Research on the Influence of ESOP on Enterprise Value

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Abstract. For the present, more and more enterprises in China have begun to adopted ESOP. Enterprises adopt ESOP because this plan can do motivation to their employees, and the existing literature have done researches and investigations for the encouraging effect, but it's results of influence are both positive and negative, and the influence factors are also multiple, so the conclusions are inconsistent. This article mainly analyzes and researches elements such as its influence mechanism and influence degree from the perspective of the impact of ESOP on enterprise value. Research findings reveal that ESOP positively affects business performance and value, innovation ability and share price, and the effect of influence is impacted by the factors such as nature of the company, background and implementation plan at the same time. Meanwhile, because of some improper purposes, ESOP will also bring negative influence to the enterprises. The research in this article helps the management of enterprises to have a deeper understanding of ESOP and to better understand its influence mechanism on enterprise value, thus bringing certain references for the management when carrying out corporate governance.

Keywords: ESOP; business performance and value; enterprise innovation; share price; negative influence.

1. Introduction

ESOP (Employee Stock Ownership Plan) represents a novel equity approach that originated in the United States during the 1950s. Its objectives encompassed establishing the groundwork for democratic enterprise management, broadening the channels of funding, augmenting employees' earnings, retaining valuable talent, ensuring employees' welfare, regulating the entitlement to enterprise profits, and transforming the enterprise's restraint mechanisms. And it is generally achieved through the internal employees of an enterprise subscribing for a portion or the entirety of the company's equity with their own funds, entrusting the Employee Stock Ownership Association to operate as a social organization legal person in trusteeship, conducting centralized management, and having the Employee Stock Ownership Management Committee (or Council) enter the board of directors as a social organization legal person to take part in the voting and dividend distribution. It includes two main types: (1) Enterprise employees acquire a portion of the enterprise's property rights by purchasing a fraction of its stocks and thereby obtain the corresponding managerial rights.; (2) Employees purchase all of the enterprise's equity and thus possess all of its equities, enabling the employees to Possess comprehensive management rights and voting rights over the enterprise. The main difference between the above two types lie in the proportion of employees' shareholding and whether they have voting rights after shareholding. In June 2014, the China Securities Regulatory Commission issued the *Guiding Opinions on the Pilot Implementation of Employee Stock Ownership Plans by Listed Companies*. This guiding opinion is of milestone significance for the design of relevant systems regarding employee stock ownership in China and marks the formal implementation of ESOP in China.

The existing literature on ESOP mainly studies its impacts from aspects such as the reasons for implementation, comparison of the effects of different shareholding models, influencing factors, influencing results and relevant policies. In terms of the impact on enterprise value, most of the literatures have studied the positive impact of the ESOP on enterprises. For example, Ou and Zhao document that ESOP can improve enterprise innovation [1]; and Jones and Kato believe that ESOP can influence enterprise value by enhancing the production efficiency [2]. However, there is relatively little research on its negative impacts, the reasons for the negative impacts and how to improve and avoid its negative impacts. On the basis of these studies, this paper will specifically discuss and research the positive impacts of the ESOP on enterprise performance value, innovation ability and stock prices, as well as its negative impacts on the stock price level of enterprises. Through the research in this paper, theoretically, it can provide certain supplements and expansions for ESOP; in practice, it can bring references and lessons for the management of enterprises in corporate governance.

2. The Influence of ESOP on Enterprise Value

In general, ESOP can make positive influence on enterprise value by enhancing the production efficiency of the enterprises [2,3], strengthening enterprises' application of social performance practices [4] and improving their leverage ratios and liquidity ratios [5], and different factors like type and nature of enterprises, design plan of ESOP, the implementation environment and background will have different impacts on the effects produced by ESOP.

2.1. Different Design Plans of ESOP

The greater the proportion of employee shareholding in the ESOP and the lower the agency cost are, the more positive impact of the ESOP on enterprise value will be strengthened [6]. At the same time, a relatively high shareholding ratio, funds sourced from employees' salaries or self-raised by employees, and a longer shareholding lock-up period can further significantly improve enterprise performance and value by reducing the probability of enterprises becoming *Corporate Zombification* [7]. However, the optimal proportion of employee shareholding depends on the types of employees and the willingness of employees. Therefore, when formulating the proportion of ESOP, it is necessary to continuously make adjustments according to factors such as the type of the enterprise and whether employees have a sense of corporate responsibility and social responsibility [8].

2.2. Different Types and Natures of Enterprises

ESOP can gain a more obvious promoting effect on high-tech industries and state-owned enterprises [9]. Enterprises in regions with a higher degree of marketization, monopoly industries, those with higher importance of human capital and higher stock price information content can better reduce the probability of enterprises becoming *Corporate Zombification,* thus improving enterprise performance and value in a larger margin [7].

2.3. Different Implementation Environment and Background

ESOP has significantly improved the financial performance of enterprises, and the degree of industry risk has a negative moderating effect on the above positive relationship, while the degree of industry prosperity has no significant impact on the above relationship [10]. Companies with weaker employee rights protection, poorer employee stability and a higher proportion of highly educated employees, as well as innovative enterprises, have shown a stronger positive market reaction to the employee stock ownership pilot policy.

2.4. Different Scales of ESOP

Small-scale ESOP can bring better benefits to both employees and shareholders in companies without a large number of employees. However, for large-scale ESOP, their effects will be influenced by the motives and purposes of enterprises in implementing these plans. Therefore, whether their effects are positive or negative, they will all be affected by the implementation purposes and motives [11].

3. The Influence of ESOP on Enterprise Innovation

Generally speaking, since ESOP has functions of promoting the research and development of utility model patents, increasing analyst attention [12], inspiring employee value and strengthening corporate cohesion, etc. Meanwhile, as a sharing mechanism for stock residual earnings, the ESOP can also stimulate employees' working enthusiasm and creativity, enhance employees' salary sensitivity and improve the level of the company's total factor productivity, it has a positive effect on enterprise innovation. However, different factors will have diverse impacts on the degree of enterprise innovation, and the ESOP does not necessarily have a significant positive effect on all aspects of enterprise innovation.

Firstly, for different types of employees and enterprise and attributes of enterprises, although executive shareholding and core-technical-staff shareholding can both enhance the enterprise's innovation ability, the shareholding of core-technical-staff has a more obvious impact on enterprise innovation. The alleviation of financing constraints, as an important mechanism through which ESOP affects enterprise innovation, plays a more prominent role in high-tech enterprises and private-owned enterprises [13]. By the same time, the implementation of the ESOP in non-state-owned enterprises has a stronger promoting effect on innovation performance than that in state-owned enterprises, and the implementation of the ESOP in high-tech enterprises has have a more powerful impetus on innovation performance than that in non-high-tech enterprises [14].

Secondly, the number of times that ESOP is implemented also brings different effects on enterprise innovation. Implementing the ESOP multiple times can improve the enterprise's innovation efficiency to a greater extent [8]. So, enterprises should carefully plan the number of times to implement the ESOP so as to make effective use of it and achieve the expected goals.

Thirdly, innovation at different levels in enterprises. The implementation of the ESOP in state - owned enterprises markedly helps to improve the overall innovation output and the output of exploitative innovation of enterprises, but it has no significant impact on the improvement of the output of exploratory innovation of enterprises [13].

4. Influence of ESOP on Enterprise Innovation

Some studies believe that ESOP can reduce the risks brought by trading financial assets to enterprises and increase their liquidity by attracting outstanding employees, strengthening the enthusiasm of employees at work, reducing the moral hazard of the management, Upgrading the standard of enterprise information revelation, increasing corporate value, improving corporate information quality, enhancing corporate information transparency, improving enterprise technical efficiency and enterprise value, raising the level of corporate governance, attracting outside investors to follow up, and alleviating the degree of corporate financing constraints. Different implementation environments, the scale of employee shareholding and the nature of enterprises will produce different effects. Meanwhile, some other studies think that if the management has certain improper motives and purposes during the implementation process of the ESOP, it will have a negative impact on the stock prices of enterprises on the contrary. On one hand, it is because some ESOP have degenerated into disguised executive performance-based incentive tools. On the other hand, it is because employees play a role in colluding and covering up for their own interests. Moreover, there is a more significant positive correlation exists in ESOP with a shorter duration, managed by financial institutions, involving leveraged financing and having the number of incentivized people within a specific range and the improper behaviors of companies [14].

First, in terms of stock price informativeness, the implementation of ESOP can improve stock price information by increasing external attention and supervision. However, it is worth noting that since its mechanism of action is the announcement effect, with its novelty gradually diminishing, the role of the announcement effect is also gradually weakening. Therefore, in order to maintain the continuous optimization efficiency of the ESOP on stock prices, the intensity of the ESOP should be continuously increased, otherwise, it will continue declining [15].

Second, regarding the issue of reducing the probability of mispricing of company stocks, although ESOP can alleviate the mispricing of company stocks by improving the efficacy of internal control, the scale of employee shareholding is not the bigger the better. Instead, there is a critical point, and once it exceeds this critical point, the free-rider problem will be triggered, that is, there is a U-shaped relationship between the scale of employee shareholding and stock mispricing. In companies which have a lower shareholding percentage held by the directors, supervisors and senior management. those with self-funded subscription and private enterprises, the above relationship is more significant [16].

Third, in terms of the negative impacts caused by improper purposes. At the present stage, the implementation of the ESOP will drive management and major shareholders to be more inclined to conceal bad news, resulting in a higher risk of a sharp drop in the stock prices of listed companies in the future. Meanwhile, in non-state-owned enterprises and companies with poor internal control quality, the positive relationship between the ESOP and the risk of a sharp drop in stock prices is more significant [17]. During the implementation process of the ESOP, problems such as the encroachment by major shareholders and the self-interested behaviors of management may also suppress the exertion of its positive effects and lead to serious incentive distortion problems, thereby raising the risk of a stock price crash. [18]. The higher the subscription ratio of senior executives in the ESOP and the situation where major shareholders do not have relative controlling rights and the company does not face the risk of external acquisition, the greater the risk of a sharp decline in a company's stock price. [18]. Meanwhile, the ESOP will have a negative impact on the stock liquidity of listed companies. For the outside world, the ESOP will send a negative signal to external investments, thus causing a decline in the stock liquidity of listed companies. However, this decline can be adjusted through the ownership structure and informed institutional investors: the concentration of shareholding will exacerbate the negative impact of the ESOP on stock liquidity, while the degree of shareholding balance alleviates this negative impact [19]; the shareholding of informed institutional investors alleviates the negative impact of the ESOP, while the shareholding of uninformed institutional investors has no obvious effect on it [19].

5. Conclusion

This article has sorted out the mechanisms through which ESOP affects enterprise value. It is found that the ESOP can improve enterprise performance and innovation. However, in terms of stock prices, the impact of the ESOP on them will bring influences in different directions according to different implementation purposes. Meanwhile, conditions such as the characteristics, backgrounds and implementation plan of different enterprises will also affect the degree of the impact of the ESOP.

Therefore, it is recommended that when enterprises adopt the ESOP, they should not only pay attention to its positive impacts but also focus on its negative impacts and make good judgments and controls on risks.

Moreover, most of the current studies focus on the discussion of the positive effects of the ESOP, lacking research on the causes of improper purposes behind the negative impacts of implementing the ESOP and its corresponding countermeasures, identification mechanisms and punishment measures. However, only by researching and improving the negative effects of the ESOP can it play a more effective role. Therefore, it is also necessary to strengthen the research on the negative effects of the ESOP and the existing improper purposes and improve relevant policies, laws and regulations on the ESOP in China.

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