CORPORATE LAWS

EMPLOYEE STOCK OPTION SCHEMES - AN ANALYSIS

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Infosys Technologies Ltd. virtually pioneered the concept of Employee Stock Option Schemes (ESOS) in India around a decade back. ESOS is a contract between a company and its employees that gives employees the right to buy a specific number of equity shares of the company at a fixed price within a certain period of time. Employees who are granted stock options hope to profit by exercising their options and selling the shares in the market at a higher price as compared to the price at which the shares were issued to them. Many Companies are using ESOS to compensate, retain, motivate and attract employees. This article endeavours to present a detailed analysis of the salient features, advantages, disadvantages, regulatory framework and the compliances required for the employee stock options.

INTRODUCTION

1. Many companies are using Employee Stock Option Schemes (ESOSs) to compensate, retain, motivate and attract employees. ESOS is a contract between a company and its employees that gives employees the right to buy a specific number of equity shares of the company at a fixed price within a certain period of time. Employees who are granted stock options hope to profit by exercising their options and selling the shares in the market at a higher price as compared to the price at which the shares were issued to them. In India, it is popularly known as 'Employee Stock Option Plans' or ESOPs. It is somewhat similar to a call option contract that is traded at stock exchanges since both give a right to their holder, but not an obligation to buy the shares. The difference, however, is that ESOS does not expire within three months as is the case with a 'call/put option' contract that is traded at the stock exchanges. Similarly, in an option contract, the option writer charges a premium from the buyer of the option, whereas in case of ESOS the employees are not required to pay any such premium to the company ('option writer').

The rationale behind employee stock options is that the employees should have a stake in the company so that they not only share the prosperity of the company but also bear some risk. When the employees become shareholders of the company, they have a feeling of ownership and belongingness towards the company which acts as a strong motivational force leading to accelerated growth of the company. In the western countries, stock options form a considerable part of the remuneration/compensation package of employees, particularly the

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senior employees. Almost all the fortune 500 companies provide stock option schemes to their employees and all the employees are covered under such schemes. More than 1,000 employees of Microsoft Corporation have become millionaires through stock options. These companies look at ESOS as an opportunity for wealth creation. Thus, for them, employee compensation package is not just salary and perquisites but salary *plus* wealth creation opportunity. Infosys Technologies Ltd. virtually pioneered the concept of ESOS in India around a decade back, as a result of which many of its employees have turned millionaires. Several other software service sectors as well as manufacturing companies like Wipro, Bharti Airtel, Polaris, Mphasis BFL, Rolta, ITC, Glenmark Pharmaceuticals, Nicholas Piramal, HDFC Bank, Cairn India, etc., have introduced ESOS. The primary reason for the popularity of ESOS in companies in knowledge based sector is that these companies derive their competitive strength from the talent and skills of their employees, who are critical for success of the company.

SALIENT FEATURES OF EMPLOYEE STOCK OPTIONS

2. Securities and Exchange Board of India framed the SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 which became effective on June 19, 1999 and have been amended thereafter from time to time. These Guidelines apply to all the companies whose shares are listed on any recognised stock exchange in India. As per the aforesaid Guidelines, 'Employee Stock Option' means the option given to the Whole-time directors, officers or employees of a company, which gives such directors, officers or employees, the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a predetermined price. Section 2(*15A*) of the Companies Act, 1956 also defines the 'Employee Stock Option' in the same words. In fact, the aforesaid definition was first inserted in the Companies Act, 1956 by the Companies (Amendment) Act, 2000 with effect from December 13, 2000 and thereafter the same definition was incorporated in the SEBI guidelines also with effect from June 30, 2003. The salient features of an employee stock option are as follows :-

- An option is given to employees to acquire equity shares (or other convertible securities) in the company after a future date but the price is fixed in advance.
- The employee has the choice to decide whether to acquire the shares/convertible securities or not.
- In case the employee opts for the shares, he has to exercise an option and pay the agreed price.
- In case the employee decides not to acquire the shares and the option lapses, he does not lose anything except the notional loss as he would have anticipated some profit at the time when the option was granted to him.

- After the lock-in period (if any), the employee can sell the shares in the market and realize the gain.
- The employees holding stock options do not have the right to receive dividend or vote or enjoy any other privileges of a shareholder till the shares are actually issued on exercise of option, after the completion of vesting period.
- The options granted to employees are not transferable to any other person. The option granted to the employee cannot be pledged, hypothecated, mortgaged or otherwise alienated in any other manner.

DIFFERENCE BETWEEN EMPLOYEE STOCK OPTION, EMPLOYEE STOCK PURCHASE AND SWEAT EQUITY

3. For the purpose of introducing employee stock option, a scheme has to be framed in accordance with the SEBI guidelines, which has to be approved by the board of directors and the shareholders of the company. The scheme has to be administered by a Compensation Committee consisting of a majority of independent directors. ESOS involves a number of regulatory compliances. Under ESOS, employees have to wait for at least one year for the allotment of shares, which is called vesting period. However, there may not be any lock-in period after allotment.

'Employee Stock Purchase Scheme' (ESPS) means a scheme approved by the board of directors and the shareholders of the company, under which the company straightaway offers shares to its employees as part of a public issue or otherwise. ESPS provides immediate gratification to employees as compared to ESOS which involves longer vesting period. In ESPS the lock-in period after allotment is one year, except when the shares are issued to employees as a part of public issue and at the same price at which the shares are issued to public. In ESPS, the regulatory compliances are not much but at the same time its advantages are also limited as compared to ESOS.

Sometimes, the terms 'Employee Stock Options' and 'Sweat Equity' are used interchangeably but both are altogether different concepts. Sweat equity is governed by section 79A of the Companies Act, 1956. In addition thereto, the listed companies have to comply with the SEBI (Issue of Sweat Equity) Regulations, 2002 and the unlisted companies have to comply with Unlisted Companies (Issue of Sweat Equity Shares) Rules, 2003 before the issue of sweat equity shares. 'Sweat Equity' means the equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called. Thus, it is clear that sweat equity can be offered/given only to very few selected employees who are involved in scientific research or technical fields, whereas ESOS and ESPS have wide coverage as they can be offered to almost all the permanent employees of the company across

all departments/functions after appraisal of their performance/achievements. The sweat equity shares are subject to lock-in period of three years. Moreover, in case of listed companies, sweat equity shares have to be issued at a price which shall not be less than the higher of the following two averages :—

(i) The average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the six months preceding the relevant date;

(ii) The average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the two weeks preceding the relevant date.

In case of unlisted companies, the fair price for issue of sweat equity shares has to be calculated by an independent valuer. On the other hand, all the companies including the listed companies have complete flexibility to fix the price at which the shares are to be issued to employees under ESOS or ESPS.

ADVANTAGES OF ESOS

4. Given below are certain advantages of ESOS :

- It is an innovative way to retain employees since the employees are tempted to stick to their present company till the vesting of stock options. Therefore, sometimes ESOS are also referred to as 'golden handcuffs'.
- ESOS can be effectively used to reward high calibre employees; since the company can give stock options instead of giving hefty performance bonus/incentive in cash. Thus, the company can save precious cash which can be utilized for other purposes. Rather, when the employee exercises the option and the shares are allotted, it results in cash inflow for the company.
- ESOS inculcates a sense of ownership and belongingness amongst the employees which enhances their dedication, commitment and loyalty towards the company.
- It facilitates in proper alignment of the individual goals of the employees with the overall goals of the organization.
- ESOS is a very effective tool to motivate employees. It has the capacity to convert average performers into high performers.
- ESOS is not treated as taxable perquisite in the hands of employee whereas performance bonus/incentive paid in cash is a taxable perquisite. Thus, there is no immediate tax liability for the employees at the time of allotment of shares.
- In case an employee sells the shares within one year from the date of allotment, short-term capital gains tax is payable on the difference between the sale price and the fair value, which was arrived at on the

date of vesting of stock options. However, if the shares are sold after one year from the date of allotment, there is no tax liability since the long-term capital gain is tax-free, subject to the condition that the shares have been sold through a recognised stock broker, who has issued a valid contract note and the Securities Transaction Tax (STT) has been paid.

DISADVANTAGES OF ESOS

5. Given below are certain disadvantages of ESOS :

- Stock markets are highly volatile and the share prices may go up or down to the extent of 20 per cent in a single day. Thus, the waiting period of one year for the vesting of stock options and thereafter the time involved in exercise of options, allotment and listing of shares followed by the lock-in period (if applicable) is too much wait for the employees to encash their options. During this waiting period, quite often the stock price dips below the issue price which makes the entire process meaningless.
- ESOS can increase the financial risk of employees in case they over-invest in their company and the share price falls at the stock exchanges. The employees of well-known companies such as Enron and Worldcom lost substantial part of their savings by over-investing in their company's stock, when these companies became bankrupt.
- The difference between the 'fair value' and the discounted 'exercise price' has to be treated as employee compensation and as such the same has be debited to the profit and loss account of the company. This leads to reduction in net profits and EPS of the company. However, it is just one side of the coin since the enhanced level of employee dedication and motivation, due to implementation of ESOS, can easily offset such costs by increasing the productivity and profitability of the company.
- The company has to pay the 'Fringe Benefit Tax' (FBT) at the time of exercise of stock options, which is an additional burden on the company. The value of 'fringe benefit' is the difference between the fair value of options (as on the date of vesting) and the exercise price. Some of the companies have started recovering FBT from their employees, which becomes a sort of disincentive for the employees.
- The employees are regarded as 'Insiders' in terms of the SEBI (Prohibition of Insider Trading) Regulations, 1992 due to which they have to comply with the said Regulations which, *inter alia*, requires that the designated employees cannot sell the shares of their company during the period when the trading window is closed. Besides this, certain other compliances have to be observed by the employees under the aforesaid SEBI Regulations, which increases the paper work of employees who have been allotted shares under ESOS.

- The options cannot be transferred and therefore the employees cannot mitigate their risks by selling the whole or part of the options, before the shares are allotted. There has been a debate from quite sometime that the stock options should be made freely transferable just like rights entitlements can be renounced by the shareholders in case they don't wish to subscribe to the rights shares. However, it may be noted here that rights issue is a way of rewarding the existing shareholders for their continued association with the company, whereas ESOS is a way of ensuring long association of the employees with the company. Thus, the basic objective of ESOS, *i.e.*, retention of talented employees will be defeated if the stock options are made freely transferable.
- In case the ESOS scheme has a lock-in period after allotment of shares, then it leads to blocking of funds. Due to the lock-in restrictions, the employees cannot sell the shares even to meet their emergency needs.
- ESOS leads to dilution in the shareholding percentage of other shareholders including the promoter group.
- Last, but not the least, most of the employees while switching over from one company to another usually ask their prospective employer to compensate them for the loss they will incur on account of foregoing the unvested stock options. In case the prospective employer agrees to compensate such loss, the basic purpose of ESOS gets defeated.

ELIGIBILITY TO PARTICIPATE IN ESOS

6. The companies have been given the flexibility to decide regarding the category of permanent employees who may be covered under ESOS. As per the definition of 'Employee' given in the SEBI guidelines, it includes directors and whole-time directors. However, an employee who is a promoter or belongs to the promoter group is not eligible to participate in ESOS. Similarly, a director who either by himself or through his relative(s) or through any body corporate, directly or indirectly holds more than 10 per cent of the equity shares of the company, is also not eligible to participate in ESOS.

It may be noted here that it is not necessary to cover all the classes of employees under the scheme. Thus, a company has the option to exclude the employees belonging to the categories whose role is not critical since their performance may not have much impact on the topline and bottomline of the company. However, in order to build up team spirit in the organisation, it is desirable that ESOS should have maximum possible coverage.

Recently, the SEBI has *vide* its Circular No. SEBI/CFD/DIL/ESOS/4/2008/04/08 dated August 4, 2008 permitted the nominee directors appointed by the financial institutions, banks, etc., on the board of

directors of the assisted companies to participate in ESOS subject to the provisions of the contract/agreement entered into between such director and the nominating institution.

The aforesaid contract shall, *inter alia*, specify the following :

(*a*) Whether options granted by the company under ESOS can be accepted by the said employee in his capacity as director of the company;

(*b*) that options, if granted to the director, shall not be renounced in favour of the nominating institution; and

(*c*) the conditions subject to which fees, commissions, ESOS, other incentives, etc., can be accepted by the director from the company.

The institution has to file a copy of the contract/agreement with the company, which, in turn, has to file the same with the stock exchanges on which its shares are listed. The director so appointed is also required to furnish a copy of the aforesaid contract/agreement at the first board meeting of the company attended by him.

In a way, the aforesaid amendment in SEBI ESOS guidelines is a welcome move since it will motivate the nominee directors to oversee the company's working with renewed dynamism and contribute their best for the progress of the company. However, the above move may prove to be disastrous if the nominee directors are tempted to compromise the interest of the nominating institution in lieu of the stock options that may be granted to them.

STAGES IN ESOS PROCESS

7. The various stages in the process of employee stock options are given below:—

- *Grant* - It means issue of stock options to employees under ESOS. In other words, some employees are identified based upon their performance/achievements and are granted stock options which enable them to subscribe to the company's shares/convertible securities at a certain price within the stipulated period. The employees may be required to pay an upfront amount at the time of grant of options, depending upon the provisions of the scheme framed by the company. The said amount is adjusted when the shares are allotted on exercise of options.

- *Vesting* - Vesting means the process by which the employee gets the right to apply for and be issued shares of the company under the options granted to him. Till the vesting takes place, the employee does not have a right to apply for the company's shares. Upon vesting, the employee gets an unfettered right to apply for the issue of shares. In case an employee resigns from the services of the company or his employment is terminated, due to any reason whatsoever, all the

unvested options expire but the employee can retain the vested options.

- *Vesting Period* - It means the period during which the vesting of the options granted to an employee takes place. The SEBI guidelines provide that the vesting period shall not be less than one year from the date of grant of options. However, in case of merger of two companies, if the options are proposed to be granted by the transferee-company to an employee of the transferor-company in lieu of the options already held by him in the transferor-company, then the period which has already lapsed since the grant of options by the transferor-company shall be deducted from the minimum vesting period required under the ESOS of the transferee-company.
- *Vesting percentage* - It refers to that portion of the total options granted, which an employee is eligible to exercise. In other words, vesting of the entire lot of options granted can take place either in one stroke at the completion of a fixed period (say one year or two years from the date of grant of stock options) or it can be 'staggered' or 'phased' vesting. For example, if an employee was granted 1,000 options on January 1, 2009 with a vesting schedule of 30 per cent, 30 per cent and 40 per cent at the end of 1st year, 2nd year and 3rd year, respectively, from the date of grant of options, then 300 options will vest on January 1, 2010, 300 options will vest on January 1, 2011 and 400 options will vest on January 1, 2012. Suppose the aforesaid employee tenders his resignation on July 31, 2011, then he would have to forego 400 options as the same would vest on January 1, 2012.
- *Exercise Period* - It means the time period after vesting within which the employee should exercise his right to apply for the shares, otherwise the vested options would lapse. This period starts from the date of vesting of options.
- *Exercise* - It means making of an application to the company by an employee together with the requisite amount, for issue of shares against the options already vested.

ROLE OF COMPENSATION COMMITTEE

8. As a first step, the board of directors of every company intending to commence ESOS has to constitute a Compensation Committee for the purpose of administration and superintendence of the ESOS. The 'Compensation Committee' is a committee of the board of directors consisting of majority of independent directors. The board has to appoint a SEBI registered Merchant Banker also for framing the ESOS and to obtain the in-principle approval of the stock exchanges, immediately after the stock options are granted to employees. The information to be furnished to the stock exchanges for obtaining the in-principle approval is contained in Schedule V of the SEBI guidelines. The merchant banker and the Com-

pensation Committee formulate the detailed terms and conditions of the ESOS including:—

(*a*) identification of classes of employees entitled to participate in ESOS and the quantum of options that can be granted under ESOS per employee and in the aggregate.

(*b*) the conditions under which the options already vested in employees may lapse in case of termination of employment for misconduct.

(*c*) the exercise period within which the employee should exercise the option, otherwise the option would lapse.

(*d*) the specified time period within which the employee should exercise the vested options in case he tenders his resignation or his services are terminated.

(*e*) the right of an employee to exercise all the options vested in him at one time or at various points of time within the exercise period.

(*f*) the procedure for making a fair and reasonable adjustment to the number of options granted and to the exercise price in case of corporate actions such as rights issue, bonus issue, merger, sale of division and others. The compensation committee in order to protect the interests of the option holders has to take into account the following :

(*i*) the adjustment required in number and the price of ESOS so that total value of the ESOS remains same even after the corporate action.

(*ii*) global best practices in this area including the procedure followed by the derivative markets in India.

(*iii*) the vesting period and the life of the options should not be altered as far as possible.

(*g*) the grant, vest and exercise of option in case of employees who are on long leave; and

(*h*) the procedure for cashless exercise of options. The company may itself fund the stock options subject to the provisions of section 77(2) of the Companies Act, 1956 or permit some empanelled stock broker to fund the payment of exercise price which shall be adjusted against the sale proceeds of some or all the shares.

In addition to the above, the Compensation Committee has also to frame suitable policies and systems to ensure that there is no violation of the SEBI (Prohibition of Insider Trading) Regulations, 1992 as well as the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to the Securities Market) Regulations, 1995.

APPROVAL OF SHAREHOLDERS

9. The companies granting stock options to their employees pursuant to ESOS have complete freedom to determine the exercise price subject to

compliance with the accounting policies specified in the SEBI guidelines and the approval of the shareholders. Stock options cannot be offered to employees, unless the shareholders of the company approve ESOS by passing a special resolution at a general meeting in terms of section 81(1A) of the Companies Act, 1956. The explanatory statement pursuant to section 173(2) of the Companies Act, 1956 should, *inter alia*, contain the following information/disclosures:—

(*a*) the total number of options to be granted.

(*b*) identification of classes of employees entitled to participate in the ESOS.

(*c*) requirements of vesting and period of vesting.

(*d*) maximum period within which the options shall be vested.

(*e*) exercise price or pricing formula.

(*f*) exercise period and process of exercise.

(*g*) the appraisal process for determining the eligibility of employees to the ESOS.

(*h*) maximum number of options to be issued per employee and in aggregate.

(*i*) a statement to the effect that the company shall conform to the accounting policies specified in the SEBI Guidelines.

(*j*) the method which the company shall use to value its options, whether fair value or intrinsic value.

(*k*) the following statement :

'In case the company will calculate the employee compensation cost using the intrinsic value of the stock options, the difference between the employee compensation cost so computed and the employee compensation cost that would have been recognized if it had used the fair value of the options, will be disclosed in the Directors' Report and also the impact of such difference on the profits and EPS of the company.'

◆ *Approval of shareholders by way of a separate Special Resolution is required in case :*

(*a*) the options are to be granted to the employees of a subsidiary or holding company.

(*b*) the options to be granted to some identified employees, during any one year, are equal to or more than 1 per cent of the issued capital of the company.

The company may by a special resolution vary the terms of the options already granted to employees under ESOS, pursuant to an earlier resolution of a general body which have not yet been exercised by the employees, provided that such variation is not prejudicial to the interests of the option holders. The notice of the general meeting convened for passing the

special resolution for variation of terms of ESOS shall disclose the full details of the variation, the rationale therefor and the details of the employees who are likely to be benefited by such variation.

EXERCISE OF OPTION

10. An option is valuable since it gives the employees a right, with no obligation, to subscribe to the shares/convertible securities of the company at a pre-determined price. In due course of time, if the share price increases at the stock exchanges, the employees who were granted stock options can exercise these options and acquire the shares at the pre-determined price, which is lower than the market price. It may be noted here that the options can be exercised only after completion of the vesting period, which is minimum one year from the date of grant of stock options.

Whenever the stock's market value is greater than the exercise price, the option is said to be 'in the money.' Conversely, if the market value is less than the exercise price, the option is said to be 'out of money' or 'under water'. In case the share price has gone below the exercise price, the employees may choose not to exercise the options. Stock options issued by almost all the leading software companies were rendered 'underwater' in the year 2000, when the dotcom bubble bursted. In the year 2008 also most of the stock options have suffered a similar fate as the stock market indices have come down by more than 50 per cent from their peak in January 2008, due to the global financial meltdown and the economic slowdown.

The SEBI guidelines permit the companies to forfeit the amount, if any, paid by employees at the time of grant of options in case the employees choose not to exercise the 'underwater' stock options. However, this is not an employee friendly gesture. Therefore, most of the companies re-price the stock options that have not been exercised by the employees due to fall in the market price of shares. The SEBI guidelines permit re-pricing of the unexercised options, irrespective of the fact whether they have been vested or not, by taking prior approval of the shareholders by means of a special resolution passed at a general meeting.

In the event of death of any employee, all the options granted to him vest in the legal heirs or nominees of the deceased employee. Therefore, the legal heirs/nominees of the deceased employee can exercise the vested options. In case any employee suffers permanent incapacity while in employment, all the options already granted to him as on the date of permanent incapacitation, vest in him on that day and can be exercised by him during the exercise period.

ALLOTMENT OF SHARES

11. Upon exercise of stock options by employees, the company has to take steps to convene a meeting of the committee of directors to pass a resolution for allotment of shares. Thereafter, the share certificates are issued or the shares are directly credited in the demat accounts of the

concerned employees through credit corporate action. A return of allotment has to be filed with the concerned Registrar of Companies pursuant to section 75 of the Companies Act, 1956. The company has to intimate the details of the shares allotted pursuant to the exercise of stock options, as per Schedule VI of the SEBI guidelines. In addition thereto, the company has to take the necessary steps to ensure prompt listing of the shares on the concerned stock exchanges.

SALE OF SHARES

12. The employees can sell the shares immediately after allotment if the ESOS does not stipulate any lock-in period post allotment. Clause 9.2 of the SEBI ESOS guidelines gives freedom to the companies to decide the lock-in period for the shares that are allotted pursuant to ESOS. It is worthwhile to note here that the latest amendments made in the SEBI (Prohibition of Insider Trading) Regulations, 1992 with effect from November 19, 2008 provide that the insiders (read 'employees' in this context) cannot sell the shares for a period of six months from the date of purchase. Similarly, they cannot sell the shares for a period of 30 days from the date of allotment in Primary Market Offerings (IPOs).

Since clause 9.2 of the SEBI ESOS guidelines specifically provides that there shall not be any lock-in period for the shares allotted pursuant to ESOS, until the Scheme framed by the company provides for the same, one can safely conclude that ESOS shares are not subject to any lock-in period despite the amendment made in the SEBI (Prohibition of Insider Trading) Regulations, 1992. In other words, the amended provisions of Insider Trading Regulations are applicable to insiders/employees who purchase the company's shares at the stock exchanges. In such cases, they would be bound to keep those shares as investment for at least six months, before entering into a sale transaction. This argument can be further substantiated by the fact that shares are acquired under a stock option scheme by means of 'subscription' and not by way of 'purchase', which is hit by the new Regulations. Moreover, as far as the subscription to the shares is concerned, the amended regulation under SEBI (Prohibition of Insider Trading) Regulations specifies that shares allotted in subscription to Primary Market Offerings (IPOs) cannot be sold for a period of 30 days from the date of allotment. Thus, other modes of subscription to shares like Rights Issue, Preferential Allotment and Employee Stock Option Schemes are exempt from the applicability of the abovementioned amendments in Insider Trading Regulations.

DISCLOSURE IN DIRECTORS' REPORT

13. The board of directors has to disclose either in the Directors' Report or as an annexure thereto the details of : (*a*) options granted; (*b*) the pricing formula; (*c*) options vested; (*d*) options exercised; (*e*) the total number of shares arising as a result of exercise of options; (*f*) options lapsed; (*g*) variation of terms of options; (*h*) money realised by exercise of options;

(*i*) total number of options in force; (*j*) employee-wise details of options granted to the following categories of employees :—

(*i*) senior managerial personnel.

(*ii*) employees who have been granted options exceeding 5 per cent of the total options granted during the year.

(*iii*) employees who have been granted options equal to or exceeding 1 per cent of the total issued capital.

(*k*) diluted Earnings Per Share (EPS), as per Accounting Standard 20, pursuant to issue of shares on exercise of options.

(*l*) Where the company has calculated the employee compensation cost using the intrinsic value of the stock options, the difference between the employee compensation cost so computed and the employee compensation cost that would have been recognized if it had used the fair value of the options, shall be disclosed. The impact of this difference on profits and on EPS of the company shall also be separately disclosed.

(*m*) Weighted-average exercise prices and weighted-average fair values of options shall be disclosed separately for options whose exercise price either equals or exceeds or is less than the market price of the stock.

At every AGM, the company has to place a Statutory Auditors' certificate stating that the scheme has been implemented as per the SEBI guidelines and the special resolution passed by the shareholders.

ESOS IN A BEARISH MARKET

14. The calendar year 2008 has been a year of turmoil for the global financial markets, that has affected even the stalwarts of the financial sector like Lehman Brothers, Bear Stearns, Merrill Lynch, Morgan Stanley, etc., just to name a few. Due to the financial crisis, vast unprecedented FII selling and the global economic slowdown, the Indian equity indices have fallen by more than 50 per cent from their January peak. Most of the non-index stocks have fallen by more than 70 per cent as compared to their price in January 2008. In situations like these, when stock prices have fallen like a pack of cards, investors become completely averse to equities and prefer to invest their surplus funds in Government Securities/ Treasury Bonds or commodities like gold where there is no chance of capital erosion. In such a gloomy scenario, employees also lose charm about the stock options.

In other words, during bearish phase in the stock markets, employees are neither interested in grant of fresh stock options nor they are interested in exercising the options already vested. However, the employees should understand very clearly that the price at which any company grants stock options is directly proportional or linked to the market price of shares. Therefore, when the market was high the price of the options granted was also very high due to which those options have become worthless paper

after the market crash. Now when the market has come down considerably, the price of fresh options that will be granted by the companies would be considerably lower as a result of which there is enough scope for capital appreciation in the next two to three years. Thus, the employees should try to grab as much options as possible during the bearish phase, rather than repenting on the past stock options that have become worthless paper.

Now we come to another important aspect, as to what is the fate of the existing stock options that were granted at high price during the bull run. The moot question is what should be done by the companies to sweeten the options already granted as employees are reluctant to exercise these options since the market price is considerably lower than the exercise price. In such a scenario, a company may take recourse to any of the following alternatives :—

- Wait and watch for the company's stock to stabilise and simultaneously counsel the employees that the stock markets would recover and the bear phase will not continue for a long time.
- Increase the exercise period so that the options already vested don't lapse.
- Cancelling the existing stock options and issuing equivalent number of fresh options at much reduced price after some time, say six months.
- Take a decision regarding re-pricing of the options through shareholders' approval, if the difference between the exercise price and market price is considerable.

These are some of the measures through which the company can show its employees that it is really concerned about the sagging share price and wants to protect the interest of its employees. Such measures will definitely go a long way in boosting the morale of employees.

CONCLUSION

15. The spectacular success of Silicon Valley companies and the resulting economic riches that have flowed to employees of such companies through stock options has been an eye opener for the corporates across the globe. The companies have understood that stock options work as a powerful motivational force that drives the collective efforts of employees towards the success of the company.

Moreover, with the growing awareness, favourable laws and globalisation even the family run Indian companies have also begun to offer stock options to their promising employees. However, unfortunately stock options have been projected as an easy way of becoming a millionaire. Thus, it is important to keep the expectations realistic because if the share price dips below the issue price in a bearish market, the employees don't get anything except frustration.