<u>Quick tips on Employees' Stock Options</u>

Organizations at all levels face the challenges of employee attrition. There are challenging times in big or small sized business houses where the management anticipates future profitability but expresses inability to compensate the employees at the present instance.

This brings the relevance to understand the concept of "employees' stock option".
As per provision of section 2(62) of the Companies Act, 2013, employee stock options are the <u>options</u> given <u>to the directors, officers or employees</u> of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the <u>benefit or right to purchase, or to subscribe for, the shares</u> of the company at a <u>future date</u> at a <u>pre-determined price</u>;

It is basically a deferred compensation plan which helps a company to retain its key personnel.

Here we will answer some striking questions that help any entrepreneur to decide and adoptany employees' stock option policy (ESOP).

Barely Answered Questions on ESOPs:

1. Does the issuance of ESOP make an employer lose the ownership of shares/ control in the company to an outsider?

   Response:It is generally observed that there is concern amongst the business owners which restricts them from floating the employee stock option scheme in their companies. They generally fear to lose control in the company to the mercy of employees who might misuse the rights acquired under the ESOPs converted shares against the promoters or the Company. To cover such situation ,restrictive clause can be incorporated in the scheme as per which the employees who had acquired the shares under ESOP would have a limited right in the company, they can be kept away from the voting rights and accordingly in the management of the company.

   Further the scheme may even have restrictive clauses pertaining to transfer of shares which could mandate the employees to transfer the shares back to the company/ trust in the event the employee intends to resign from the company/ decides to not to continue to hold the shares in the company.

2. Do these ESOP require company to go through the process of buy back every time an employee resigns?

   Response: It is general accepted notion that in case of private limited companies where an employee resigns from the company, the company should buy-back those shares, but practicality buy-back of shares is a cumbersome process with both technical and monetary complexities, so it is generally advised that the company should float ESOP scheme under the trust route. In such case if the employeeresigns the shares in turn will go back to the trust.

3. Employees concern that accepting ESOP may restrict their job movement from the company? Is there any resort to meet this impediment?

   Response: The employees on the other hand have a fear that acceptance of ESOP would restrict them to switch to the other job opportunities that in a way would restrict the acceptance of policy by the employees and the payment made by them towards acquiring the options might get wasted. So, in order to bring about a whelming acceptance for ESOP from the employees' side, the company can give the right to the employees to surrender the options in case they do not intend to continue with the company.

   However, the Company may also further decide to either forfeit or to refund the monies paid towards acquiring the options.

Benefit of giving ESOPs:

- securing the long-term commitment and retention of key resources;
- incentive for better performance;
- enhances productivity and profitability of the company;
- ESOPs are the options initially and not shares issued at the first instance, the options are materialized after the fulfillment of terms provided therein;

Guiding principles of drafting ESOP Scheme:

Employee stock options floated by a company are governed by the provisions of the scheme, that is a customized charter document which drives the entire Policy on the subject matter. It includes the legal clauses pertaining to:

- Administration of the ESOP;
- Eligibility of employees;
- Vesting and exercise of options;
- Exercise Price and manner of arriving at the price for the exercise of options
- Terms and conditions covering various eventualities like employee cession, retirement, employee death etc.
- Manner of arriving at the price for exercise of options;
- Procedural aspects and clarities, wherever required

Method of operation of an ESOP Policy

1. Trust Route:

In this method, a Trust is specifically created and registered for the purpose of implementation of ESOP. A company drafts a scheme and gets it approved. Simultaneously, a Trust is formed and registered to act as an intermediary between the company and employees. In this structure, trust is funded by the company itself and its financial obligations are fulfilled by the company by the way of loan. The company issue shares to the trust only and in turn, the trust is responsible to issue the shares to the option holders upon the exercise of option by them. Also, the funds are utilized by the trust to acquire shares either by subscribing to the issue of shares by the company or from the secondary market. Generally, it is observed that shares are transferred by the promoters of the company. The procedural aspect regarding the issue of shares is governed by the prevailing scheme.

2. **Direct Route**:

Under this route, the Company grants option to the eligible employees and upon the exercise the Options at the stipulated time, fresh equity shares are directly issued by the Company to such employees. This is convenient for the private limited Companies. However, the under this route each time the employee exits the Company will have to buy back the shares, following the complex

Procedure as prescribed

It is imperative to keep in mind that the ESOP scheme should be drafted and implemented in a manner that it is fair and beneficial to the employees otherwise the whole purpose of ESOP as a tool to attract and retain talent may be lost and would bring about a negative sentiment in the organization.

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