TenStep Supplemental Paper

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Paying in Sweat

Current rules and regulations in India provide a certain degree of flexibility in the way companies reward, motivate and pay their employees. Sweat equity falls in the same stable as ESOPs and options, but varies in the sense that it can be best used at start-up and by SMEs.

How does it work?

Sweat equity is more of a transaction than an actual reward. An employee, in return for services, accepts equity shares of the company. Sweat equity is normally given in consideration of the intellectual know-how that employees provide to an organization.

To illustrate, four people join hands to start a business venture. In the initial stages, when resources are scarce, the team agrees that two of the people will not be paid a salary. Instead, their efforts during the start-up phase are rewarded in the form of equity in the company.

What are the issues involved?

- Almost all companies are allowed to issue "sweat equity," provided they meet the norms and regulations as prescribed by the Company Law Board.
- Current regulations stipulate that only equity shares can be issued as sweat equity.
- Regulations also state that sweat equity can be offered only if the employee provides "value addition" to the company. A precise legal definition for "value addition" is still elusive.
- It can be difficult to calculate the number of shares that an employee should get as sweat equity.
- Stock market fluctuations could impact the value of the shares; therefore, there is an element of risk involved.

Summary

For cash-starved SMEs who are looking for ways to offer better pay to their employees, sweat equity could be a good option. From the organizational perspective, it also builds a sense of ownership in the employees.

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