

Employee Stock Option Plan on the Company's Performance

¹Aishwarya J, ²Kranti Purohit, ³Vineet Rathi & ⁴Dr. Thangjam Ravichandra

^{1,2,3}B.Com F&A, Department of Professional Studies, Christ University, Karnataka (India)

⁴Department of Professional Studies, Christ (Deemed to be University), Karnataka (India)

ARTICLE DETAILS

Article History

Published Online: 10 December 2018

Keywords

Employee Stock Ownership Plan (ESOP), attrition rate, company's performance, correlation, T-test.

ABSTRACT

Because of the impact of globalization on Indian business, ESOP thought spreads crosswise over corporate India and corporates began looking at ESOPs as an effective tool to hire and retain employees after SEBI ESOS & ESPP Guidelines 1999. In this paper we have used the historic financial statements of the listed Indian companies who have issued ESOP's and the impact it had on their revenue and employee turnover ratio. The companies taken into consideration are Infosys, Wipro, Mindteckand Tech Mahindra.

For the purpose of the paper we have taken 4 pre ESOP and 4 post ESOP years of financial statements. We have also taken into consideration the number of options exercised and the attrition rates for 5 immediately preceding years. Based on the data obtained we have tried to analyze the impact of ESOPs on the performance of the company.

1. Introduction

An employee stock ownership plan (ESOP) is a program that helps the employees of the company to own interest in the company in which they work. These plans are contracts between a company and its employee that give employees the right to purchase a specified number of shares of the shares of the company at a specified price within a specific timeframe. The specified price is called as the exercise price. Employees generally exercise the option when the shares of the company are trading at a higher price compared to the grant or exercise price. When the stock price is trading below the exercise price, companies sometimes revalue the exercise price. Companies which issues ESOP are known as employee- owned companies. This was done to prevent possible abuse of the law. The issue of stock in India to employees of a company depends upon two principles. They are complete disclosure and shareholder's approval.

2. Review of literature

1. The researcher tries to examine the effect of ESOP's on performance of the companies. At the end of year 2000 more than 220 out of 700 companies traded on French stock markets have issued ESOP's. Approximately one in every three French company listed has ESOP's. The average ownership was 3.7%. Except Heinfelt&Curcio (1997), there is no research study that has indicated a negative effect of ESOP's on financial performance of a company. Company's performance can be measured in terms of accounting and market measure. Accounting measures can be done in terms of profitability while market measures can be done in terms of share price. According to the studies, ESOP's companies have average increase in profit by 3% to 6%. Also annual productivity of employees is 6% higher compared to non -ESOP. ESOP's tend to have better results when they are linked to active participation of employees in the management of the company. Based on research outcome the researcher believes there is a positive

impact on the performance of firms and ESOP's.(Trebucq, 2004)

2. ESOP is a recent concept in India compared to Europe and US. ESOP's became popular in India after the issue of guidelines from Security Exchange Board of India in the year 1999. The research is done on 80 listed Indian companies which includes 60 from software and 20 from pharmaceuticals. The data is pertaining from 1st April 1996 to 31st March 2012. Data have been analyzed for 8 year which include pre four years and post four years for issue of ESOP's. ESOP's were issued from 2000-2008. ESOP is used as a tool to motivate employees to work hard and retain talented employees. The study found that that there is a positive side between employee performance and stock option. The study also found that the share capital owned by employees is relatively insignificant to have a major impact on the share prices. The software companies were the first to adopt ESOP's but it is the pharmaceutical companies that were the most benefited in terms of performance of the companies. i.e., share price.(Dr.Nithya kala, 2015)
3. Finance is the backbone of any economy. The present paper makes a study on the impact of ESOP on 20 listed finance companies in India. The ESOP's were issued between 2000 to 2008. The companies were categorized between low, medium and high based on the employee stock ownership. Out of 285 only 20 financial companies listed have ESOP. The minimum employee stock ownership was 0.01% and the maximum was 5.49%. The researcher used the Mann Whitney U test and the results did not show any significant difference in performance pre and post ESOP. There were no significant difference in Asset Turnover Ratio (ATO), Net profit margins and Earnings per share. The study also revealed that the percentage of employee stock ownership was relatively insufficient to change employee behavior or motivate them. The management should take efforts to change employee behavior and attitude to make

improvement in company's performance.(Dr.Poornima, Nithya Kala, & Dr. Vidya Kala, 2015)

4. This article attempts to investigate the effect of employee stock option plans on the financial performance of Indian non-finance companies. The study employed the quartile regression(QR) model to examine the effect of ESOP on the financial performance of sample companies. The study reflects two aspects of financial performance and employee compensation. First,the fluctuating behavior of financial achievement is strongly related to the growth/decline phases of the firm. Second, the adoption of ESOP as a business strategy aims at retaining executives and solves agency problems. The study also indicates that industry plays an important role in deciding the equity-based compensation and its effect on firm performance. In the present paper the relationship between ESOP and market performance is taken into consideration. The results implied that the firms with high growth potential and profitability, the impact of equity-based incentives are positively related to firm performance. The results also indicated that if a firm adopts stock based compensation schemes in their early stage of growth may cause a declining firm performance.(Ray, 2016)
5. The article sheds light on performance of ESOP and Managerial Turnover. It investigates the impact of a firm's employee stock ownership plan on managerial turnover. Managers of firms that use ESOPs typically wield more comparative control of their companies than do their peers in similar non-ESOP firms because they possess ESOP voting rights. It states that employee stock ownership plans has grown dramatically over the past three decades with a total of about \$500 billion in assets under management as of 2005. For the purpose of the study 49 ESOPs and 49 matching companies are considered. This paper examines CEO and director turnover following the launch of an ESOP and relates it to the long term performance of companies. In order to detect entrenchment, the strategy adopted consisted of two broad steps. These steps clarified the relationship between ESOP Implementation and managerial entrenchment as well as share-holder value. It also finds evidence that ESOPs can be used to provide significant entrenchment benefits. (Lu, Stohs, & Reising, 2007)

3. Research Methodology

1. Scope of Study

For the purpose of this research we have considered 4 major companies belonging to the IT sector. We have taken into consideration, data of the years in which ESOP was issued within 5 immediately preceding years, of each company. The data we will be looking into will be the numbers of shares exercised and the attrition rate. We have also taken into consideration profit of respective companies' pre and post issue of recent ESOP plan.

2. Statement of Problem

Employee Stock Option Plan is long believed to be a motivational tool. It is considered that ESOP incentives play as a booster for employees to work harder. This in turn improves employee performance and results in improving the firm's performance.

3. Objectives

- To study the impact of Employee Stock Ownership Plan (ESOP) on the company's profitability.
- To study the impact of Employee Stock Ownership Plan (ESOP) on the attrition rate of company

4. Hypothesis

H₀ – There is no significant relationship between of Employee Stock Ownership Plan(ESOP) and the company's profitability

H₁ – There is significant relationship between of Employee Stock Ownership Plan(ESOP) and the company's profitability

5. Source Data

Secondary data has been used for the purpose of this research. All the data has been collected from: <https://moneycontrol.com/> and respective company websites.

6. Limitation of the Study

- There are other factors which affect a company's profitability and its overall financial performance
- Only 4 companies in the sector has been considered
- The results are probabilities and not certain

4. Data Analysis

Part 1: The first part of the study deals with the effect of the ESOP on the profit of the companies. Here the profits before and after the year of declaration of ESOP has been considered. The following are the data used for the research:

Infosys		
Year	Profit	Year of issue of ESOP
2007	3867	
2008	4659	
2009	5988	
2010	6226	
2011	6835	
2012	8332	
2013	9429	
2014	10656	
2015	12373	

Mindteck		
Year	Profit	Year of issue
2004	-0.73	
2005	0.75	
2006	2.12	
2007	2.18	
2008	3.04	

		of ESOP
2009	1.78	
2010	0.74	
2011	5.72	
2012	1.77	

Tech Mahindra		
Year	Profit	
2009	974.8	
2010	727.4	
2011	696.7	
2012	460.6	
2013	652.5	Year of issue of ESOP
2014	2458.9	
2015	2256.2	
2016	3220	
2017	3047.3	

Wipro		
Year	Profit	
2009	2973.8	
2010	4898	
2011	4843.7	
2012	4685.1	
2013	5650.2	Year of issue of ESOP
2014	7387.4	
2015	8193.1	
2016	8200.5	
2017	8161.7	

Analysis of Data:

Using the above data an attempt is made to analyze if the declaration of ESOP by the company has an effect on its profit. In order to understand if there is any significant difference between pre-profit (i.e. profit before declaration of ESOP) and post-profit (i.e. profit after declaration of ESOP), **Paired Sample T-test** has been used.

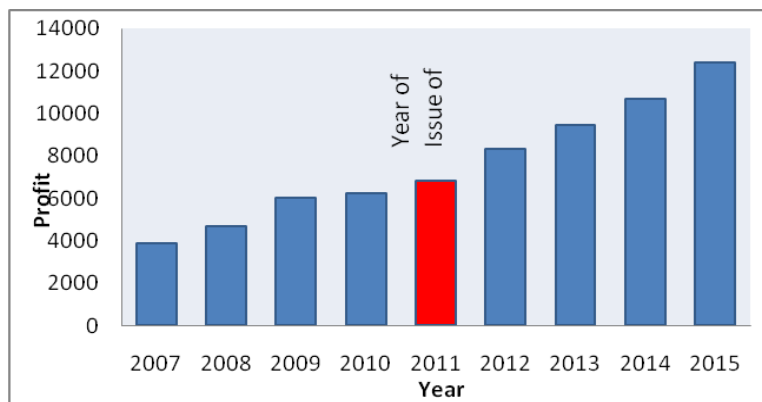
Infosys

Paired Samples Test

	Paired Differences						t	df	Sig. (2-tailed)
	Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference					
				Lower	Upper				
Pair 1 Co1 - Co2	-7021.00000	2514.67599	950.45819	-9346.68740	-4695.31260	-7.387	6	.000	

Since the P-value (denoted as Sig.(2-tailed)in the table) of the test is less than the significance level i.e. 0.05, there exists a significant difference between pre-profit (i.e. profit before declaration of ESOP) and post-profit (i.e. profit after declaration

of ESOP). The profit significantly increase after the declaration of the Employee Stock Option Plan(ESOP). The graph below signifies the consistent increase in profit after declaration of Plan:



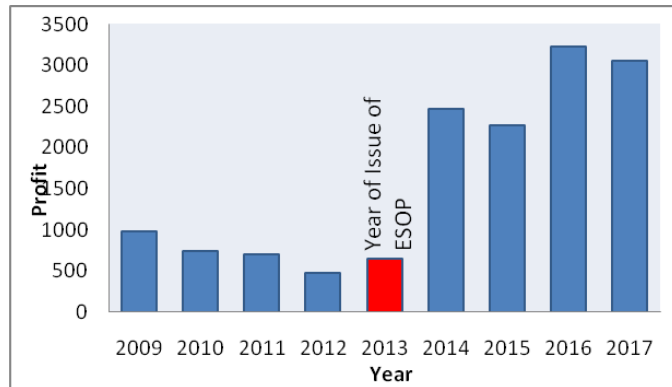
Tech Mahindra

Paired Samples Test

	Paired Differences						t	df	Sig. (2-tailed)
	Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference					
				Lower	Upper				
Pair 1 Co2 - Co1	1728.73750	1134.52688	401.11582	780.24929	2677.22571	4.310	7	.004	

Since the P-value(denoted as Sig.(2-tailed)in the table) of the test is less than the significance level i.e. 0.05, there exists a significant difference between pre-profit (i.e. profit before declaration of ESOP) and post-profit (i.e. profit after declaration

of ESOP). The profit substantially increase after the declaration of the Employee Stock Option Plan(ESOP). The graph below signifies the increase in profit after declaration of Plan:

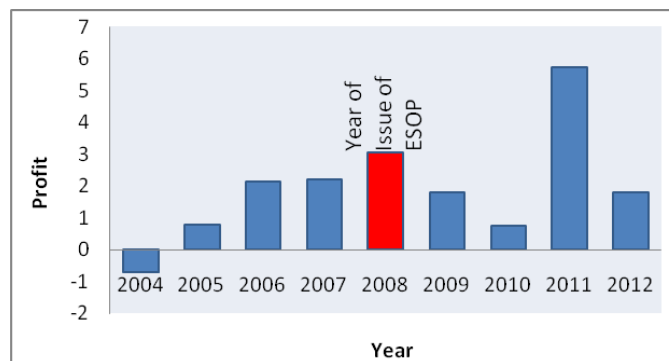


**Mindteck
Paired Samples Test**

	Paired Differences					t	df	Sig. (2-tailed)
	Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
				Lower	Upper			
Pair 1 Co1 - Co2	-.29125	1.71343	.60579	-1.72371	1.14121	-.481	7	.645

Since the P-value(denoted as Sig.(2-tailed)in the table) of the test is greater than the significance level i.e. 0.05, there exists no a significant difference between pre-profit (i.e. profit before declaration of ESOP) and post-profit (i.e. profit after declaration of ESOP). This due to the fluctuations in profit due to various other reasons such as global economic environment

and resultant slowdown in business in U.S(since their main customers lie in U.S). The declaration of the Employee Stock Option Plan(ESOP) has failed to have a significant impact on the profits as the other factors have a major effect on the profit. The graph below signifies the fluctuations in profit:



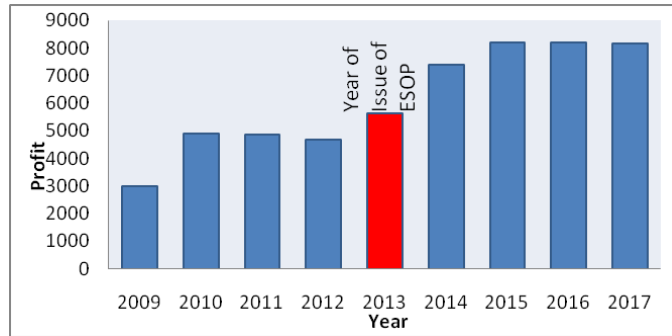
**Wipro
Paired Samples Test**

	Paired Differences					t	df	Sig. (2-tailed)
	Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
				Lower	Upper			
Pair 1 Co1 - Co2	-6166.41250	2051.05891	725.15883	-7881.14066	-4451.68434	-8.504	7	.000

Since the P-value(denoted as Sig.(2-tailed)in the table) of the test is less than the significance level i.e. 0.05, there exists a significant difference between pre-profit (i.e. profit before

declaration of ESOP) and post-profit (i.e. profit after declaration of ESOP). The profit significant increase after the declaration

of the Employee Stock Option Plan(ESOP). The graph below signifies the increase in profit after declaration of Plan:



Part 2:The first part of the study deals with the effect of the ESOP on the profit of the companies. Here the profits before and after the year of declaration of ESOP has been considered. The following are the data used for the research:

Infosys

Year	No. Of shares exercised	Attrition rate
2018	700629	0.16
2017	100760	0.15
2016	0	0.14
2015	0	0.19
2014	0	0.19

Mindteck

Year	No. Of shares exercised	Attrition rate
2018	163204	0.22
2017	151494	0.23
2016	65230	0.23
2015	0	0.23
2014	0	0.21

Tech Mahindra

Year	No. Of shares exercised	Attrition rate
2018	4391935	0.18
2017	2085571	0.17
2016	1945769	0.2
2015	621073	0.19
2014	421252	0.15

Wipro

Year	No. Of shares exercised	Attrition rate
2018	5325217	0.166
2017	1113775	0.163
2016	1329376	0.161
2015	1968609	0.165
2014	555040	0.163

Analysis of Data:

Using the above data an attempt is made to analyze if the number of options Exercised by the employees affect the attrition rate of the company. In order to understand the relationship between the variables the **Bivariate Correlation** model is adopted.

**Infosys
Correlations**

		NoOfESOPEexercised	AttritionRate
NoOfESOPEexercised	Pearson Correlation	1	-.084
	Sig. (2-tailed)		.893
	N	5	5
AttritionRate	Pearson Correlation	-.084	1
	Sig. (2-tailed)	.893	
	N	5	5

There exists a negative relationship between the variables i.e. number of options exercised and attrition rate. As, the value of r is (-0.84).

**TechMahindra
Correlations**

		NoOfESOPEexercised	AttritionRate
NoOfESOPEexercised	Pearson Correlation	1	.250
	Sig. (2-tailed)		.685
	N	5	5
AttritionRate	Pearson Correlation	.250	1
	Sig. (2-tailed)	.685	
	N	5	5

There exists a positive relationship between the variables i.e. number of options exercised and attrition rate, as the value of r is 0.25.

**Mindteck
Correlations**

		NoOfESOPEexercised	AttritionRate
NoOfESOPEexercised	Pearson Correlation	1	.229
	Sig. (2-tailed)		.711
	N	5	5
AttritionRate	Pearson Correlation	.229	1
	Sig. (2-tailed)	.711	
	N	5	5

There exists a positive relationship between the variables i.e. number of options exercised and attrition rate as the value of r is 0.229.

**Wipro
Correlations**

		NoOfESOPEexercised	AttritionRate
NoOfESOPEexercised	Pearson Correlation	1	.750
	Sig. (2-tailed)		.144
	N	5	5
AttritionRate	Pearson Correlation	.750	1
	Sig. (2-tailed)	.144	
	N	5	5

There exists a positive relationship between the variables i.e. number of options exercised and attrition rate as the value of r is 0.75.

declaration of ESOP does have a significant effect on the profits.

5. Conclusion and findings

After analyzing the relationship between pre-profit (i.e. profit before declaration of ESOP) and post-profit (i.e. profit after declaration of ESOP), we can conclude that there exists a significant relationship between the pre-profit and post-profit. Taking into consideration that there exists other factors which have an effect on the profits, we can further conclude that

After analyzing the relationship between the number of options exercised and attrition rate, we can conclude that there exists a relationship between these variables but, taking into consideration the other factors we can further conclude that the other factors play a major role in impacting the dependent variable i.e. attrition rate.

ESOPs are one of the ways which companies adopt to retain their employees. Through this research we can conclude that although ESOPs have an effect on profit and attrition rates, it is relatively passive in nature. There are various

factors which have a major impact on both the variables. Hence, through this research we have found out that ESOPs have an effect on the performance of the company considering the existence of other dynamic factors which affect the same.

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