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TOPIC:
EMPLOYEE STOCK OPTION PLAN

EMPLOYEE STOCK OPTION PLAN (ESOP)



What are ESOP's

- **Section 2(37) of the Companies Act, 2013** defines ESOP.
- In **ESOP** the company grants an option to its employees to acquire shares at a future date at a pre-determined price.
- These are not transferable-**Clause 9** of SEBI (SHARE BASED EMPLOYEE BENEFITS) REGULATIONS, 2014
- The options cannot be pledged, hypothecated, mortgaged or otherwise alienated in any respect. **Rule 12(8)(b)** of Companies (Share Capital and Debentures) Rules, 2014)

ESOP

- ❑ ESOP's are Employee Stock Option Plans under which employees receive the right to purchase a certain number of shares in the company at a **predetermined price**, as a reward for their performance and also as motivation for employees to keep increasing their performance.
- ❑ Alternatively, employee-type stock options can be offered to non-employees also like suppliers, consultants, and promoters.
- ❑ Employees typically have to wait for a certain duration known as vesting period before they can exercise the right to purchase the shares.
- ❑ VESTING PERIOD - A period of time in which an employee must work for an employer in order to fully own their shares in the company's stock option plan

OBJECTIVES OF ESOP :

- Retention tool and bring in a sense of commitment.
- Form of Compensation/reward.
- Creating a vibrant ownership culture.
- Improvement in individual and group performance.
- Loyalty due to ownership factor.

COVERAGE OF EMPLOYEES

- ❑ There is a noticeable difference in terms of coverage. While around 43% of the IT companies have given ESOPs to more than 90% of the employees.
- ❑ Only 17% of the Non-IT companies have done so.
- ❑ A related finding is that more than 75% of the Non-IT companies offer ESOPs only to the senior and middle management employees.

ELIGIBILITY TO PARTICIPATE IN ESOS

- An *employee*
- An employee who is a *promoter* or
 - belongs to the *promoter group* shall not be eligible to participate in the ESOS.
 - A director who either by himself or through his relative or through any body corporate, directly or indirectly **holds more than 10% of the outstanding equity shares of the company** shall not be eligible to participate in the ESOS. (SEBI (Share Based Employee Benefit) Regulations, 2014)

Employee Stock Purchase Plan

- **ESPS** is generally used in listed companies, wherein the employees are given the right to acquire shares of the company immediately, not at a future date as in ESOS.
- **Clause 2(h) of SEBI Guidelines, 2014 defines "*employee stock purchase scheme (ESPS)*".**
- Employees contribute to the plan through payroll deductions, which build up between the offering date and the purchase date.

General Stages In any Employee Incentive Plan



ROUTES OF ESOP

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graph TD; A[ROUTES OF ESOP] --> B[Trust Route]; A --> C[Direct Route];
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Trust Route

Direct Route

- ❑ **TRUST ROUTE** – Trust route is a method used Trust route is the methods in which a trust is created for the allotment of shares to the employees .Company issue shares to the trust and than trust issue shares further to the employees. It eases the process of the Allotment although the work of transfer increases.
- ❑ **DIRECT ROUTE** - In direct route the shares will directly be allotted to the employees of the company.

Routes under ESOP

1. Direct Issue of ESOP's

- Rule 12 read with section 62(1) (b); (Refer Memo)

2. Creation of Trust

- Rule 16 read with section 67. (Refer Memo)
- Indian Trust Act, 1881.
- Clause 3 of SEBI (SEBI (SHARE BASED EMPLOYEE BENEFITS) REGULATIONS, 2014)

Framework governing ESOP

1. Companies Act, 2013
 - Sec 2(37)- Definition of ESOP
 - Sec 62 (1)(b)- corporate restructuring by ESOP

2. Rule 12 of the Companies (Share Capital and Debentures) Rules, 2014,

3. Income Tax Act, 1961
 - clause (iii) of sub-section (2) of section 17
 - Section 49(2B)

4. Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014.

Highlights of Rule 12 of the Companies (Share Capital and Debentures) Rules, 2014,

- Approval from Shareholders via Special Resolution
- Permanent Employees of Company, Holding Company, Subsidiary Company and Associate Company can be covered.
- All Directors excluding promoter directors and Independent Directors can be covered under the ESOP plan.
- Mandatory annual disclosures in Directors Report.

Contd.

- Minimum period of one year between grant and vesting of options
- In case of death, all options granted shall vest in the legal heirs. -Rule 12(8) (d) .
- In case of resignation, all unvested options shall lapse.- Rule 12(8) (f).
- Register to be maintained as per format prescribed by ROC.

BENEFITS

- Recruit or retain key employees
- Improved awareness for the employees about the big decisions; directions and corporate plans of the enterprise
- A Company can reduce its corporate income taxes and increase its cash flow by simply issuing treasury stock or newly issued stock to its employees
- There is a better partnership and communication between management and their employees.
- Increase employee job satisfaction

LIMITATIONS

- ❑ The employee has all their eggs in one basket. Essentially the employee is over exposed to the company's shares, so if the company does not perform or worse goes into administration the employees investment is lost.
- ❑ Share Ownership, specifically option plans can be dilutive (i.e) as more shares are issued each share you own becomes a smaller percentage of the company.
- ❑ The company must also be prepared to buy back shares of retiring employees. If a company has a large percentage of employees nearing retirement age, there is a very real potential of a cash drain.
- ❑ Inbuilt uncertainty due to fluctuating stock prices

EXAMPLES

- ❑ Infosys pioneered the concept of ESOP in India in 1994 to employees and also to even Drivers, Office Assistants and Secretaries with ESOP's and who preferred to keep those shares have turned millionaires today.
- ❑ Narayana Murthy's Chauffeur Kannan is a millionaire now and his portfolio is worth 20 million rupees and Sixty-seven other drivers are also in among 2000 Infosys millionaires.
- ❑ Telecom major Bharti Airtel group began its ESOP journey in 2001
- ❑ BPO pioneer- Raman Roy was setting up Spectramind in 2000-2001 when they offered shares to 500 staff members.

Thank you ...

