Analysis of the motivation and impact of the implementation of the employee stock ownership plan

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Abstract. Equity incentive can be divided into executive equity incentive (Executive Stock Option) and employee equity incentive (Employee Stock Option). Employees here refer to the intermediate managers, core technical personnel and other employees except for the senior executives of the company. The ESOP is a mechanism by which the employees of the company share the ownership of the company by holding the stock or options of the company. From the perspective of the implementation of the employee stock ownership plan motivation, its main theoretical basis can be divided into three categories, respectively is incentive theory (incentive theory, reduce agent costs, attract, retain quality employees and limited to financing constraints, reduce cash pressure), signal theory (undervalued company more inclined to internal equity incentives, let investors aware that the current company price relative to its internal value deviation) and major shareholders self-interest theory. From the theoretical point of view, this paper discusses the possible motives and results of domestic listed companies to launch the stock ownership plan, in order to provide theoretical support for small and medium investors to rationally understand the employee stock ownership plan, and provide regulatory suggestions to the regulatory authorities to be vigilant about the self-interest behavior of major shareholders.

Keywords: stock ownership incentive；Employee ownership；Major shareholders' self-interested.

1. Introduction

In modern enterprise system management, the separation of ownership and management rights has led to the inconsistency between shareholder interests and operator interests, resulting in agency problems. Finding a balance of interests between the two is one of the important issues that enterprises need to solve in their development. Employee Stock Ownership Plans (ESOWs) are a mechanism in which employees within a company share ownership and participate in the distribution of company profits by holding their own stocks or options. China began exploring employee stock ownership plans in the 1980s, but due to immature objective conditions such as regulatory systems and policy constraints, ESOs have not been widely implemented in listed companies.

In June 2014, the Guiding Opinions on the Pilot Implementation of Employee Stock Ownership Plans by Listed Companies (hereinafter referred to as the "Guiding Opinions") were issued, which clearly stated that listed companies can implement employee stock ownership plans according to the wishes of employees, and legally enable employees to obtain and hold company stocks for the long term, with share rights and interests distributed to employees according to the agreement. Since then, Chinese listed companies have gradually launched their own draft employee stock ownership plans. As of April 25, 2022, based on the announcement date of the plan, 80 A-share listed companies have issued employee stock ownership plan plans from January to April 2022 alone. Since the issuance of the Guiding Opinions, more than 1400 employee stock ownership plans have been implemented, and the breadth of the employee stock ownership market has increased from 2.33% in 2014 to over 30% currently.

Although the main design function of employee stock ownership plans is to motivate employees to improve performance, according to Wind data, over 60% of the employee stock ownership plans implemented by 307 listed companies since 2017 have been covered, with some companies experiencing floating losses exceeding 70%. According to data from June 2019, out of the 68 employee stock ownership plans in the Shanghai and Shenzhen stock exchanges since June 2018, employee stock ownership plans involving 35 listed companies were in a floating loss state. Since

2022, employee stock ownership plans have been intensively released. In the first quarter of 2022, 41 A-share listed companies have released employee stock ownership plans, and some listed companies have attracted market attention due to discount and low-priced acquisition of their stock ownership plans. In this context, this article attempts to analyze the actual motivations behind employee stock ownership plans and explore the possible motivations and outcomes for domestic listed companies to launch stock ownership plans. The aim is to provide practical experience for Chinese enterprises to implement employee stock ownership plans, provide case support for small and medium-sized investors to rationally understand employee stock ownership plans, and provide regulatory suggestions for regulatory authorities to be wary of the self-interest behavior of major shareholders.

2. Employee Stock Ownership Plan

Essentially, employee stock ownership plans are an incentive measure where ordinary employees of a company can become shareholders by purchasing company stocks. The original intention of this plan is to enable employees to better share in the profits of enterprise development, so that they can participate in the work and management of the enterprise as the masters, make employees more proactive in production labor, and reduce the cost of internal supervision in the enterprise.

Compared with other incentive methods, employee stock ownership plans have their inherent particularity. Compared with equity incentives, the uniqueness of employee stock ownership plans is mainly reflected in the following aspects. Firstly, the employee stock ownership plan focuses on core employees, and compared to equity incentives mainly targeting management, the employee stock ownership plan has a higher coverage. From the perspective of lock up period, equity incentives generally have strict requirements for the lock up period, and there are certain conditions for unlocking stocks. Compared to other options, employee stock ownership plans have higher flexibility. From a management perspective, after the ultimate exercise of equity incentive objects, they can obtain stocks and independently manage them, while ordinary employees participating in employee stock ownership plans cannot independently operate stocks. Instead, they need to establish independent third-party institutions or entrust asset management companies to uniformly manage the company's employee stock ownership.

3. Motivational implementation drivers

From the perspective of human capital theory, it is believed that the most important strategic resource of a company is human capital. According to the theory of human capital endowment, the level of human capital resources a company possesses will affect its competitive advantage and results in the same industry. The employee stock ownership plan plays an extremely significant role in human resource management and improving the level of human resources in enterprises. After employees obtain corresponding stocks through the employee stock ownership plan, their identity changes from being simply hired by the company as a worker to having a dual identity as both a worker and the owner of the company. In addition to receiving wages as labor income, enterprises can also participate in the sharing of surplus value. Basic fixed wages and non fixed surplus value increase employees' income choices and enrich the company's compensation measurement methods. In order to obtain as much surplus value as possible, employees who participate in employee stock ownership plans will be more actively involved in the production of the enterprise, which improves their production enthusiasm. In the long run, the work attitude and enthusiasm of employees determine whether a company can develop healthily in the long term. As an incentive measure, employee stock ownership plans can enhance the company's attractiveness to core talents, in order to achieve the goal of classifying, attracting, and retaining core talents (Zhou Donghua, 2019; Cao Yushan, 2019).

From the perspective of corporate governance supervision, employee stock ownership plans empower employees with management and voting rights over the company. Starting from the motivation to obtain higher residual value returns, employees have sufficient motivation and ability to participate in corporate governance. Shareholding employees will actively play a supervisory role (Sun, 2017), reduce management encroachment behavior (Yuan Xiaoping, 2019), improve the quality of company decision-making, improve the level of company information disclosure (Yao Shujie, 2021), reduce the moral hazard of executives, and reduce self interested behavior of management, Thereby reducing the agency costs of the enterprise.

On the basis of enhancing the return on human capital, employee stock ownership plans can also reduce the loss of human capital through certain designs. From the design of employee stock ownership plans, they generally have a certain lock in period. The higher the cost of employee turnover, the lower the probability and frequency of employee turnover. The lock in period setting of employee stock ownership plans can effectively combine the long-term interests of employees with the long-term interests of the company, thereby increasing the cost of employee turnover. Research has shown that employee stock ownership plans can effectively reduce employee turnover rates.

Of course, there are many incentive methods, mainly including cash payments and share based payments. Employee stock ownership, as a form of share based payment, is highly regarded by the capital market for its flexibility. Due to the fact that implementing employee stock ownership plans does not require cash expenditures from the company, as an incentive measure, it can avoid increasing the risk of financial strain or even cash flow disruption for the company. At the same time, when cash flow is tight, companies can even use employee stock ownership plans to finance their employees. Due to the lower degree of information asymmetry between internal employees and the company, the cost of this financing method will be lower than financing from external investors.

4. The implementation motivation of self-interest

Behavioral finance believes that the behavior of securities market participants exhibits an incomplete rational "disposal effect" characteristic, that is, they tend to quickly sell profitable assets and hold loss making assets for a long time. The restricted shares held by major shareholders from different sources have lower acquisition costs and can generate significant profits once sold. Their own demand for reducing their holdings is strong. A large amount of research has confirmed the existence of self-interest behavior in the reduction of holdings by major shareholders. Due to the existence of a lock in period of no less than 12 months, it can effectively reduce the impact of major shareholder reduction on the market in the short term, and the stock source of the shareholding plan is mainly purchased from the secondary market. The direct impact of major shareholder reduction on other shareholders is relatively small, and it is not easy to receive supervision and constraints from other shareholders, Moreover, ordinary employees have weak negotiation ability with major shareholders, so the launch of employee stock ownership plans is likely due to the self interested reduction drive of major shareholders.

Due to the scarcity of listing qualifications in our country, the "shell value" of listed companies is brought about, and controlling shareholders do not want to lose control of the enterprise. Therefore, controlling shareholders will take relevant measures to protect relevant equity, such as through related party transactions, refinancing, and other means (Liao et al., 2018). Therefore, in addition to the purpose of motivating employees, the introduction of employee stock ownership plans may also hide the defense of major shareholders against the invasion of "barbarians" The complex motivation for consolidating control (Zheng Zhigang et al., 2021).

Generally speaking, when a company's stock price is undervalued by the market, the company is more inclined to implement equity incentives for internal personnel, making investors aware of the current deviation of the company's stock price from its intrinsic value . In the framework of information asymmetry analysis, employees, as internal information advantages, voluntarily purchase company stocks, indicating confidence in the company's long-term development, Sent a positive signal to external investors. After receiving this signal, market investors will adjust their investment decisions and promote the stock price to return to a reasonable level. From the perspective of signal theory, compared to ordinary employees, management has a more obvious information advantage in terms of the company's operating conditions, and the voluntary subscription behavior of management sends a more positive signal to the market. Due to the external market effect of implementing employee stock ownership plans on increasing stock prices, companies may strengthen shareholder market value management through employee stock ownership plans. As Chen Yunjia et al. (2020) found, when stock prices drop significantly, companies will introduce employee stock ownership plans to alleviate the pressure of stock price decline. Finally, with the continuous development of the capital market, the equity pledge activities of domestic listed companies are becoming increasingly active. After the launch of the stock pledge repurchase business in 2013, the scale of equity pledge has shown an explosive growth trend. Before and after the major shareholders used equity pledge as a financing method, the controlling shareholders had a strong motivation to manage market value. Before financing, employee stock ownership plans can help shareholders inflate the value of collateral (equity) at the time of contract signing to reduce loan costs. After financing, When the stock price approaches the liquidation warning line, the risk of liquidation can be mitigated by introducing an employee stock ownership plan (Sun Xiaoyan et al., 2021).

5. The economic consequences and recommendations of employee stock ownership plans.

From a personal perspective, employee stock ownership plans can effectively enhance employee loyalty to the company, while highly binding employee and company interests to enhance employee dedication. From a company perspective, the employee stock ownership plan has a positive effect on improving the company's production efficiency and financial performance. At the same time, the employee stock ownership plan can effectively motivate employees to conduct internal supervision, enhance the transparency of enterprise information, thereby improving the quality of financial reporting and reducing the risk of stock price collapse. From a socio-economic perspective, employee stock ownership plans meet China's requirements for common prosperity and play a significant role in stabilizing the capital market, narrowing the wealth gap, and building harmonious labor capital relations.

However, in recent years, the performance of employee stock ownership has not been ideal, and most employee stock ownership plans have not been able to play their original role. From the perspective of increasing employee income, many examples show that after the introduction of employee stock ownership plans, a large number of employees have been trapped in them. From the perspective of increasing corporate value, the market value of many scholars indicates that although the company's stock price has indeed risen in the short term, it has not achieved growth in corporate value in the long term. This is largely attributed to the interference of the self-interest behavior of major shareholders on relevant plans, as well as the imperfect laws. To achieve common prosperity at the enterprise level and enable employees to truly play the role of masters, the government must first improve relevant legal systems, ensure that the self-interest behavior of major shareholders is subject to legal constraints, and ensure that the long-term incentive mechanism of employee stock ownership plans can be properly utilized.

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