



ESOPs

WHAT ALL STAKEHOLDERS SHOULD KNOW

In this presentation

- ▶ Introduction and Background
- ▶ What are ESOPs
- ▶ ESOPs and the Mining Charter
- ▶ How ESOPs are Structured and Financed
- ▶ What Workers should Expect
- ▶ Brief Outline of SATRI Research
- ▶ Conclusion and Way Forward

Introduction and Background

- ▶ Employee Share Ownership Plans (ESOPs) have been a common feature in SA's mining industry since adoption of MC in 2004 and their key objective is to encourage employee ownership of shares mainly for HDSA's.
- ▶ They are not uniquely South African. In developed countries they are perceived as a retirement tool and in developing countries they are used mainly for transformation purposes.
- ▶ Stakeholders in the mining sector, especially beneficiaries tend to have limited knowledge of what ESOPs are and how they work. This tends to hinder any constructive engagements on ESOPs.
- ▶ For Trade Unions ESOPs are important because it means their members get additional benefits. As such unions have the responsibility to negotiate the best possible deals with mining companies for their members.

What are ESOPs

- ▶ ESOPs are an empowerment tool allowing for the transfer of ownership of shares to employees within a company. They are very common with different kinds of companies both locally and abroad.
- ▶ Different company and country circumstances inform the purposes for which ESOPs are implemented either as a retirement benefit or a transformational tool.
- ▶ Various criticisms have emerged due to lack of meaningful yields for intended beneficiaries from the schemes that have been implemented. ESOPs have in most part failed to meet stakeholders expectations.

What is the benefit of Implementing ESOPs?

- ▶ One major benefit is that it enhances business performance and productivity. If employees are made to feel like business owners, then they are more likely to work hard towards achieving production targets
- ▶ In the SA mining sector, ESOPs are implemented for transformation purposes. They are a value creation instrument which advocate for workers to be part owners of the companies in which they work.

ESOPs and the Mining Charter

- ▶ Genesis of ESOPs can be traced to the Mineral and Petroleum Resources Development Act (2002). This Act is deemed as the broad legislation that is behind the mining sectors transformation which allows the Minister to initiate policies.
- ▶ In order for the act to be operational , the Minister came up with the intervention of the Mining Charter in 2004 with revisions in 2009 and 2015 respectively.

ESOPs and the Mining Charter

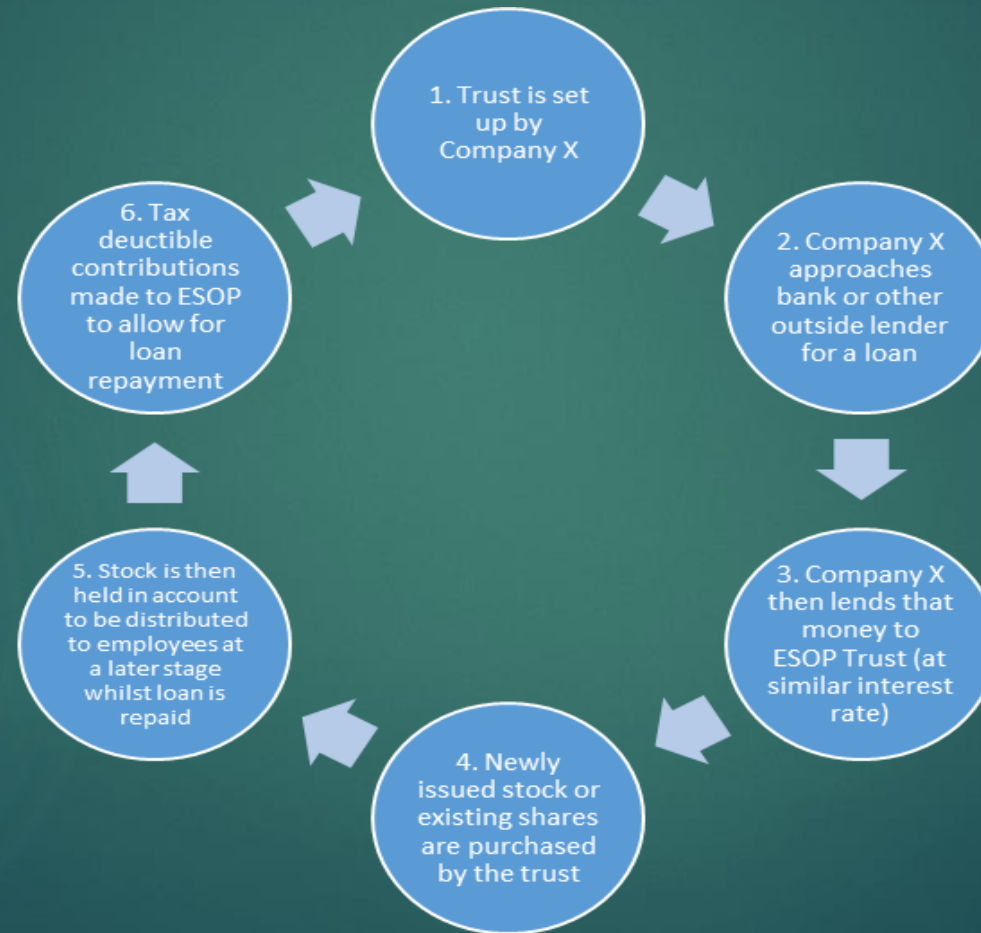
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- ▶ Mining Charter **one** in 2004, ESOPs were part of the 26% BEE requirement for HDSA's, no specific portion of the 26% was allocated to ESOPs.
- ▶ Mining Charter **two** implemented in 2010, ESOPs also had no specifications in terms of what percentage should be allocated to ESOPs
- ▶ Mining charter **three** of 2018 maintains a 5% BEE allocation towards ESOPs despite the total BEE portion reaching up to 30% in some instances
- ▶ *Source: Government Gazette, 2002, 2010, 2018*

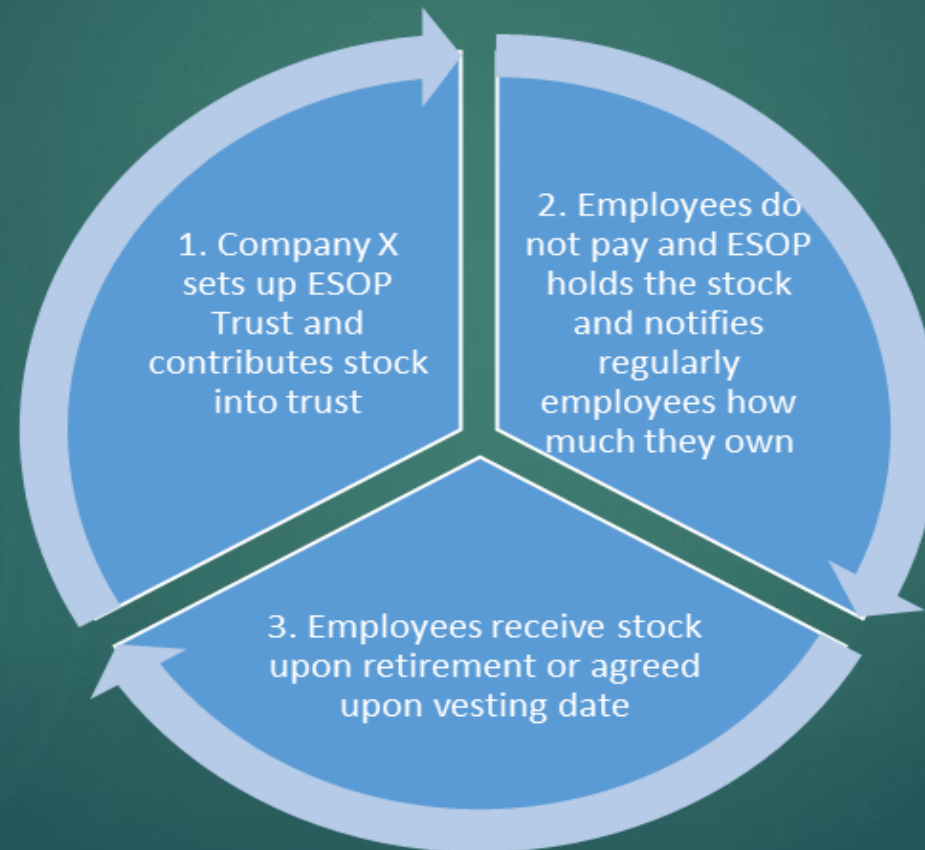
How ESOPs are Structured and Financed

- ▶ There are a number of ways in which ESOPs can be structured however specific to SA's mining industry, the most common structure is for an employer to set up an ESOP trust and then purchase the shares on behalf of employees.
- ▶ However most ESOPs are structured according to a company's circumstances. The manner in which an ESOP is structured informs the manner in which it will be financed and how it will work.
- ▶ However, holding all other factors constant, how an ESOP is financed has a strong bearing on how the ESOP will perform in terms of yields.
- ▶ ESOPs commonly employ two basic structures but these are not the only ones:

Leveraged (Loan) ESOP Structure



Non-Leveraged (Loan Free) ESOP Structure



What Should Workers Expect?

- ▶ ESOPs are put in place so that employees can gain dividends and shares. Potential beneficiaries are given award letters explaining how the particular ESOP they are about to join is structured and what they should expect.
- ▶ Depending on the structure and performance of an ESOP, some companies pay out dividends once or twice a year and in other instances not at all. Though not guaranteed there is also a large sum payable to workers at the end of the vesting period.
- ▶ There are conditions that may disqualify or result in accelerated vesting for a beneficiary, i.e. resignation, dismissal, retirement, death, incapacity, permanent disability and/or retrenchment. Most trust documents highlight these conditions to employees.
- ▶ The above paints an ideal scenario of how an ESOP should perform. It should offer constant yields which are of notable value to employees though this has not been the case in the mining sector.

What key Aspects in an ESOP will Ensure that Workers Continuously Benefit?

- ▶ Global Economy, depending on its performance many economic factors are affected
- ▶ Commodity Price – performance of Gold, Diamonds, Iron Ore etc...
- ▶ Company Performance – is production good, are targets being met cost effectively too?
- ▶ Health and Safety, has the company maintained a good record?
- ▶ Future Projections about the company? Strikes? Management?

How do Market forces affect the yield of an ESOP?

- ▶ One needs to look at the commodity price from inception of the scheme to when the scheme finally matures/vests
- ▶ The value of the shares in the market will be determined largely by the factors/key aspects discussed in previous slide.
- ▶ A higher share price throughout = good returns on investment meaning a successful scheme
- ▶ A lower share price = bad returns on investment meaning a less successful scheme

Brief Outline of SATRI Research

- ▶ **Problem Statement:** Ideally ESOPs should be giving workers constant dividend yields to add to their wealth and value creation. In the SA mining space this has not been the case and it is important for all relevant stakeholders to understand what contributes to these failures.
- ▶ **Purpose:** to document those factors responsible for the failure of ESOPs and develop a generic ESOP model that can be used by trade unions such as NUM to develop their existing generic ESOP model.
- ▶ **Objective:** to identify those factors critical for an ESOP yielding dividends and recommend a generic ESOP model to the NUM with a high likelihood of yielding dividends to workers.
- ▶ The research is still under way and findings will be shared once it has been finalised.

Conclusion and Way Forward

- ▶ ESOPs are not widely understood by most relevant stakeholders in SA's mining industry.
- ▶ **Employers and trade unions** need to play a more active role in informing beneficiaries of the potential benefits and concerns attached to ESOPs.
- ▶ **Beneficiaries** need to understand that ESOPs, like any other investment comes with potential risks and may not always yield the desired benefits.
- ▶ **Beneficiaries** need to familiarise themselves with the structure of their organisation's ESOP as well as be aware of those conditions that may qualify or disqualify them from benefitting.

THE END, THANK YOU

