



FINANCIAL ANALYSIS

Sweat equity and ESOPs

Two ways a company can pay people in shares instead of cash, and the rules that govern each

Rules in force on 16 October 2026

For training and education only. Not investment advice.

Sweat equity hands over shares now. An ESOP gives a right to buy shares later at a price fixed today.

Both reward people with equity rather than cash. The difference is timing: one allots real shares at the start; the other grants an option the holder may exercise in future.

What each one is



Sweat equity

Equity shares a company issues to its directors or employees for non-cash value: their know-how, intellectual property or other value addition. The shares are allotted upfront, free or at a discount to price.



ESOP (stock option)

An option: the right, not the duty, to buy or subscribe to a set number of shares on a future date at a price fixed when the option is granted. The holder pays that price only on exercise.

Both are equity compensation under the Companies Act, 2013, and each needs shareholders' approval.

Sources: Companies Act, 2013, sections 2(88) (sweat equity) and 2(37) (employees' stock option).

Sweat equity: rules for unlisted companies

Rule	What it requires
Who approves	A special resolution of shareholders, stating the number of shares, the price, the consideration and who receives them.
Who may receive	Only directors or permanent employees, including those of a holding or subsidiary company. The shares rank with other equity shares.
Valuation	A registered valuer values the shares and the know-how, intellectual property or value addition being paid for.
How much	In a year: 15% of paid-up equity capital or shares worth ₹5 crore, whichever is higher. At any time: no more than 25% of paid-up equity.
Lock-in	Sweat equity shares cannot be transferred for three years from the date they are allotted.

Sources: Companies Act, 2013, section 54; Companies (Share Capital and Debentures) Rules, 2014, Rule 8.

How much sweat equity, in numbers

ONE COMPANY

A company has paid-up equity share capital of ₹40 crore.

It wants to pay some employees in sweat equity shares. Two limits apply at the same time.

- 1 In a year: the higher of 15% of ₹40 crore (= ₹6 crore) and ₹5 crore. So up to ₹6 crore of sweat equity this year.
- 2 At any time: sweat equity in issue may not exceed 25% of ₹40 crore = ₹10 crore, counting earlier years.
- 3 A recognised start-up is treated differently: up to 50% of paid-up capital = ₹20 crore, within ten years of incorporation.
- 4 Each figure is a ceiling set by the rules, not a target. The shares must still be valued and approved.

The yearly cap is the higher of two figures; the overall cap is 25% (50% for a recognised start-up).

Illustration with an assumed paid-up capital. The percentages and the ₹5 crore figure are from the rules.

Sweat equity next to an ESOP

Sweat equity

- Real shares, allotted at the start.
- Paid for with know-how, IP or value addition, or at a discount to price.
- Locked in, non-transferable, for three years after allotment.

ESOP

- An option first; shares only if the holder exercises it.
- The holder pays a price fixed on the grant date to get the shares.
- For an unlisted company, at least a year must pass between grant and vesting.

One pays for past value with shares now; the other offers a stake the holder earns and buys over time.

Sources: Companies Act, 2013, sections 54 and 62(1)(b); Rules 8 and 12, Share Capital and Debentures Rules, 2014.

Who makes the rules



Unlisted companies

Follow the Companies Act, 2013 and the Share Capital and Debentures Rules, 2014: Rule 8 for sweat equity, Rule 12 for ESOPs. The Ministry of Corporate Affairs administers these.



Listed companies

Follow SEBI's rules instead of Rules 8 and 12. The SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 put stock options, share purchase and sweat equity in one rulebook.

A listed company meets both the Companies Act and the SEBI regulations.

Sources: Share Capital and Debentures Rules, 2014; SEBI (SBEB and Sweat Equity) Regulations, 2021, notified 13 August 2021.

Why the start-up window matters

The 50% allowance applies to recognised start-ups, and India's recognised start-up base is large and still growing.

RECOGNISED START-UPS

2.23 lakh

DPIIT-recognised start-ups as on 31 March 2026.

ADDED IN FY 2025-26

55,200+

Recognised during 2025-26, the most in a single year since 2016.

WOMAN DIRECTOR

~48%

Share of recognised start-ups with at least one woman director or partner.

Source: Press Information Bureau, 'Government recognizes more than 55,200 startups during FY 2025-26', 17 April 2026 (DPIIT).

If you learnt this from older material

Older decks say

- Start-ups get the 50% allowance for five years from incorporation.
- Listed companies follow two SEBI rulebooks (2002 and 2014).
- A company must wait a year after starting business to issue sweat equity.

What holds now

- The window is ten years, after the 2020 amendment to Rule 8.
- One merged SEBI rulebook applies to listed companies, since 2021.
- The one-year-since-commencement bar was removed in 2018.

The framework has changed more than once; check the current rule before you quote it.

Sources: Companies (Share Capital and Debentures) Amendment Rules, 2020; Companies (Amendment) Act, 2017 (section 54(1)(c) omitted, effective 7 May 2018); SEBI 2021 Regulations.

Four things people get wrong



'Sweat equity and an ESOP are the same.'

One is shares allotted now for non-cash value; the other is a right to buy shares later at a price fixed today.



'Any company can issue it freely.'

Caps apply: the higher of 15% or ₹5 crore a year, 25% in total, 50% for a recognised start-up, plus a special resolution.



'Sweat equity shares can be sold at once.'

They are locked in and cannot be transferred for three years from the date of allotment.



'An ESOP is free money for staff.'

An option has to be earned over a vesting period and then bought at the grant price. The benefit can also be taxed.

Check yourself

Q1

A company wants to issue sweat equity. To whom may it issue these shares, and what shareholder approval does it need?

Q2

A company has paid-up equity capital of ₹20 crore. What is the most sweat equity it may issue in one year?

Q3

In one line, how does an ESOP differ from sweat equity?

Sources and disclaimer

SOURCES FOR THE FIGURES IN THIS DECK

- Definitions of sweat equity shares and employees' stock option: Companies Act, 2013, sections 2(88) and 2(37).
- Approval, eligibility, valuation, caps and lock-in for sweat equity (unlisted): Companies Act, 2013, section 54; Rule 8, Companies (Share Capital and Debentures) Rules, 2014.
- ESOPs (unlisted), including the one-year grant-to-vesting gap: Companies Act, 2013, section 62(1)(b); Rule 12 of the 2014 Rules.
- Start-up window extended 5 to 10 years: Companies (Share Capital & Debentures) Amendment Rules 2020. One-year-since-commencement bar omitted: Companies (Amendment) Act 2017, eff. 7 May 2018.
- Listed companies: SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021, notified 13 August 2021.
- Recognised start-ups (2.23 lakh as on 31 Mar 2026; 55,200+ in FY 2025-26; ~48% with a woman director/partner): Press Information Bureau release, 17 April 2026 (DPIIT).

This material is for training and investor education only. It is not investment, tax or legal advice and is not a recommendation to buy, sell or hold any security or scheme. Examples use assumed figures unless a source and date are shown. Mutual fund investments are subject to market risks; read all scheme related documents carefully. Trustner Asset Services Pvt. Ltd. is an AMFI-registered Mutual Fund Distributor (ARN-286886).