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EMPLOYEE STOCK OPTION PLANS: A META-ANALYSIS (UNDERSTANDING IMPACT OF ESOPS THROUGH LITERATURE)

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Abstract:

The usage of psychological ownership as an HR practice has been of a relatively recent origin. It is fast being recognized as a useful tool in the area of human resource management. Employee Stock Option Plans are being used as a technique to propagate psychological ownership and gain many advantages including a competitive edge. This paper explores the available literature on psychological ownership in general and Employee Stock Option plans in particular over a thirty year period from 1988 till 2018. An attempt has been made to integrate all matter into a theoretical model indicating the effect of such plans on individuals and organizations. In the study, several empirical as well as theoretical papers have been studied and the impact of Employee Stock Option Plans on several parameters like organizational productivity, individual performance, absenteeism, employee turnover and organizational citizenship behaviour have been reported. Several job attitudes like job satisfaction and commitment of employees towards their organization have also been reported. The studies reporting conditions of these plans that make them successful have been covered comprehensively.

Key words: *Employee Stock Option, Productivity, Performance, Absenteeism, Turnover, OCB*

1. Introduction

Organizations have been experimenting with novel ways to improve their HR practices. Several innovations have taken place and new HR practices continue to make their inroads into organizational policies. Side by side, the concept of psychological ownership has been fast gaining momentum. Accordingly, employees feel and start identifying with the organization's goal and strategies and feel as if they belong to the organization and vice versa. The usage of psychological ownership as an HR practice has been on a relatively recent origin and is being recognized as a useful tool in human resource management. Psychological ownership manifests itself in various ways, employee stock option plans being one such method.

According to Employee Ownership Foundation (2016), it helps enhance the levels of competitiveness, improves productivity and boosts the system of free enterprises in US. Employee Stock Option Plans aims to calibrate individual interests with the organizational (McHugh et al, 2005). ESOPs are integral to most of the organizations that are owned by employees (Knapp, 1988). Employee Stock Option Plans were a relatively new entry but continues to be popular around the globe. Their utility in improving individual and organizational performance has been thoroughly debated and differently answered. According to Ahrens et al. (2018): *“Employee stock-ownership plans (ESOPs) offered by multinational enterprises (MNEs) present an attractive investment for employees”*

Besides the above it can bring in motivation and retention and serve as contributions to the employees (NCEO, 2017) and help in management of people (Martin et al., 2016). Actually, the positive effect of ESOs are determined by their potential to motivate (Torp, 2011) as it is one of the components that motivates employees for harder work (Blasi et al., 2008). They are a part of several important issues that contemporary organizations encounter in employee management (Martin et al., 2016) and are a part of defence mechanisms used by organizations (Dann & DeAngelo, 1988).

Moreover it adds to the strategic value as well as human capital uniqueness (Lepak & Snell, 2002) creates effects for wealth that are positive in nature (Dhillon & Ramirez; 1994) and helps in maintaining good employee relations (Leat, 2009). They also help in avoiding takeovers by placing stocks with trusted employees, have low levels of risk of going bankrupt and report “lower stock price volatility” (Brown et al., 2006) and reduce the chances of takeover (Beatty, 1995). ESOPs have been strongly propagated as a positive HR practice in different models proposed {(Martin et al., 2016); (Ledford, 2014); (Bloom & Van Reenen, 2011); (Barringer et al., 2005); (Poutsma et al, 2015)}. They have even been reported as useful in enabling firms make “sizeable R&D expenditures” (Tucker et al, 1989) and in reducing the “cost of liquidity services” Jennings et al., (2002). They have helped in the survival of organizations and ESOs have helped them in their success in tough times (Gilbert et al, 2009).

2. ESOs Around the World

Employee Stock Option plans are prevalent around the world. In Japan, 91% of organizations listed had an ESO plan by 1988 covering around 50% of workforce and the non-executives, on an average, owned close to \$14000 in ESOs (Jones & Kato, 1993). In US, an equal percentage of workers were covered by 2001 which was an increment of 100% since 1987 (Sesil et al., 2003). By 2015 this number had tuned into 28 million (NCEO, 2017). D’Art and Turner (2005) reported close to half a million employees were covered in a twenty year period between 1983 and 2003 in Ireland,. In a study of 1000 public and private organizations, it was found more than 300 were offering ESOs (CIPD, 2002).In China, they were found to be effective as a partial substitute to cash compensation (Fang et al., 2015) while they were reported to be vital in Taiwan (Morton, 1998), as well as in entire Europe (Martes, 2012), as a part of workplace change in Philippines (Sibal et al., 2008) practiced in private and cooperative sectors in Britain

(Robinson & Wilson, 1993) and a tool for gaining competitive advantage in East and South east Asian countries (Burton et al., 2003). Over 50% of the people in Australia and 20% in Germany were a part of ESO by owning shares and the trend is on the rise in the entire western world (Sesil et al., 2003). In France, they are considered a means of shift in risk to the employees (Aubert et al., 2017), while in Australia they are fast picking up (Aitken & Wood, 1989). In Finland, the effect of ESOs on the wealth of shareholders was studied (Ikaheimo et al., 2004) and the effect of ESOPs was also studied for Germany (Sanders & Tuschke, 2007). On a global level, ESOPs are influenced largely by expatriates (Ahrens et al., 2018).

However, it may also turn out that not everyone is interested in ESOP (Flock & Ramnath, 2009) as in South Korea where participation in ESO and decision making is low (Cin & Smith, 2002). Still, according to Dhar & De (2011): *"It is now being gradually accepted that if stock option-based compensation expenses are omitted from the income statement, the financial statements became less transparent."*

ESOPs are prevalent in hospitality sector (Murphy & Murrmann, 2009), steel businesses (Oswald et al., 1991), manufacturing (Morton, 1998) and airlines (Wallace et al., 2006) and are used as rewards for technical employees (Gomez-Mejia et al., 1990). As a part of corporate governance, they have definitely showed positive results as was evident in case of Carris companies in US (Betit, 2007). ESOPs are an integral part of compensation for employees and has become "institutionalized in certain firms and sectors" O'Donnell et al., (2006).

In the Indian context, Workers Equity Bill, 1985 facilitated the growth of ESOP as it paved the way for worker participation in equity as a major tool in enhancing workers participation in management (Kochan et al., 2005). It was furthered by the issuance of ESO Scheme and Employee Stock Purchase Scheme Guidelines, 1999. Indian employees view it as "generic term for a basket of instruments and incentive schemes that find favour with the new upward mobile salaried class and which are used to motivate, reward, remunerate and hold on to achievers." (Jain, 2015). Basariya (2015) lists the IT giant Infosys the major propagator of ESOP in India. Due to bounce back by economy, ESOPs in India had doubled at the beginning of the current decade Venkatasubramanian (2010). Ray (2016) studied ESOPs in non-finance companies while Gada (2010) has studied ESOP with respect to Indian Accounting Standards. Nithya. (2015) suggests a revamp of ESOPs in terms of their timings and magnitude.

3. ESOP, Productivity & Performance

Most researches on ESOs have studied the relationships between the ESOPs and individual & organizational productivity and profitability Hallock et al., (2003). The impact of ESO on organizational productivity has been examined in detail {Kala, 2015; Sharma, 2014; Martes, 2012; Ray, 2016; Jones & Kato, 1995; Marsh & Mc Allister, 1981; Ben-Ner & Jones, 1995; Conte & Svejnar, 1988; Van & Pierce, 2004}. The ESOs have had an impact on organizational productivity although not very significant (Logue & Yates, 2001; BCI Group, 2002) and collective participation is necessary (Dhiman, 2009).

Several variables that serve as moderators in the effect of ESOs on the performance of organizations have been studied by Long (1978). The popularity of ESOs have been attributed to their ability to enhance organizational productivity (Livingston & Henry, 1980). Murphy et al., (2009), in their study of restaurants, found ESOs as an important dimension of organizational performance in terms of performance management systems while Betit (2007) reported them to be vital for the success of organizations in their study of an organization based in USA and Mexico.

Pierce et al., (1991) claim ESOs impact organizational performance through an interface between employees and owners. Conte & Svenjar, (1988) reported better organizational productivity when employees were involved in decision making as compared to implementation of ESOs. Kala (2015) has used financial ratios and measures to analyze organizational productivity and performance using data of organizations before and after implementing ESO measures. Martes (2012) has studied the impact of ESO on organizational performance in Europe while Jones & Kato (1995) have reported the same for Japan. Fang et al., (2015), comparing the performance of organizations offering and not offering ESOs in China, reports performance of the former as better. Such organizations gained from manpower that felt they received incentives specially the small ones and those operating in the private sector.

Blasi et al., (1996), comparing two different groups of companies with and without ESO plans, reported better organizational performance for the former. They also reported smaller organizations with ESO doing better. Similarly, Park & Song (1995) found ESOs to improve the long term performance of organizations. It was found they increase organizational performance by improving the flow of cash (Beatty, 1995) and by providing "abnormal positive returns" Chang, (1990). On the contrary, Huang (1997), reports an inverse relation between ESOs and organizational effectiveness and Pan et al. (2014) also found they were negatively related.

In terms of individual performance, the impact of ESOs were found and reported {Torp, 2011; Ben-Ner & Jones, 1995; Pierce et al., 1991}. Kruse et al., (2004) reported in a study of 11 organizations that had ESO plans, a positive impact on performance of workers. In a study of a Chinese company, Zhu et al, (2013) reported ESOs to be extremely successful in their effect on productivity of employees. The majority of workers need to participate in ESOs and they need to be supplemented with other ways for an overall performance increase (Pendleton & Robinson, 2010). Bigger ESOs and smaller ones up to 5% were found to enhance individual productivity (Kim & Ouimet, 2014).

The effect of ESOs on productivity has been reported even in figures. Jones & Kato (1993) reported this figure to be close to 7% In Japan while in South Korea, Cin & Smith (2002) found the productivity to have improved by 2.6% when the ESOs were increased by 1% (from 2-3 as percentage of the total shares), in Taiwan, Ya-Ting (2003) reported the improvement in productivity by 4-5% and in the Silicon valley the annual turnover generated increased between 20 and 30% (Pfeffer, 2001). Kumbhakar & Dunbar (1993), in a five year study of organizations that used ESO plans, found that: *".....productivity effect increased with the age of the ESOP at the rate of 1.8 to 2.7 percent per annum and with the age of the profit sharing plan at the rate of 3.9 to 4.6 percent per annum."*

Kruse (2002) found that: *“the average estimated productivity difference between ESOP and non-ESOP firms is 6.2%, and the average estimated additional increase in productivity following adoption is 4.4%.”* According to Kumar (2008): *“the average productivity of ESOP software firms is 1.15 against 0.93 for ESOP non-software Indian companies which are not statistically significant.”*

4. ESOs and Organizational Citizenship Behaviour

Organizational Citizenship Behaviour (OCB) is “emerging as an important aspect of human behavior at work. Good citizenship behavior is characterized by altruism, conscientiousness, sportsmanship, and courtesy.” (Organ, 1988). It is also being impacted by ESOs (Mayhew et al., 2007). Simbula & Guglielmi (2013) in a study of 157 school teachers found the same. Van Dyne & Pierce (2004), in a study of 800 employees, found a direct relation between psychological ownership and OCB. Chiu & Tsai (2007), in their study conducted in Taiwan, found a combination of ESO and profit sharing to have a positive impact on OCB. Park et al., (2013), in a study from Korea, found a significant relationship between psychological ownership and OCB. Bernhard & O’Driscoll (2011) had also reported the same in the context of family owned businesses while Chan & Tan (2015) found the same in a study conducted in China. In a study conducted in Netherlands, Poutsma et al., (2015) found that OCB is not influenced by even a strong performance workplace system if ESOs are not there.

5. ESO, Employee Turnover & Absenteeism

ESOs were likely to influence the employee turnover {Buchko, 1992; Selvarajan et al, 2006} and reduce it (Livingston & Henry, 1980; Klein, 1987). Selvarajan et al, (2006) found ESO create psychological contracts leading to a sense of ownership. They are efforts to employee retention and their motivation Coff and Rousseau (2000). It helps organizations retain skilled employees (Olckers & Du Plessis, 2012). Evidence from Australia (Aitken & Wood, 1989) indicates ESOs besides enhancing organizational performance, also reduces grievances, employee turnover and the rates of absenteeism. The effect of ESOs in reducing employee turnover finds support from Oyer & Schaefer (2005) and on absenteeism from Basariya (2015) who conducted a study in India. Blasi (2008), in a study conducted with 40,000 people, reports the effect on both turnover and absenteeism. However, Dhiman (2009) rejects that employees can be retained by introduction of ESO plans in a study conducted on Indian organizations. Similarly, Caramelli & Carberry (2014), in a study of 900 French employees, found turnover has no relation with employees opting for stock option plans.

6. ESO and Job Attitudes

Klein (1987) had reported high levels of organizational commitment when ESOs gave financial gains, upon their proper communication and the level to which management

was committed to ESOs. Brandes et al. (2003), in a study covering non-executive employees, reported organizational commitment to be more when ESOs were increased. Caramelli & Carberry (2014), in a study of 900 French employees, found organizational commitment affected the decisions of employees opting for stock option plans. Similarly, Alfianty & Susanty (2016), in a study of a telephone company in Indonesia, reported ESOs had a significant impact on the levels of organizational commitment and employees had a positive perception of ESOs.

Torp (2011) has propagated that ESOs create employee involvement with the organizations besides providing other benefits. Ben-Ner & Jones (1995), demonstrate that ESOs affect motivational levels, an idea echoed by Blasi et al., (2008) who has also reported the impact on employee loyalty, while Pendleton (2006) suggests ESOs inculcate cooperation and trust among employees.

Culpepper et al., (2004), in a study of airline pilots, show the normative component of organizational commitment is most affected by ESOs and workplace empowerment. Gamble et al., (2002) had also proved that job satisfaction enhances among pilots of three airlines (covered in their study) when they perceive autonomy on their jobs to be more. Earlier, Long (1978) had also found ESOs to have enhanced the attitudes of employees and this also found support from Buchko (1992). Aitken & Wood (1989) reports ESOs affect motivation levels and morale of employees in Australia. This is true for India as well as Kumar (2004) found them to be vital if ESOs were to prove successful.

Van Dyne & Pierce (2004) shows a positive relationship between ESOs and organizational commitment, job satisfaction and esteem. Pan et al. (2014) reports ESOs may affect organizational commitment while Pierce et al., (2004) have connected them with work environment and control. The mediating role of leadership has also been reported by Bernhard & O'Driscoll (2011).

7. Conditions of ESOP

Kruse et al., (2004) claim that ESOs are successful when they are backed up by a conducive corporate culture against free riding, the kind of incentives employees perceive they get and the systems and mechanisms for their implementation. ESOs, as a form of mode of employment have been studied by Lepak & Snell (2002) who did it in the context of the value added in terms of organizational strategy. Shipper et al., (2013) attribute the ESOs to be effective not only when they are implemented but also on the methods and context in which they are implemented. Ledford (2014) has attempted to explain several factors that influence changes in reward systems including ESOs and outlines changes in law, regulations and technology as well as diversity of workforce, competition, globalization and labour patterns as some of them. He suggests commitment of top management and investments into reward systems to make them more successful.

The success of ESOP depends on their implementation (Shipper et al., 2013) incentives, participation by employees and corporate culture (Douglas et al., 2004) as well as on lower stock price volatility and lower bankruptcy risk (Brown et al., 2006) and the circumstances (Beatty, 1995). Therefore, ESOPS are not only prevalent among established and big organizations, they are fast spreading to small firms although they are

different from the former (Cardon & Stevens, 2004). ESOs form an integral part of compensation packages even in “relatively staid industries” (Pfeffer, 2001).

In Polaroid, the success of ESOs were due to redesign of work and a work culture that facilitator participation on workers (Giblin *et al.*, 1995). Two airlines Northwest and United had used ESOs but was more successful in later due to their efforts in redesigning and bringing about change (Bartkus, 1997). The intentions of introducing ESOs, expectations of employees as well as the management, organizational culture and participation level determine the role of ESOs in making an organization effective (Bartkus, 1997). Gamble *et al.* (2002), in a study of three airlines, proved the job satisfaction among pilots of these airlines was greater when they perceived a better approach to ESO from the management. Hallock *et al.* (2003) have also included demographics along with job related attitudes that effect the satisfaction levels of employees with ESOs and in turn affect individual and organizational productivity. Rathore & Shukla (2015), in reference to Indian pharmaceutical sector, report ESOs to be successful when they are properly designed, implemented and communicated. Caramelli & Carberry (2014), in a study of 900 French employees, had also reported the commitment of management as perceived by employees and the communication to effect the employee’s decision in opting for stock option plans.

The role of various stakeholders other than management is important as far as ESOs are concerned, unions being one such case Wichman (1994). In a study of United Airlines in particular and aviation industry in general, Lamberg (2003) reports negotiation with various stakeholders specially unions as important for ESOs. Clark (1990) had also reported the role of unions and their relationship with management to be vital to success of ESOs.

Dhiman (2009) found that the productivity of Indian companies is not affected by ESO nor does it help in employee retention directly but the age of ESO does affect the former. McHugh *et al.*, (2005) introduced three more conditions vital to ESOs and explored them namely extent to which employees are influential in the organization, degree of information sharing and the equality provided to employees and employers through ESOs. They also claim ESOs would be successful only if they are designed to protect the interests of both the parties. Adding to this Vyas (2007), claims ESOs are effective depending on the motive of the management, how much they are able to meet and take advantage of the expectations of employees and most importantly the kind of effects Employee Stock Option Plans continue to have on the dynamics of the stock market.

Thompson *et al.* (2013) have tried to investigate why ESOs fail in their purpose and report the manager’s incapability to maintain an organizational culture for the same is the reason. Maaloe (2006) claim a mutual set of expectations set in giving way to a spirit of cooperation that facilitates ESOs. The finding is based on a study conducted in organizations in USA over a four year old period. On the contrary, McConville *et al.* (2016), based on a study of 37 respondents in an organization, concludes psychological ownership is not affected by ESO plans and the latter plays little role in the former.

Regarding the role of the size of an organization in the success of an ESO, smaller organizations were found to have an advantage {Fang *et al.* (2015); Blasi *et al.* (1996); Smaller ones that gave upto 5% in ESOs enhanced individual productivity (Kim & Ouimet, (2014)}. On the contrary, Sesil & Kroumova (2005) reported the size of an organization as

having no effect on ESOs. Under certain circumstances, ESOs create problems as well including complicating the agency problem with respect to managerial staff and those who hold shares as outsiders (Chang & Mayers, 1992).

8. Understanding ESOP: The Conclusion

The studies cited above show ESOPs influence a variety of factors with certain variables acting as moderators. The entire model can be depicted diagrammatically as shown in Figure 1 below:



Figure 1: Understanding ESOPs

This way review of literature shows the ESOP schemes benefit organizations in several ways ranging from individual to organizational benefits. The increase in productivity of organization has been reported in figures as well. The effect of ESOP is moderated by several internal and external factors.

Further Scope of Study

- This model can be tested empirically by studying organizations that offer ESOPs. This study can be either conducted longitudinally or comparing the effects before and after the implantation of ESOP schemes
- A comparison can be made between organizations offering ESOP schemes and those not offering such plans in terms of productivity and other outcomes listed
- More variables can be included for the effect caused on them due to introduction of ESOP schemes.

Key Points

- a) Employee Stock Option Plans (ESOPs) are prevalent across organizations in different sectors globally.
- b) They affect productivity, both individual and organizational, job attitudes and organizational citizenship behaviour.
- c) ESOPs help in reducing employee turnover and absenteeism according to most researchers.
- d) ESOPs are successful due to a host of conditions both internal and external to organizations.

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