

Impact of Employee Stock Options on Corporate Performance with special reference to selected Financial Services Companies in India

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Abstract

Due to the effect of globalization of Indian business, ESOP idea spreads across corporate India. Financial Sectors also began looking at ESOPs as an attractive tool to hire and retain employees after SEBI ESOS & ESPP Guidelines 1999. This study is an attempt to identify and analyze the macro trends of ESOP phenomenon in Indian Financial Services Industry. The present paper makes an empirical study on the sample of 20 pharmaceutical companies listed in Indian stock market which has adopted employee stock option plan and analyze its impact on firm performance.

Key words: Employee Stock Options, Companies, Performance.

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1. Introduction

Competitive pressures to improve productivity continue to place significant demands upon organizations globally. In response to these competitive pressures in India firms adopted ESOPs to motivate employees. Development of organizational capability based on the skilled and motivated human resource is a most important source of competitive advantage in business in the context of rapid advances in technology, financial markets and marketing strategies (Kumar, 2004).

Financial services are the economic services provided by the finance industry, which encompasses a broad range of organizations that manage money, including credit unions, credit card companies, insurance companies, consumer finance companies, stock brokerages, investment funds and some government sponsored enterprises. India's financial services sector has postulated a stable growth curve over the years driven by sound fundamentals, rising personal incomes corporate restructuring, financial sector liberalization and the growth of a consumer-oriented, credit-oriented culture. According to the Central Statistical Organization (CSO) data, financial sector rose by 9.7 per cent in 2009-10. The financial system of a country is of immense importance as it portrays the stability as well as sustainability of the country. The volume and growth of the capital in the country depends greatly upon the efficiency and intensity of the operations and activities in its financial markets. Demand for financial services in India is taking off rapidly. International financial institutions are playing an increasing role in the expansion of India's large corporations. Since broad-based options are a relatively recent phenomenon, it is only now beginning to be possible to make a serious assessment worldwide of their impact on productivity and performance.

2. Review of Literature

Blasi et al. (1996) in their study compared the corporate performance in 1990/ 91 of two groups of public companies those in which employee owned more than 5% of the company's stock. The results of the study indicated that productivity, profitability and compensation were consistent with neither negative nor highly positive views of employee ownership, but where differences are found, they are favorable to companies with employee ownership, especially among companies of small size. The study concluded that the circumstances in which employee ownership was used specifically as a part of wage/ benefit concession package or in a takeover threat do not appear to have significant effect on the 1990 performance levels or performance growth of the firms. The study results were consistent with those of past studies.

D'Arcimoles and Trebucq (2002) in their study examined how employee ownership affects corporate performance and risk in France. The sample size was approximately 220 listed French firms. The study used ownership, performance and risk and control variables. The study results showed some positive links between the presence of ESOPs and some financial performance measures, such as the result on equity and the return on investments. The presence of ESOPs reduces the return on equity variability, but increases beta co-efficient. The study concluded that investors tend to consider firms with ESOPs to be more risky, even if their profitability is more stable.

Robinson and Zhang (2005) examined the empirical link between the likelihood of ESO and the presence of valuable human capital using the Workplace Employee Relations Survey 1998. The analysis revealed that ESO is more likely to be observed in a workplace that depends on and encourages employees to make valuable investments in large financial services firm. To test the model multiple regression equations were used to derive the path co-efficient. The findings revealed that the psychological contract variable of met expectations mediated the relationship between stock options and tenure intent and organizational commitment thus providing support for the intrinsic value model. Equity perceptions mediated the relationship between stock exercised and met expectations. Equity perceptions, however, did not mediate the relationship between stock options and employee attitudes. Similarly, stock earnings also had a direct effect on external career intent indicating that employees who had exercised their stock options were looking for outside career opportunities contrary to the framed hypotheses.

3. Objectives

The main objective of the study is to examine the impact of ESOP on corporate performance in listed financial services companies in India.

4. Methodology

The study was confined to the listed financial services companies in BSE. The data for the study are drawn from the Centre for Monitoring Indian Economy (CMIE) PROWESS data base. The companies were selected based on the criteria that the companies should have allotted/ adopted ESOP between April 2000 to 2008. The year of adoption/ allotment of ESOPs were taken as 0, four years prior to adoption of ESOP were taken as -4, -3, -2, -1 and four years after adoption of ESOP was taken as +4, +3, +2, +1. Based on this criterion 20 financial services companies which are listed in Bombay stock exchange were selected for the study.

Employee stock options or employee ownership is the main variable of this research paper. There are several ways to measure ESOPs. One is the number of employee participants, another is the amount invested by the employees in ESOPs. At present, such information is not available for Indian companies. Allotment of Employee Stock Options is more commonly published. This measure can indicate the presence or absence of ESOPs.

The companies are categorized into three groups such as low, moderate and high ESOP companies based upon their employee stock option percentage. Categorization for this purpose has been based on 30th and 70th percentile (percentage varying between 0.01 to 7.81). Companies whose employee ownership percentage fall below or at 30th percentile value (0.083) were classified as low ESOP companies and companies whose employee ownership percentage fall above 70th percentile value, namely 0.465, were classified as having high ESOP companies. The companies whose employee ownership percentages fall between 30th and 70th percentile values were grouped as moderate ESOP companies.

Results:

Based on Percentage Analysis:

Out of 285 listed Financial Services companies in India, only 7.02% i.e. 20 financial services companies have adopted ESOPs (Source: Prowess Data Base; Results: Computed).

The minimum employee ownership percentage was found to be 0.01% and maximum employee ownership percentage was found to be 5.49% (Source: Prowess Data Base; Results: Computed).

Based on Mann Whitney U test:

The Mann Whitney U test revealed that valued added per employee metric did not show significant difference during pre- and post- ESOP in financial services sector.

Significant differences were not noted in Asset Turnover Ratio (ATO) during pre- and post-ESOP.

There is no significant difference in Net Profit Margin during pre- and post-ESOP for financial services sector.

Significant differences were not noted in Earnings per share during pre- and post- ESOP.

5. Conclusion

The study did not find any association with the use of broad-based stock options and improved performance. Value added per employee, as measure of employee productivity that most closely captures employee effort and motivation, provides some evidence that stock options did not influence employee productivity in financial services sector. The study's result indicates that employee stock options did not improve profitability and overall performance of companies after ESOP allotment. It is also identified that percentage of capital owned by employee shareholders are relatively insufficient to change employee attitudes and behaviour in a way that improves overall performance of the firm. It is concluded that the company's management system should synergize the intellectual capital and financial capital to provide a way to link employee and corporate fortunes for long term goals. Such an initiative will certainly result in enhanced employee motivation and improve company performance.

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6. References

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Annexure I: LIST OF SAMPLE ESOP COMPANIES

S.no	Company Names	ESOP Year
1	Brescon Corporate Advisors Ltd.	2007
2	Centrum Capital Ltd.	2008
3	Crisil Ltd.	2007
4	Edelweiss Financial Services Ltd.	2001
5	Emkay Global Financial Services Ltd.	2007
6	Geojit B N P Paribas Financial Services Ltd.	2008
7	Gruh Finance Ltd.	2007
8	H S B C Investdirect (India) Ltd.	2007
9	Hinduja Ventures Ltd.	2006
10	Housing Development Finance Corpn. Ltd.	2002
11	I L & F S Investment Managers Ltd.	2007
12	India Infoline Ltd.	2007
13	Indiabulls Financial Services Ltd.	2007
14	Infrastructure Development Finance Co. Ltd.	2007
15	Multi Commodity Exchange Of India Ltd.	2007
16	Network 18 Media & Invst. Ltd.	2007
17	Networth Stock Broking Ltd.	2006
18	Pioneer Investcorp Ltd.	2007
19	Religare Enterprises Ltd.	2007
20	Shriram Transport Finance Co. Ltd.	2007

Annexure II: Mann Whitney U test

Table 1: Significance of Value Added per Employee ratio in pre- and post-ESOP

Sector	Mean rank	Sum of ranks	Mann-Whitney U	Z value	Sig
Financial Services	68.64	4942	2314	1.619	Ns
	80.05	6084			

Significant at 1% level, * - Significant at 5% level, Ns- Not significant

Table 2: Significance of ATO ratio in pre- and post- ESOP

Sector	Mean rank	Sum of ranks	Mann-Whitney U	Z value	Sig
Financial Services	59.18	4498	1572	4.849	**
	93.82	7130			

Significant at 1% level, * - Significant at 5% level, Ns- Not significant

Table 3: Significance of Net Profit Margin in pre- and post- ESOP

Sector	Mean rank	Sum of ranks	Mann-Whitney U	Z value	Sig
Financial Services	75.35	5425.50	2386.5	0.821	Ns
	69.65	5014.50			

Significant at 1% level, * - Significant at 5% level, Ns- Not significant