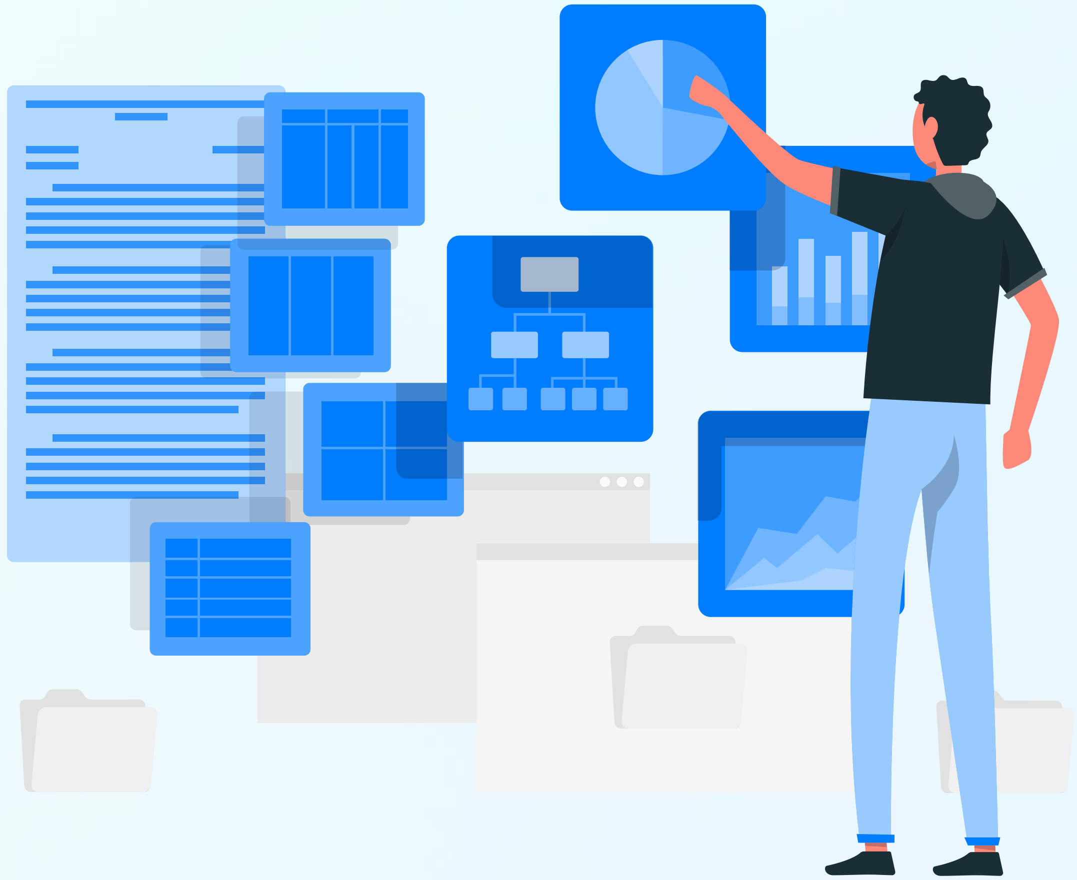
Vega Equity

ESOPs Cheat Sheet



What is ESOP?

The Employee Stock Option Plan (ESOP) is designed to provide company shares to employees at a discounted price compared to the current market value. It acts as an innovative employee compensation plan, fostering more dedication and encouraging a sense of ownership among employees toward the organization.

ESOPs in India are subject to regulation under both the Companies Act, 2013, & the Securities and Exchange Board of India Regulations, 2021. Companies have the flexibility to establish an ESOP through direct implementation or by opting for a trust structure.

Key Pain Points in ESOP Management

Communication Challenges:
Lack of effective communication about the ESOP (Employee Stock Ownership Plan) details and changes can lead to confusion among employees

Valuation Complexity:
Determining the FMV of company shares for ESOP transactions can be intricate & subjective, leading to dissatisfaction among employees

Regulatory Compliance:
Failure to adhere to regulatory requirements for employee stock options can result in penalties and legal complications

Employee Understanding & Education:
Inadequate educational programs about the benefits and risks of ESOPs may lead to skepticism and resistance among employees

Succession Planning:
Ensuring a smooth transition of leadership and decision-making processes is essential to maintain stability and continuity

Process Flow

- Designing the Different Aspects of the ESOP Plan
- Granting & Vesting of Employee Stock Options
- Exercise of Employee Stock Options
- Tracking, Reporting, & Continuous Monitoring
- Preparing and Conducting Liquidity Events
- Employee Exit and Treatment of Unvested Options

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ESOP Terms Explained

1 Accelerated Vesting

Employee stock ownership plans (ESOPs) come with a vesting period. This means that options can be exercised only after the vesting period is over. However, sometimes, the company can choose to shorten the vesting period of an employee. They may choose to do so to motivate the employee. This is known as accelerated vesting.

2 Buy Back

When a company opts to repurchase its own shares, it's termed a buyback. The company acquires the shares either from the open market or from the existing shareholders at a price exceeding the current market value. The company may choose to buy back when it intends to regulate the valuation of its shares or to prevent shareholders from accumulating a majority stake in the company.

3 Cliff

A cliff refers to a vesting schedule where employees gain ownership rights only after a specific period, typically one year. If an employee leaves before the cliff, they receive no stock benefits. For instance, with a one-year cliff, an employee who resigns within the first year receives no shares, but those who stay past the cliff date are entitled to the agreed-upon stock options or grants.

4 Dilution

When the earnings or book value per share decreases as a result of issuing additional shares to shareholders, it is termed dilution. Consider when a new shareholder acquires ownership of company shares. This influx of new shares leads to a dilution of share value for existing shareholders.

5 Exercise

In ESOPs, exercising the right refers to the action taken by an employee to acquire company shares at a predetermined price. This move allows the employee to convert their options into actual shares after the vesting period, thereby capitalizing on any increase in the company's value over time and realizing a potential profit.

6 Fair Market Value (FMV)

FMV, or Fair Market Value is the value at which the company's options can be traded in the open market. It is the price at which both the buyer and the seller find a mutually beneficial agreement, as the buyer is willing to purchase and the seller is willing to sell at this particular price.

7 Grant Letter

A grant letter is a legally binding agreement provided by the company to an ESOP holder. This document comprehensively defines the allocated number of options, the duration of the vesting period, and the exercise price at which the employee can sell the options. Moreover, the grant letter explicitly outlines the potential scenarios that may arise if an individual opts to depart from the company before the vesting period concludes.

8 Vesting Period/ Schedule

Upon completing a designated waiting period, an ESOP holder attains the right to claim ownership of their stock options — a process commonly known as vesting. The employer defines the specific vesting period upon the initial grant of options. This acts as a powerful incentive for employees to commit to the organization for an extended duration, fostering improved dedication and motivation in their work.

About Vega Equity

Vega Equity is a **cloud-based digital equity management solution** that helps organizations manage their complex ESOPs and Cap table with ease. Offering a contemporary, user-friendly, and paperless approach to equity management, the platform streamlines operations for companies aiming for efficiency. With a host of features such as ESOP Pool, Granted Options, Vested & Unvested Options, Lapsed or Forfeiture Options, our platform acts as a single source of truth for all your ESOP-related data.