What is an Employee Stock Option Plan (ESOP)?

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About Employee Stock Option Plan (ESOP)

- Employee Stock Option Plan – which is **also called Employee Stock Ownership Plan** in India is a **benefit plan** that **offers employees the right to buy company shares at a predetermined price.**
- **Purpose**:
  - It's a tool companies use to **attract, retain, and reward employees**.
  - ESOPs help to **align employees' interests with the company's growth** and success.
- **Granting of Options:**
  - Under an ESOP, eligible **employees are granted the right, but not the obligation**, **to purchase company shares at a predetermined price**, known as the "**exercise price" or "strike price."**
  - This price is **typically set at a discount to the current market price** of the company's shares.
  - Employees **have to wait for a certain time period – known as the vesting period** – **before they can exercise the right** to purchase those specified number of shares.
- **All companies other than listed companies** should **issue it in accordance with the provisions of the Companies Act, 2013 a**nd Companies (Share Capital and Debentures) Rules, 2014.

- **In the case of listed companies**, they should **issue in accordance with the Securities and Exchange Board of India Employee Stock Option Scheme Guidelines**.
    - **To Whom Can The ESOP Be Issued? Rule 12(1) of Companies (Share Capital and Debentures) Rules, 2014** states that ESOP can be issued to the following employees-
    - **A permanent employee** of the company who is **working in India or outside India**.
    - **A Director of the company**, including a whole-time or part-time director but not an independent director.
    - **A permanent employee or director of a subsidiary company in India or outside India**, or holding company, or an associate company.
- **A company cannot issue ESOP to the following employees-**
    - An **employee who belongs to the promoter group** or **is a promoter of the company.**
    - **A director who either himself or through any body corporate** or through his relative **holds more than ten per cent of the outstanding equity shares** of the company, whether **directly or indirectly.**
    - However, the **above two conditions do not apply to Startup Companies for a period of ten years from the date of its incorporation**.

Q1) What is Equity Security?

An equity security, often referred to simply as “equity,” represents ownership in a company or corporation. When you hold equity in a company, you are considered a shareholder, which means you have a partial ownership stake in that company. Equity securities are a type of financial instrument that allow individuals, institutions, and investors to invest in and participate in the success (or failure) of a company.

Source: Startups: MPs’panel for making ESOPs non-taxable till sold

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