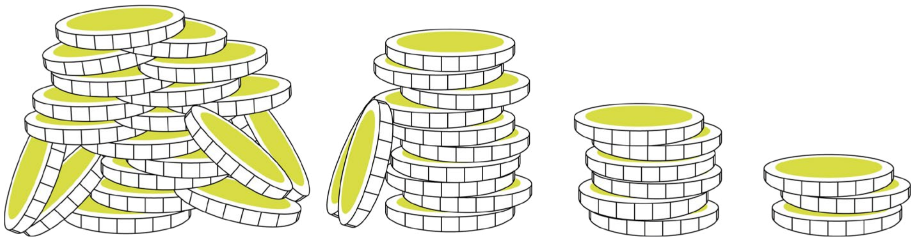
Comparatively, ESOPs are less of a headache. If Option-holders don't meet the Vesting requirements, the Options will simply Lapse, and can then be recycled into the Option pool to be used for further offers. Simple.

### No upfront payment

Under an ESOP, the Option-holder is not required to pay anything up-front to accept the offer.

Under an ESS, Fair Market Value must be paid for the Stocks on acceptance of the offer. This can sometimes cause confusion and delays, and ultimately might make the offer feel less like a slice of cake and more like a plate of vegetables.

With an ESOP, the Option-holder only pays when it Exercises the Option, and it is often a nominal value.



# How many Options should I allocate to my team members?

No two companies are the same, so it is important to specifically consider your own staff, and your plans for the next few years.

Above all, every company should keep team incentivisation top-of-mind.

### Size of the Pool

A good starting point when thinking about Option allocations, is to consider the total size of the Option Pool. For example, if the company has an allowance for a 10% Option Pool, and it wants to offer Options to at least 20 team members over the next couple of years, it clearly needs to take this into account in making the allocations.

### Role v Time

While Option allocations will sometimes vary between roles, it's more common for them to be based on time spent in the company. For example, the early employees will have higher allocations, and the later employee allocations will be smaller, despite them being in similar roles. Although this isn't to say late joiners can't get higher allocations – it all comes down to the specific values of the team member and company goals.

### Valuation of Options

It can be useful to work out the value of Options by considering how much they'd be worth if they were offered as stocks as part of the most recent Capital Raising round. This is especially useful where the Options are being offered as a remuneration package top-up, as the company can clearly communicate how they decided how many Options would be offered, based on the most recent valuation of the company.

### Common Percentages

It's quite rare for an employee or contractor to receive more than 1% fully diluted ownership in a company, except where that team ember is a senior hire, or the Options are in substitution for a significant salary package.

Please keep in mind that where the recipient is an employee, they must be paid at least the minimum salary under the employment laws relevant to your jurisdiction and this salary cannot be substituted with Options in most jurisdictions.

## How do I value my Company for an ESOP?

Often, a company will initially be valued internally to determine how much equity they want to give to each participant, and then the company will apply the ESOP specific valuation to set the Exercise Price in compliance with any tax rules.

*Singapore has specific valuation requirements for setting the Exercise Price for an ESOP. It is important that you ensure you use the correct method of valuation to access  the Startup Tax Concessions.*

*Cake has expert legal and valuation partners in Singapore who specialise in providing ESOP valuations.  Just reach out if you'd like to be connected with them!*

# The Regulatory Stuff.

## How is an ESOP taxed?

In some countries, the recipient will not be taxed upfront on the Grant, Vesting or Exercise of the Options and will only be taxed through Capital Gains Tax (CGT) when they get a direct financial benefit from those Options (i.e. when they dispose of them for a profit).

In Singapore, the Equity Remuneration Incentive Schemes (ERIS) provides tax incentives to companies and employees, applying three tiers of rules. One to start-ups, one to SMEs and one to all corporations.

*For more information on the disclosure rules in your Singapore please get in touch and our expert legal partners can assist.*

## Does an ESOP need to be registered with the Tax Office or Regulator?

This will depend on your jurisdiction.

As always, our expert legal and accounting partners are ready to help you work out which rules apply to your ESOP.

*Cake's expert legal partners can help you navigate the tax rules specific to Singapore and to your ESOP. If you need assistance, just let us know.*

# 2021 ESOP Statistics

Here is some data direct from the Cake platform in 2021 to get your brain buzzing...

**4**

Median Employees per Organisation

**8.3**

Average Employees per Organisation.

**25:75**

Most common Vesting rules.
25% of Options Vesting after a 12 month cliff, and the remaining 75% of Options Vesting quarterly, over 3 years.

**15%**

Milestones were only used for 15% of recipients

**11.1%**

Average Option Pool size: 11.1% of the fully diluted capital in the company

**0.2%**

Median Equity % Per Employee.

**1.2%**

Average Equity % Per Employee.

*We find that companies generally like to set the Exercise Period for as long as possible, so there is no rush or pressure for employees to Exercise their Options quickly. In reality, if the Options haven't been Exercised within a 15-year window, it's unlikely they would ever be Exercised anyway.

# Cake can help.

## We make equity easier to use.

On average, our solution takes 85% less time and costs 90% less money than the average DIY equivalent.

Our ESOP feature allows you to plan, approve, implement, issue and manage your ESOP in minutes. Our recipe? The perfect blend of automation and professional advice from expert partners.

Grow your company, reward your team, eliminate the hassle.

www.cakeequity.com

**Get started for free today.**