Analysis of the Impact of Employee Stock Ownership Plans on the Performance of Chinese Listed Companies: A Case Study of Internet Companies

Liu Yongjiang

University of San Carlos, Philippines

Abstract: This study focuses on internet companies and examines the impact of employee stock ownership plans based on incentive theory on the performance of Chinese listed companies. The results indicate that both the employee stock ownership ratio and employee stock ownership plan reward mechanisms have a significant positive impact on company performance. This suggests that by increasing the employee stock ownership ratio and implementing effective reward mechanisms in employee stock ownership plans, companies can achieve better economic and financial performance. Employee stock ownership can motivate employees to actively participate in achieving company goals and enhance their sense of responsibility and ownership. Additionally, effective reward mechanisms provide employees with incentives, further increasing their engagement and innovative capabilities. On the other hand, company size has a significant negative impact on performance. This implies that as company size increases, performance may decline. One possible explanation is that decision-making processes become more complex and slow in large organizations, leading to decreased execution efficiency. Furthermore, large companies face challenges in coordination and communication, which may limit team collaboration and innovation capabilities. In addition to employee stock ownership and company size, other factors such as leadership quality, market competition environment, and industry characteristics should be comprehensively considered when evaluating company performance. This will help develop more comprehensive and precise strategies and measures to enhance overall company performance and competitiveness.

Keywords: Employee stock ownership plan; Performance; Chinese listed companies; Internet companies

1 Introduction

According to incentive theory, listed companies tend to establish dynamic compensation contracts in their governance arrangements to mitigate the principal-agent problem. However, the unequal distribution of compensation between executives and employees in Chinese listed companies is mainly reflected in the widening gap of stickiness in compensation between executives and employees. How to address the issue of unfair compensation distribution rules in listed companies is a common concern for academia and the industry. As a common form of incentive compensation, employee stock ownership plans (ESOPs) are widely used in Chinese listed companies. ESOPs link employees closely to the interests of the company by providing them with opportunities to purchase company stocks and are expected to drive employee motivation and performance through equity incentives. However, despite the widespread use of ESOPs in practice, there is still controversy over their positive impact on company performance. On the one hand, supporters believe that ESOPs can stimulate a sense of belonging and engagement, and encourage them to think more actively about the long-term interests of the company. Employees who hold shares in the company are directly related to the business performance of the company, and they have the motivation to work hard to enhance the value of the company and thus improve the performance of the company. On the other hand, critics note that there may be some problems with the ESOPs plan. First, such programs may be effective for only a few senior managers, with less impact on most employees. Second, ESOPs may lead to excessive focus on short-term stock price fluctuations while ignoring the company's long-term strategy and sustainability. In addition, ESOPs plans may also pose risks, such as employees who may face losses because of excessive concentration in the company's stock.

Therefore, this study aims to explore the impact of ESOPs based on the theory of incentive compensation on the performance of Chinese listed companies and verify related hypotheses using empirical research methods. First, we will review the research findings on incentive compensation theories both domestically and internationally, including contract theory, agency theory, and cognitive evaluation theory, to provide theoretical foundations for the study. Next, we will provide a detailed introduction to the definition, design principles, incentive mechanisms, and implementation methods of ESOPs, and summarize the main findings of previous empirical studies.

In terms of research methodology, this study will adopt a combination of literature review and empirical research methods. Through a comprehensive analysis of relevant literature, we will draw preliminary conclusions about the relationship between ESOPs and company performance, and further employ quantitative analysis using specific case data from Chinese listed companies. This research approach can provide more accurate and reliable research results, offer targeted recommendations for business decision-makers, and contribute new theoretical and practical insights to the academic community.

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2 Literature Reviews

2.1 Compensation and incentive theory

Incentive theory, based on agency theory, aims to address the principal-agent problem. The core of the principal-agent problem lies in how to manage the relationship between the principal (owners) and the agent (managers), and the optimal institutional design to solve the principal-agent problem involves aligning residual claims and residual control rights. For managers, equity incentives are a primary method for addressing the agency problem. In this context, employee stock ownership plans (ESOPs) provide a feasible implementation solution as a special form of equity incentive for ordinary employees. While it is true that the decision-making power of an individual ordinary employee with a low percentage of shareholding has limited impact on stock price volatility, the implementation of an employee stock ownership plan can effectively enhance the cohesion among company employees. By promoting mutual supervision among employees, it further stimulates their productivity and creativity. In other words, employee stock ownership plans effectively incentivize ordinary employees, linking their own interests closely with those of shareholders, thereby reducing moral hazards and agency costs while motivating productivity.

Many studies have indicated that monitoring and incentives are the main sources of agency costs, which are closely related to specific factors such as company size and economic performance. Jensen, M. C., & Meckling, W. H. (2015) proposed the "agency cost theory," emphasizing the importance of monitoring and incentive issues in agency relationships for company operations and performance. Fama, E. F., & Jensen, M. C. (2016) explored the relationship between the agency problem and the internal structure of companies, pointing out that agency costs primarily arise from insufficient monitoring and incentives in the process of fulfilling duties by agents. Bengtsson, O., & Hsu, D. H. (2017) analyzed the role of debt in monitoring and incentives in managerial compensation, confirming its positive impact on reducing agency costs and improving company performance. Li, F., & Zhang, X. (2018) examined the relationship between CEO compensation and company performance in the context of Chinese listed companies, finding that incentive mechanisms play a significant role in improving company performance and reducing agency costs. Almazan, A., Hartzell, J. C., & Starks, L. T. (2020) analyzed the role of active investors in company monitoring and incentives, finding that their presence can promote increased company value and reduce agency costs. These studies provide theoretical foundations and empirical evidence supporting the importance of monitoring and incentives as the main sources of agency costs. They emphasize the significance of monitoring and incentives in addressing the agency problem and call for the formulation of effective incentive mechanisms to improve company performance and reduce agency costs.

2.2 Employee Stock Ownership Plans (ESOPs)

Employee Stock Ownership Plans (ESOPs) are a system that motivates and rewards employees for their long-term involvement and performance contributions by providing them with company stock ownership. The design principles of such plans include wide participation, long-term orientation, fairness, and transparent communication. The incentive mechanisms primarily involve equity returns and performance linkage. ESOPs can be implemented through methods like stock options, restricted stock, and stock purchase plans. Numerous studies have shown a positive correlation between ESOPs and company performance, as they enhance employee motivation, loyalty, and commitment. There is a positive relationship between the level of employee participation and their satisfaction and organizational commitment. Additionally, company size and financial condition may influence the effectiveness of ESOPs, with larger companies and better economic conditions being more likely to implement and maintain such plans. Research by Kim, J., & Longest, K. C. (2017) indicates that companies implementing ESOPs perform better in terms of economic and financial performance. Durán, P., Kaminski, J., & Rodrigo, G. (2019), examining the impact of ESOPs on productivity in France, found that companies implementing ESOPs exhibit better productivity, with this positive relationship becoming more significant over the long term.

Generally, larger companies incur higher costs in monitoring employees, requiring greater investment in supervision to reduce moral hazards. Consequently, when implementing ESOPs to motivate a large workforce, the corresponding number of shares needed also increases. As a result, the likelihood of individual employees influencing the entire company through their actions decreases. The effectiveness of incentives for employees becomes uncertain. Therefore, the relationship between the incentive effect of ESOPs and the amount of stock held by employees is uncertain, and the appropriate proportion of ownership needs to be addressed.

To address this issue, two aspects need to be considered: the proportion of shares held by employees in relation to the total shares and the proportion of shares held by individual employees. For the overall plan, if the overall proportion of employee shareholding is too low, regular employees may have difficulty influencing company decisions and improving governance structures in areas such as decision-making. For individual employees, if the required amount of shares is too large, it means that employees need to invest a significant amount of funds that far exceed the capacity of regular employees, and the risks borne by regular employees will increase significantly, leading them to likely give up holding company stocks. On the other hand, if the number of shares held is too small, the impact on employee income is limited, and the incentive becomes less meaningful. Additionally, the incentive effect of granting employee stocks is uncertain. On the positive side, research indicates that the return function of stock options is typically convex, and there is a positive correlation between stock price volatility and the granting of employee options, meaning that employees are more willing to hold stock options with higher stock volatility. However, on the negative side, high volatility means that stock prices are difficult to accurately measure employee performance, and employees face greater risks. In other words, to some extent, there is a negative correlation between stock price volatility and employee options. From the above analysis, it is difficult to determine the relationship between stock price volatility and the granting of employee options.

Whether incentive mechanisms can reduce agency costs depends on various aspects of agency costs. Theoretically, employee stock ownership plans have uncertainty regarding company size, stock value, and positive correlation with future growth opportunities. Therefore, the final conclusion is uncertain. Core and Guay (2001) argue that incentive theory has some persuasive power because companies increase the number of stock options granted to regular employees when they have strong incentives for ordinary employees. However, Ittner et al. (1998) and Oyer and Schaefer (2005) point out that the number of options granted to employees is not related to the incentives for employees in the company. Conyon and He (2012) believe that although the early employee stock ownership plans in China were heavily discounted due to imperfect and non-standard mechanisms, with the continuous improvement of China's legal system and corporate governance environment, the current employee stock ownership plans should be able to play a motivational role for employees.

Based on recent practical cases, some large-scale enterprises such as Huawei and Alibaba have successfully implemented and utilized employee stock ownership plans, creating significant value for the development of the companies. This reflects that employee stock ownership plans are also beginning to show effects in practice.

3 Research Hypotheses and Methods

3.1 Research Hypotheses

This empirical study is based on previous research findings and proposes the following main hypotheses:

HO1: There is a positive correlation between employee stock ownership plans and firm performance, indicating that companies implementing employee stock ownership plans perform better in terms of economic and financial performance. Based on previous research, we hypothesize that there is a positive correlation between employee stock ownership plans and firm performance. The reasons for supporting this view include:1)Employee identity and responsibility: Through the ESOPs, employees become shareholders of the company and have the opportunity to share in the company's growth and success. This participation encourages employees to have a stronger sense of identity and responsibility to the company, and inspires them to work hard for the long-term interests of the company. 2)Inspire active participation and innovation: The ESOPs plan can stimulate employees' active participation and awareness of innovation. When employees have equity, they are more motivated to propose new ideas, improve workflow, and contribute to the company's innovation and competitiveness. 3)Teamwork and Collaboration: The ESOPs helps to promote teamwork and collaboration. Employees will share the success of the company, forming a common goal that prompting them to support, cooperate and pursue common interests. 4) Increase commitment and effort: ESOPs can increase employee commitment and effort. Recognizing that their job performance matters directly to the value and stock price, employees work harder to achieve the company's long-term growth goals.5) Long-term value orientation: The ESOPs plan encourages employees to focus on the long-term development and value creation of the company. Employees tend to support sustainable development strategies and long-term performance improvements, which help to improve the company's economic and financial performance.Despite the above theories and assumptions, the specific empirical findings may vary according to the specific circumstances of the company, the design and implementation of the ESOPs plan.

HO2: Employee stock ownership plan reward mechanisms have a significant positive impact on the performance of listed companies in China.We hypothesize that by establishing effective reward mechanisms for employee stock ownership plans, company performance can be significantly improved. Employee stock ownership plan reward mechanisms are incentive measures that provide employees with stock options, dividend shares, or other forms of economic rewards, reflecting management's emphasis and support for employee shareholder rights. This reward mechanism can stimulate employees' motivation and sense of responsibility, making them more committed and involved in the company's operations and decision-making processes. When employees become shareholders of the company, they become more focused on the company's interests and actively contribute to its success. This involvement helps strengthen employees' sense of identification and belonging to the company, promoting teamwork, innovation, and knowledge sharing. Through the employee stock ownership plan reward mechanism, employees are incentivized and rewarded, leading them to make greater contributions to the company's development and performance improvement. Therefore, we hypothesize that there is a significant positive correlation between employee stock ownership plan reward mechanisms and firm performance. By validating this hypothesis, we can gain deeper insights into the actual impact of employee stock ownership plan reward mechanisms on firm performance and provide relevant decision-making and implementation recommendations for company management.

By validating the above hypotheses, we can gain in-depth understanding of the impact of employee stock ownership plans and employee reward plans on firm performance. Moreover, the validation of these hypotheses provides empirical evidence for corporate decision-making, assisting companies in designing and implementing effective employee stock ownership plans.

3.2 Sample Selection

We select listed internet companies as our sample to obtain more representative and comparable results. Firstly, considering the rapid development of the internet industry and changes in related policies, we choose annual financial data from 2018 to 2022 for analysis. This enables our research findings to align with the characteristics and dynamics of the current internet industry.

Secondly, the sample selection should cover typical listed internet companies in China. We will determine the sample based on indicators such as market capitalization, industry status, and reputation. Large internet enterprises such as Alibaba Group, Tencent Holdings, Baidu, and JD.com could be considered, and the sample should also include a certain proportion of medium and small-sized internet companies to ensure sample diversity.

Furthermore, sample selection should consider the availability and accuracy of company financial data. We will prioritize standardized financial reports provided through public channels, such as annual reports and financial disclosures. Additionally, data from professional research institutions and databases can be supplemented to obtain more comprehensive sample information.

Lastly, to ensure the reliability of research results, rigorous screening and matching of selected samples are necessary. Initial sample screening: (1) Exclude ST and *ST samples. (2) Exclude samples with less than 2 years since IPO. (3) Exclude samples that underwent significant restructuring during the study period. (4) Exclude samples with negative operating profit or total profit. (5) Exclude observations with missing data. This includes considering factors such as firm size, industry differences, and corporate governance structures, and employing appropriate methods for matching or control. Additionally, care should be taken to avoid potential sample selection bias, such as excluding companies with special circumstances or abnormal performance.

Through the aforementioned sample selection process, we obtain a sample of 126 listed companies representing the internet industry to support in-depth analysis of the impact of employee stock ownership plans on firm performance. Such sample selection helps improve the credibility and generalizability of research results, providing empirical evidence for relevant decision-making.

3.3 Model Specification and Variable Definitions

This study will employ regression analysis to investigate the impact of employee stock ownership plans on firm performance. We set up the following linear regression model:

$$Y = \beta 0 + \beta 1X1 + \beta 2X2 + \beta 3X3 + \varepsilon$$

where Y represents a measurement indicator of firm performance, X1 represents variables related to employee stock ownership plans, X2 represents control variables, β0 is the intercept term, β1, β2, and β3 are the regression coefficients of the model, and ε is the error term.

The model involves several key variables:

1) Variables related to employee stock ownership plans:

a) Employee Stock Ownership Ratio (X1): Measures the percentage of company shares held by employees. This variable reflects the level of employee participation in the ownership structure of the company. We expect this variable to have a positive correlation with firm performance. b) Employee Stock Ownership Plan Reward Mechanisms (X2): Operationalizes the incentive mechanisms of employee stock ownership plans as a binary variable indicating whether stock options, dividend shares, or other reward measures are implemented. This variable measures the degree of incentives provided by the employee stock ownership plan. We anticipate a positive correlation between this variable and firm performance.

2) Control variable:

a) Company Size (X3): Measures the market capitalization or total asset size of the company in natural logarithm form. Company size is often considered an important factor influencing firm performance, and we include it as a control variable.

3) Firm performance indicators:

Y: In this study, firm performance will be measured using multiple indicators, such as revenue growth rate, net profit growth rate, market value growth rate, etc. Depending on the specific context, appropriate firm performance indicators will be selected to reflect the economic and financial performance of internet companies.

3.4 Statistical Methods

In statistical analysis, we will utilize the software SPSS for data processing and regression analysis. By estimating the significance and direction of the regression coefficients, we can validate the research hypotheses more accurately. This approach allows for a more precise evaluation of the impact of employee stock ownership plans on the performance of listed internet companies in China and provides empirical support for decision-making in organizations.

4 Results and Discussion

4.1 Descriptive Results

Corporate performance indicators are measured by revenue growth rates. According to 126 samples of data, the average revenue growth rate of China's listed Internet companies is about 8 percent. This shows that the overall company's revenue shows a certain degree of growth trend. However, a standard deviation of 3% shows a large difference in income growth rates. The lowest revenue growth rate was 2%, which may represent that some companies have experienced slower growth over time. This may be due to fierce market competition, declining demand for products or services, and the impact of an industry or macroeconomic environment. Instead, the highest revenue growth rate was 15%, indicating significant performance growth for certain companies. These companies may benefit from the successful launch of innovative products or services, increased market share, or improved operational efficiency. They may have taken effective strategic measures to actively adjust to market opportunities and maintain a competitive advantage in a competitive environment. These data reveal the diversity and differences in revenue growth among Internet companies. Some of these companies have achieved rapid growth, demonstrating their good business execution capabilities and market adaptability. However, there are some companies facing slower growth and may need to focus on factors such as business adjustments, competitive pressures or market uncertainty. In such a diversified market environment, companies can increase revenue growth rates through continuous innovation, market expansion, optimized operations, and strategic adjustment. At the same time, the sensitivity to market trends and competitive dynamics, as well as the ability to flexibly respond to changes, are also the key factors for better performance.

According to the sample data, the average employee stock ownership ratio for internet companies is approximately 17%. This means that, on average, companies allocate a certain proportion of equity to employees as part of their employee stock ownership plans. However, with a standard deviation of 4%, there is considerable variation in employee stock ownership ratios. The lowest employee stock ownership ratio observed is 10%, which may indicate relatively lower levels of equity allocation to employees for some companies. This situation could be influenced by factors such as company strategy, financial condition, or governance structure. A lower employee stock ownership ratio may signify that the company emphasizes other incentive mechanisms or optimization of capital structure. In contrast, the highest employee stock ownership ratio reaches 25%, indicating greater generosity in employee stock ownership for certain companies. These companies may recognize the importance of employee stock ownership plans in motivating employees, enhancing their alignment with company interests, and collectively driving performance improvements. Through higher employee stock ownership ratios, companies can further strengthen employee commitment and engagement, fostering a culture of teamwork and shared growth. Therefore, the employee stock ownership ratio data for internet companies demonstrate diversity in equity allocation. While the average value is 17%, the low standard deviation suggests significant variation in employee stock ownership ratios within the sample. This reflects the influence of different factors such as strategic decisions, governance structures, and financial conditions on employee stock ownership plans. By setting employee stock ownership ratios appropriately and combining them with other incentive mechanisms, internet companies can maximize employee motivation and participation, thereby positively impacting performance.

According to the sample data, 79.3% of internet companies have implemented reward mechanisms as part of their employee stock ownership plans, while the remaining 20.7% of companies have not implemented such mechanisms. This indicates that the majority of companies place significant emphasis on employee stock ownership plans and further motivate employee participation in equity management and performance improvement through the implementation of rewards. By providing rewards, companies can effectively stimulate employee motivation and engagement. These rewards may include equity-based returns, special allowances, or other forms of incentive measures to encourage employees to exert more effort in achieving individual and company goals. Such incentive mechanisms help strengthen employee loyalty to the company and align them more closely with company interests. However, there are still 20% of companies without reward mechanisms, which could be due to various factors such as different organizational cultures, strategic objectives, or financial conditions. These companies may employ alternative means to incentivize employees, such as offering more flexible benefits, training opportunities, or promotion pathways. Despite the absence of reward mechanisms, these companies can still stimulate employee motivation and engagement through other avenues. Therefore, the majority of internet companies value employee stock ownership plans and use reward mechanisms to further motivate employee participation and performance improvement. However, whether or not a company implements reward mechanisms may be influenced by various factors.

Company size is represented by the natural logarithm of market capitalization or total asset size, with an average value of approximately 10.0 and a standard deviation of around 0.5. This indicates some variation in company size within the sample. Most companies likely fall within the medium-size range, while a small portion belongs to larger or smaller scales. Based on the sample data, the average natural logarithm of market capitalization or total asset size for listed internet companies in China is approximately 10.0, with a standard deviation of around 0.5. This suggests a certain degree of variation in company size within the sample. Most companies fall within the medium-size range, which is close to a natural logarithm value of 10.0 for market capitalization or total asset size. These companies occupy relatively stable and common scale levels in the market. However, there are also a few companies that belong to larger or smaller scales. Larger-scale companies have higher market capitalization or total asset sizes and may be market leaders or significant participants in the industry. Smaller-scale companies, on the other hand, could be emerging enterprises, startups, or institutions facing certain operational challenges. The company size of internet companies exhibits some diversity. Employee stock ownership plans based on compensation incentive theories can play a role in companies of different sizes. For larger-scale companies, employee stock ownership plans can further motivate senior management and key employees, strengthening their sense of responsibility and long-term stability, thereby supporting the company's sustained growth. For smaller-scale companies, employee stock ownership plans can attract and retain key talent, helping them achieve shared goals with the company and providing stable human resources for the company's development.

4.2 Regression of Employee Stock Ownership Plans on Performance in Chinese Listed Companies

We obtained the following data analysis results:

The coefficient of determination (R-squared) for the regression model is 0.893. This means that the independent variables (employee stock ownership ratio, employee stock ownership plan reward mechanisms, and company size) in the model can explain 89.3% of the variation in the dependent variable (performance indicators of the company). This indicates that the selected variables have a high predictive ability in explaining company performance.

The regression coefficient ($\beta 1$) for the employee stock ownership ratio (X1) is 1.986, with a p-value of 0.021. This implies that the employee stock ownership ratio has a significant positive impact on company performance. Specifically, for every 1 percentage point increase in the employee stock ownership ratio, the performance indicator of the company (Y) will increase by 1.986 units.

The regression coefficient ($\beta 2$) for the employee stock ownership plan reward mechanisms (X2) is 0.677, with a p-value of 0.037. Therefore, it can be concluded that the employee stock ownership plan reward mechanisms have a significant positive impact on company performance. Specifically, implementing reward mechanisms will lead to an increase of 0.677 units in the performance indicator of the company (Y).

The regression coefficient ($\beta 3$) for company size (X3) is -0.454, with a p-value of 0.049. This indicates that company size has a significant negative impact on company performance. For every one unit increase in company size, the performance indicator of the company (Y) will decrease by 0.454 units.

Finally, we obtain the regression analysis result as:

$$Y = 3.742 + 1.986*X1 + 0.021*X2 - 0.454*X3$$

5 Conclusion and Recommendations

The employee stock ownership ratio and employee stock ownership plan reward mechanisms have a significant positive impact on company performance. This means that by increasing the employee stock ownership ratio and establishing effective employee stock ownership plan reward mechanisms, companies can achieve better economic and financial performance. Employee stock ownership can motivate employees to actively participate in achieving company goals and enhance their sense of responsibility and ownership. At the same time, effective reward mechanisms provide employees with incentives, further enhancing their commitment and innovative capabilities.

Company size has a significant negative impact on performance. This suggests that as company size increases, performance may decline. One possible explanation is that in large organizations, decision-making processes may become complex and slow, leading to decreased efficiency. In addition, large companies also face challenges in coordination and communication, which may limit team collaboration and innovation capabilities.

The regression model fits well, and the selected variables can effectively explain the variation in company performance. This indicates that the chosen variables such as employee stock ownership ratio, employee stock ownership plan reward mechanisms, and company size are reliable and effective in predicting and explaining company performance.

Based on the above conclusions, we suggest the following recommendations for company management:

Establish or improve employee stock ownership plans: Companies can consider establishing employee stock ownership plans and ensuring that these plans have clear incentive mechanisms and reward measures. This includes providing employees with stock options, profit sharing, or other forms of financial returns to stimulate employee participation and contribution to the company's development. Management should also value employee stock ownership plans, provide necessary support and attention, and enhance employees' sense of identification and responsibility towards the company.

Pay attention to the impact of company size on performance: While pursuing scale expansion, large companies should be mindful of coordination and communication issues. Management can implement measures such as establishing cross-departmental collaboration mechanisms, optimizing decision-making processes, and strengthening internal communication to improve the execution efficiency and team collaboration capabilities of large organizations.

In addition to employee stock ownership and company size, other factors that may affect company performance, such as leadership quality, market competition environment, and industry characteristics, should be considered comprehensively. This will help formulate more comprehensive and accurate strategies and measures to enhance overall company performance and competitiveness.

Given the specific sample and regression model of this study, we recommend further studies to verify the generalizability and reliability of these results. In order to more accurately evaluate the impact of ESOP on company performance, the following aspects can be considered: Expand the sample scope and add more samples of Internet companies, covering companies of different sizes, industries and geographical locations, to obtain more comprehensive data. This can increase the representativeness of the study and improve the reliability of the results; use different methods and models, adopt various statistical methods and models for analysis, such as panel data model and time series analysis, which helps to test the sensitivity of the results and verify the consistency of the results; combine the research results with the actual business situation, analyze the specific mechanism and path of ESOP performance, consider the differences in culture, organizational structure and market environment, and explore the implementation mode and performance influence of ESOP. In addition, potential factors including other influences, such as management team quality, market competitiveness, technological innovation ability, etc. Considering these factors allows a more comprehensive assessment of the impact of ESOP on company performance.

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