

ESOP: Process & Allotment

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Topic: ESOP, Allotment, process & FAQ's

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-)

1. A permanent employee of the company who is working in India or outside India.
2. A Director of the company, including a whole-time or part-time director but not an independent director.
3. A permanent employee or director of a subsidiary company in India or outside India, or holding company, or an associate company.
4. A company cannot issue ESOP to the following employees-
5. An employee who is belonging to the promoter group or is a promoter of the company.
6. 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.

Process Of Issue Of ESOP

(Section 62(1)(b) of the Companies Act, 2013 and Rule 12 of Companies (Share Capital and Debentures) Rules, 2014 ("Rules") governs the issuance of ESOP. The procedure for issuance of ESOP under the Rules is similar to that of the procedure under the Securities and Exchange Board of India Employee Stock Option Scheme Guidelines for listed companies).

The process for issuing ESOP by a company are:

1. Prepare the draft of ESOP in accordance with the Companies Act, 2013 and Rules.
2. Prepare the notice for the board meeting along with the draft resolution to be passed in the board meeting.
3. Send the notice of the board meeting to all the directors at least seven days before the meeting.
4. Pass the resolution for the issuance of shares through ESOP, determine the price of shares to be issued pursuant to ESOP and fix time and date and approve for calling the general meeting to pass a special resolution for issuing ESOP.
5. Send the draft minutes of the board meeting to all the directors within fifteen days of its conclusion and file the MGT-14 form with the Registrar of Companies of passing the board resolution.

6. Send notice of the general meeting to all the directors, auditors, shareholders and secretarial auditors of the company at least before twenty-one days of the date of the meeting.
7. Pass the special resolution for the issuance of shares under the ESOP to the employees, directors and officers of the company in the general meeting.
8. File MGT-14 form with the Registrar of Companies within thirty days of passing the special resolution in the general meeting along with the documents.
9. Send options to the employees, directors and officers of the company for purchasing shares under ESOP.
10. Maintain a 'Register of Employee Stock Options' in Form No.SH-6 and enter the particulars of the ESOP granted to the employees, directors or officers of the company.
11. If a private company wants to issue ESOP, then it should ensure that the Articles of Association (AoA) authorises for issuance of shares through ESOP. If the AoA does not authorise, then the company should first hold an extraordinary general meeting to alter the AoA to include the provisions of issuance of shares through ESOP and then proceed with holding the board meeting for the passing of the resolution and getting the shareholder's approval for ESOP Scheme.

Allotment of ESOP

1. There are three terms that are mainly focused on the time of issuance of shares through ESOP to the employees. They are as follows-
2. **Grant:** Grant means the issue of stocks to the employees. It means informing the employee that he is eligible for ESOP. The company will have the freedom to determine the exercise price while providing the option of ESOP to the employees.
3. **Vest:** Vest means the right of the employees to apply for the shares granted to them. There shall be a minimum of one year between the grant of option and vesting of option for the ESOP scheme.
4. **Exercise:** The exercise period is where the employees can exercise the option of buying the shares. The company will have the freedom to specify the lock-in period for the shares issued (if any) after the exercise of the option. The employees will not have the right to receive any dividend or to vote or enjoy the advantages of a shareholder in respect of the ESOP granted to him until the shares are issued on exercise of his option.

Disclosures To Be Made While Issuing ESOP

1. The company should make the following disclosures in the explanatory statement annexed to the notice for passing the special resolution for the issuance of ESOP-
2. The total number of stock options which is to be granted,
3. The identified class of employees who can participate in the ESOP,
4. Requirements of vesting period of ESOP,
5. Maximum period within which the options can be vested,
6. The exercise price and process of exercise,
7. The lock-in period, if any,
8. The grant of the maximum number of options for an employee,
9. The methods used by the company to value its options,
10. The conditions of lapsing of the options vested in employees,
11. A statement that the company will comply with the applicable accounting standards.

Frequently Asked Questions

Is ESOP beneficial for employees?

ESOPs are an important form of remuneration for employees. It helps to maintain the liquidity of a startup and it acts as a reward for loyalty for the employees. Startups have found ESOPs to be an attractive motivation for joining a company besides the in-hand salary. ESOPs encourage a feeling of ownership in the employee, especially when they can't afford very high compensation packages.

Who is considered as a permanent employee for the issue of ESOP?

The legal provisions of ESOP do not explain the term – 'Permanent Employee' nor it has been defined under the Companies Act. Considering the practical aspects, in the case of listed and unlisted companies, an employee who has completed the probation period can be considered to be a permanent employee.

Can the ESOP scheme also include future employees?

Yes, the ESOP scheme can cover both existing and future employees of the company, i.e. employees who join after the approval of the scheme.

Can the exercise price of the ESOP be less than the face value?

No. A company can set the exercise price below the prevailing market price or at a discounted price but it cannot be below the face value of the shares.

Can the exercise price be different for each employee for the same exercise date?

Yes. The grants may be given to each employee or class of employees at a different exercise price on a discretionary basis.

Checklist:

Documents & Information to Call from Client (For Drafting ESOP Scheme & Grant Letters)

1. Company Master Details:

- 1.1. MOA & AOA (for restrictions, clauses related to share capital, etc.)
- 1.2. Latest Shareholding Pattern / Cap Table- Number of shares, classes of shares, current shareholders
- 1.3. Valuation Report (if already available) – If not, ask if they want you to coordinate valuation too.
- 1.4. Updated registers.

2. Board & Corporate Details

- 2.1. List of Directors & Key Managerial Personnel (KMP) – For Board approvals and deciding eligibility
- 2.2. Existing Employee List (proposed ESOP beneficiaries) – Name, designation, DOJ, department

- 2.3. Employment Terms of Proposed Grantees– Any specific agreements, offer letters, etc., for reference (to check conflicts)

3. Scheme Drafting Inputs (for ESOP Policy):

Ask the client for their intent & preferences on:

- 3.1. Eligibility Criteria – Who will be covered (employees, directors, consultants?)
- 3.2. Vesting Schedule – Standard is 4 years with 1-year cliff, but ask what they want
- 3.3. Exercise Price – Face value, FMV, or other?
- 3.4. Lock-in or Transfer Restrictions – Post-exercise lock-in? Buy-back terms?
- 3.5. Treatment of Resignation/Termination/Death– What happens to unvested/vested options?

4. Compliance & Filings:

- 4.1. Board Meeting Minutes & Resolutions (if available) – For records, if they've done anything informally yet
- 4.2. Statutory Registers (if required for reference) – Register of Members, etc., to align with share data

Summary: What You Should Ask the Client For

Document / Data

MOA & AOA

Latest Shareholding

Valuation Report

Employee List (proposed grantees)

Terms of Employment (if any specific cases)

ESOP Preferences (vesting, exercise price, lock-in)

Board Meeting Dates (if already scheduled)

Purpose

Check powers & restrictions

Draft cap table, check dilution

For deciding exercise price

For preparing grant letters

For checking clauses

For drafting scheme

To align your drafts

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