

**Post-adoption Productivity Performance of Indian ESOP Company**

Anju Sharma,

Assistant Prof of Commerce,

DAV College, Karnal

Human Resource Professionals and Managers can use ESOPs as a tool to reward and motivate employees. Employee Stock Options (ESOP) offered by a company to its working employees entitles them to buy shares of the company at a future date and at specified price. They provide an opportunity to the employees to acquire a stake in the company and are intended to create an ownership culture and align their interest with those of the company in order to get corporate objectives. The shares to be allotted to their employees are decided by the compensation committee. The compensation committee contains senior members from the company. All the shares to be given to the employees in the company will transfer to employee stock option trust (ESOT). This financial tool can be used to make sound financial position of the said company. In leveraged ESOP the company can borrow money from the financial institutions and the borrowed money would be utilized for further expansion of the business and its operation. The employee's participation in ownership as well as in decision making would results to improve the profitability performance and productivity performance of the company. In present study, an effort would like to evaluate the impact of ESOP on the profitability performance of Indian banking sector where ESOP became popular after 1<sup>st</sup> April, 2000. The public sector and private sector banks implemented ESOP to attract the talent and motivate the employees for increasing the wealth of the bank. In India, Indian Banking Sector, Pharma., Engineering and many software companies like Infosys, Wipro, and Polaris etc. have issued ESOPs. The employee usually holds the contract for a few years. The date on which the company allots the shares is called date of vesting. After the allotment of shares, the employee may wish to book profit by selling the stock in the market.

**The ESOP is an employee benefit plan**

ESOPs are utilized by company to offer an alternative and more lucrative profit sharing plan so that the employees get more motivated and in the long run contribute in increasing the productivity of the company. Also it has some major fringe benefits like tax benefits, financing options etc which makes it an attractive investment both from employers and employee view point. For implementation of ESOPs the company creates a trust to which it

---

makes annual contributions. These contributions are then allocated to the individual employee accounts within the trust. Allocations can be done in proportion to compensation, years of service or a combination of both. Usually, employees might join the plan and begin receiving allocations after completing a year of service with the company, where any year in which an employee works at least 1000 hours is counted as a year of service.

Moreover an ESOP is very useful for companies at the growing stage to attract good employees. As the high growth employers are utilizing most of the funds for sustaining the growth, they don't have many resources to distribute to the employees and hence may be considered as with low paying ability.

### **Development of ESOP**

The employee stock ownership plan (ESOP) concept was developed in the 1950s by lawyer and investment banker Louis Kelso, who argued that the capitalist system would be stronger if all worker not just a few stockholders could share in owning producing assets. In 1973, Mr. Kelso convinced Senator Russell long, chairman of the tax-writing senate finance committee of US that tax benefits of ESOPs should be permitted and encouraged under employees benefit law, soon federal legislation promoting ESOPs appeared, most importantly the employees retirement Income security Act 1974 (ERISA) which governs employee benefit plans and established a statutory frame. In the following years the number of ESOPs expanded dramatically now that sharing ownership was in the economic self-interest of company owners. There are now about 11,000 ESOPs and similar plans (stock bonus plan) covering over 8.5 million employees ESOPs are found in publicly traded and closed held companies of over size.

### **Objective of the Study**

The extent to which ESOPs affect worker productivity and performance may depend, in large part, on the organizational structure of the firm. ESOPs may have entirely different effects in small, private companies and public companies for several reasons. First, in large corporations, top management decisions are more likely than the actions of lower-level employees to affect the stock's price, so stock ownership is likely to be a better motivator for key executives than for operating-level employees. This is particularly true if the lower-level employees have little or no say in firm decisions. Second, there may be a free-rider problem among lower-level employees. The present study focuses to measure the productivity performance of Indian ESOP corporate sector.

To study the impact of ESOP on the productivity of business firm in it's off suits as reduced taxes, lower absenteeism, and larger participation in the management and increased employee

morale in its tangible variant. In order to achieve objectives stated earlier and to evaluate the impact of the ESOP on the corporate productivity performance, the study under consideration is based on single window duration i.e. post-adoption period.

As pointed, the present study intends to examine the productivity performance in post-adoption period for the experiment group. This experiment group account for 70 companies of the sample companies who have adopted the ESOP. The study under consideration used five Indian industries to the impact of ESOP on corporate productivity. These five corporate sectors are:

1. Software Industry in India
2. Banking Industry in India
3. Engineering Industry in India
4. Pharmaceutical Industry in India
5. Miscellaneous Industry in India

### Data and Sample Strength

For the secondary data, The Economics Times, Business Standard published annual reports, power database and website [www.bseindia.com](http://www.bseindia.com) as well as [www.indiainfoline.com](http://www.indiainfoline.com) have been used. The annual reports contain the results of past performance and considered the most important and reliable sources of financial data of business enterprises.

### Financial Analytical Tools

The present study intends to examine the productivity performance either increase/decrease in post adoption period of ESOP. In estimating the impact of ESOP on corporate productivity based on post - adoption period includes 0 year (the year in which ESOP implemented period ) 1 year, 2 year and 3 year after ESOP implementation. To measure the impact of ESOP on productivity, the study took assumption that any change (increase/decrease) in productivity in post period is due to implementation of ESOP. The study under consideration is based on 3 basic variable i.e. Net Sale, total assets and Assets turnover ratio.

This includes:-

1. Net Sale : Sales - sale return.
2. Total Assets : Total Assets - outside investments.
3. ATO : Assets turnover Ratio.

The ATO means that at what extent the company used its assets effectively. There are two methods to find out the value of ATO of a firm.

1. On the base of sale per Employee
2. On the base of assets used effectively

As the availability of the data, the study used the second way to determine the productivity level of firm. This is known Assets Turnover ratio i.e. ATO.

ATO can be arrived as:

$$\text{Productivity} = \frac{\text{Sale amount of ESOP Company}}{\text{Total Assets of the ESOP Company}}$$

### A Vista on corporate productivity performance in India

ESOPs in unlisted companies have been a case of mixed successes. There are some companies that granted ESOPs while they were unlisted and employees made a bounty when the company went public – recent success stories are SKS, VA Tech Wabag, Persistent Systems. There are also cases where employees have been able to cash their value (buyback by existing/ incoming investors) even if the company has not gone public – cases in instance are ICICI Prudential and VA Tech Wabag. On the other hand, there have also been companies which neither managed to go public nor provided exit to the option holders. It depends on the company's management and their outlook towards ESOPs as a tool. In the next section, we consider the listed companies while compile the information for the measurement of productivity performance of Indian ESOP corporate sector

Table - 1  
Sale Performance of ESOP Corporate Sectors in India  
(Rs. in Crore)

Sector	ESOP Post-adoption window				
	Year 0	Year 1	Year 2	Year 3	Total Sale
Software	35744.31	16401.17	21671.77	29153.12	102970.40
Banking	166269.95	24427.31	35632.31	52635.72	278965.30
Engineering	87529.69	17261.41	20056.86	25675.27	150523.20
Pharma	45301.87	11088.25	5625.22	12142.34	74157.68
Misc.	123247.41	30620.64	36891.26	50190.33	240949.60

Source: Annual Report of each sample

The highest sale of software sector is Rs. 35744.31 crore for year 0 whereas Rs. 16401.17 crore is the lowest sale for year 1. The fluctuating trend is observed in sale of Indian software sector. The fluctuating trend is also observed in sale performance of banking industry in post-adoption period of ESOP. The position of engineering sector in relation to sale is not

increased in post-adoption period of ESOP. The highest sale of Pharma. Industry is Rs. 45301.87 crore whereas Rs. 5625.22 crore is the lowest sale in year 2 with the implementation of ESOP. The fluctuating trend is observed in sale performance of the Indian misc. industry. To understand the sales performance of each industry can be presented below by diagrammatically to make it more useful.

Table -2  
Total Assets performance of ESOP Corporate sector in India  
(Rs. in Crore)

Sector	ESOP Post -Adoption Window				
	Year 0	Year 1	Year 2	Year 3	Total Assets
Software	41227.94	19294.99	22178.99	30059.59	112761.52
Banking	1356115.56	296024.93	426435.04	464077.54	2542653.07
Engineering	42923.51	8076.30	10573.54	14796.22	76369.57
Pharma	56016.99	8185.78	10837.02	15746.69	90786.48
Misc.	123674.97	28077.98	34591.13	55644.14	241988.22

Source: Annual Report of each company

The assets of each industry grouped in post-adoption period for getting the empirical outputs from the current study. The total assets for year 0 are Rs. 41227.94 for Indian software sector and then assets are increased in year 1, year 2 and year 3 in total Rs. 112761.52 crore in post-adoption period. In Banking industry, the total assets are in post-adoption period i.e. Rs. 2542653.07crore. The assets of Engineering firms are in post-adoption period Rs. 76369.57crore. The fluctuating trend is observed in total assets for the Engineering in post-adopting period. The position of miscellaneous industry is good in post-adoption period from year 1 to year 2.

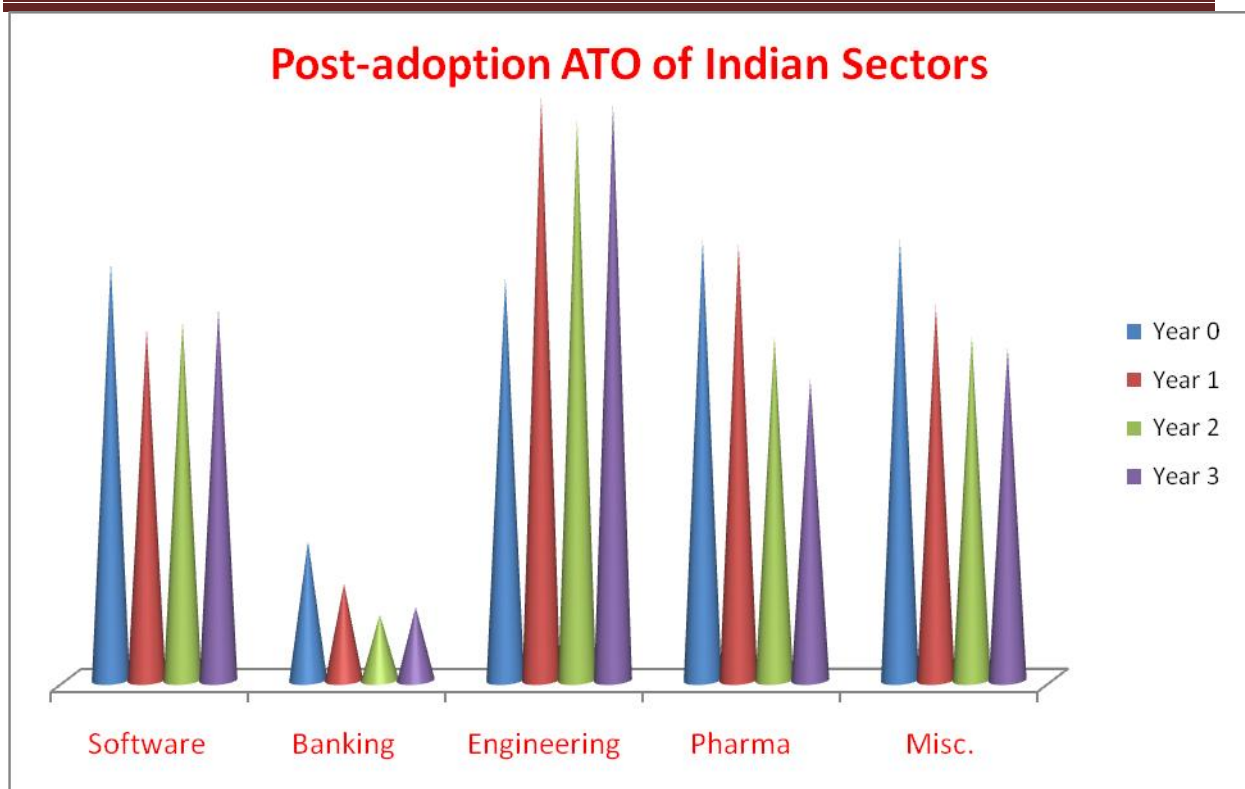
Table - 3

## Productivity performance (ATO) of ESOP Corporate Sector in India

Sector	ESOP Post-adoption window					
	Year 0	Year 1	Year 2	Year 3	Gross ATO	Avg. ATO
Software	1.08	0.91	0.93	0.96	3.87	1.29
Banking	0.36	0.25	0.17	0.19	0.97	0.32
Engineering	1.04	1.51	1.45	1.49	5.49	1.83
Pharma	1.14	1.13	0.89	0.78	3.94	1.31
Misc.	1.14	0.97	0.89	0.86	3.86	1.29

*ATO = Sale of the sector/Assets of the sector*

The ATO of each industry grouped into post-adoption period for getting the researchable results. The average ATO for the Software industry is 1.29 in post-adoption period. In Banking industry, the avg. ATO for post-adoption period is 0.32. The average ATO of Engineering firms is 1.83 which is more as compared to the ATO of post-adoption period in the other industry. The average ATO of Pharma. industry is 1.31 for the period under consideration. The ATO of miscellaneous industry is 1.29 which is more as compared to the ATO of banking industry. The fluctuating trend is recorded in ATO for the entire sector under consideration except misc. corporate sector. The ATO in post-adoption period of misc. industry is decreasing from year 0 to year 3. The highest ATO is 1.83 as observed for engineering corporate sector whereas 0.32 is lowest ATO for banking industry. The productivity performance of each industry can be presented below by diagrammatically to make it more useful. This can be presented diagrammatically below.



### Conclusion

From April 2007 to March 2009, stock options were taxable, though not in the hands of the employee. The employer was liable to pay fringe benefit tax (FBT) on the value of such stock options, the value being determined by the difference between the market price and the exercise price (price at which the shares were allotted to the employee), such difference being determined on the date of vesting of the option. When the employee sells such shares on which the employer has paid FBT, the market price of the shares on the date of vesting is to be taken as the cost of such shares for the purpose of computing the capital gains on the sale of the shares. The tax treatment of employee stock remuneration plans, therefore, depends upon the type of plan, its structure and the point of time at which the vesting or exercise of the option has taken place. The tax treatment of employee stock remuneration plans depends upon the type of plan, its structure and the point of time at which the vesting or exercise of the option has taken place.

In addition, 75% ESOP companies surveyed and found increased in productivity and profitability performance. An ESOP is protection package for employees as well as employer of the firm. An employee stock ownership is widely recognized as an effective means of improving corporate performance by enabling employer to participate in the creation and sharing of wealth they have been created in an organization. ESOP must improve

productivity and firm's performance through more employees' involvement, morale and satisfaction at work place. In India more than 95% of ESOP companies given as an additional benefit in addition to salary.

The ultimate impact of any employee ownership plan, including a stock option plan depends a great deal on the company and its goals for the plan, its commitment to creating an ownership culture, the amount of training and education. In companies that demonstrate ownership culture, stock options can be a significant motivator and gold package to increase productivity and profitability performance of an organization. Employee ownership improves financial performance of the firm.

### References

Hochner, A. & C.S. Granrose (1985), "Sources of motivation to choose employee ownership as an alternative to job loss", *Academy of Management Journal*, Vol. no. 28, pp.860-875.

Iqbal, Zahid, Shaikh Abdul Hamid and Jan Tin (2000), "Stock price and operating performance of ESOP firms": A time-series analysis, *Quarterly Journal of Business and Economics*, Vol. no. 39, pp. 25-38.

Jensen, Michael C., and Meckling, William H. (1976), "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure", *Journal of Financial Economics*, Vol. no. 3(4), pp.305-360.

Long, R.J. (1978)a, "The effects of employee ownership on organizational identification, employee attitudes, and organizational performance", *Human Relations*, Vol. no. 31, pp.29-38.

Mitchell, D.J., D.B. Lewin & E.E. Lawler (1990), "Alternative pay systems, firm performance, and productivity in U.S., Paying for productivity", *A look at the evidence Washington, DC: Brookings Institution*, pp. 15-94.

Onaran, Y.(1992), "Workers as owners: An empirical comparison of intra-firm inequalities at employee-owned and conventional companies", *Human Relations*, Vol. no.45, pp.1213-1235.

Pendleton, Andrew, Nicholas Wilson & Mike Wright (1998), "The perception and effects of share ownership: empirical evidence from employee buy-outs", *British Journal of Industrial Relations*, Vol. no. 36(1), pp. 99-123.

Derek C. Jones and Takao Kato (1993), "The scope, Nature and Effects of Employee stock ownership planes in Japan", *Industrial and Labour Relations Review*, Vol 46, No.2, pp. 352-367.

Derek C. Jones and Takao Kato (June, 1995), "The Productivity, Effects of Employee Stock ownership planes and Bonuses: Evidence from Japanese panel Data," *The American Economic Review*, pp-391-414.