



A Review of Employee Stock Ownership Plans (ESOPs) and Corporate Innovation Performance Research

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Abstract. Employee Stock Ownership Plans (ESOPs) are institutional tools that integrate incentives, governance, and wealth distribution. Their development can be traced back to the Industrial Revolution in the 19th century and became institutionalized and globalized in the 20th century. After long-term exploration by academia and enterprises, the importance of ESOPs has been gradually established. This paper employs a literature review method, based on the principal-agent theory and the two-factor theory, to review the literature on the implementation motives of ESOPs, the influencing factors of corporate innovation performance, and the relationship between the two. Finally, it analyzes whether ESOPs affect corporate innovation performance and provides insights for enterprises' long-term development.

Keywords: Employee Stock Ownership Plan, Innovation Performance, Impact

1 Introduction

The concept of ESOPs originated in France in the 1840s when the French economist Louis Blanc proposed the idea of a "workers' cooperative," a form of enterprise organization where employees are both workers and owners. The concept of ESOPs was first introduced by American scholars Kelso and Adler. Against this backdrop, understanding the concept, mechanism, and methods of ESOPs and their impact on corporate value is of great importance. This paper explores the different definitions of ESOPs by domestic and international scholars, their impact on corporate value, and the mechanisms of this impact, aiming to provide insights for the implementation and development of ESOPs in enterprises.

2 Theoretical Foundations of Employee Stock Ownership Plans

2.1 Principal-Agent Theory

Principal-agent theory (Principal-Agent Theory) is a core framework of information economics and contract theory. Its emergence is mainly due to the separation of own-

ership and management in modern joint-stock enterprises. Essentially, it is an activity where one person or a group of people authorizes another person to act on behalf of the principal's interests. However, this separation is different from ordinary contract relationships, as the principal grants significant power to the agent, which is not easily monitored by the principal. Based on this, principal-agent theory was developed^[1] (Jin Jing et al., 2008). The theory mainly arises from the conflict of interest maximization between the principal and the agent. Agency costs mainly consist of monitoring costs, bonding costs, and residual losses. Monitoring costs refer to the expenses incurred by the principal to constrain the agent's behavior, such as the fees of auditors and the costs of boards of directors. Bonding costs are the expenses incurred by the agent to assure the principal that their interests will not be harmed, while residual losses are the costs resulting from agency deviations that lead to a decrease in corporate value^[2] (Jensen, M.C. & Meckling, W.H., 2019).

2.2 Two-Factor Theory

The Two-Factor Theory, proposed by Herzberg, divides the factors influencing employee behavior into hygiene factors and motivators. Hygiene factors are external and mainly study the impact of work relationships, security facilities, and other working environments on employee attitudes. If these factors are not met, they can significantly affect employees' work emotions. Motivators, on the other hand, are internal and directly related to job content, enhancing satisfaction and enthusiasm, such as career prospects, recognition of work achievements, and employee well-being. The theory posits that enterprises need to optimize both the hygiene factors that protect employees and the motivators that inspire their enthusiasm to effectively ensure corporate production and create corporate achievements^[3] (Zhang Xi, 2011).

3 Literature Review on Employee Stock Ownership Plans

The main connotation of ESOPs is that enterprises hold company stocks or equity directly or indirectly. A review of domestic and international literature reveals that the motives for implementing ESOPs mainly lie in their ability to significantly improve corporate financial performance and alleviate corporate financing costs.

3.1 Definition of Employee Stock Ownership Plans

Employee Stock Ownership Plans (ESOPs) are incentive systems where employees hold company stocks or equity directly or indirectly, binding their personal interests to the long-term development of the enterprise. The concept of ESOPs was first introduced by American scholars Kelso and Adler, based on the Two-Factor Theory, which proposes the idea of expanding capital ownership. This theory argues that labor and capital are both necessary factors for creating corporate wealth. In modern society, those who own capital often quickly gain substantial income, while those who own labor receive only a small portion of income, such as fixed salaries. Therefore, the

concept of ESOPs was proposed to reduce the significant income gap between corporate capital and employees, thereby motivating employees' enthusiasm and ultimately enhancing corporate value^[4] (Yang Yating, 2024).

3.2 Motives for Implementing Employee Stock Ownership Plans

3.2.1 Enhancing Corporate Financial Performance.

By implementing ESOPs, companies can, on the one hand, stimulate employees' enthusiasm and creativity. When employees hold company stocks, their personal interests are directly linked to the enterprise, making them a community of shared destiny with the company. This mechanism of interest binding encourages employees to focus on the long-term interests of the enterprise rather than short-term value. Moreover, as employees hold company stocks, they enjoy the benefits of corporate value growth, similar to other shareholders, thereby reducing agency costs and significantly increasing their work enthusiasm and willingness to create more value for the company. Existing research has also proven a significant positive impact of ESOPs on corporate financial performance. A domestic scholar analyzed cross-sectional data from 1,302 companies in 2007 and found that in state-owned enterprises, ESOPs have a positive impact on corporate performance. They also discovered that in management teams with ESOPs, corporate performance is significantly positively correlated with the proportion of management holding company stocks, although there is a certain inflection point. The impact of management stockholding on corporate performance is 4-6 times that of ordinary employee stockholding^[5] (Huang Guitian and Zhang Yue, 2009).

3.2.2 Alleviating Corporate Financing Costs.

Foreign scholars, through empirical research, first studied the relationship between the calculated tax savings of companies and corporate value. They found that listed companies implementing ESOPs can, to some extent, reduce corporate taxes and increase corporate cash flow. On the other hand, when companies face the risk of being acquired, announcing the implementation of an ESOP can reduce the likelihood of being acquired^[6] (Beatty, A., 1995).

Implementing ESOPs does not increase the debt-to-asset ratio of companies. Instead, it decreases it. This is because state-owned enterprises, when implementing ESOPs, increase their capital and financing channels, reducing financial leverage and lowering the debt-to-asset ratio, thereby alleviating corporate financing costs^[5] (Huang Guitian and Zhang Yue, 2009).

4 Literature Review on Corporate Innovation Performance

There is no unified conclusion among domestic and international scholars regarding the definition of corporate innovation performance. The main viewpoints can be divided into a narrow definition focusing on the process of bringing innovative products to

market and a broad definition encompassing the entire process of creating innovative products. The influencing factors of corporate innovation performance are mainly discussed from two aspects: external government subsidies and internal executive backgrounds.

4.1 Definition of Corporate Innovation Performance

A review of domestic and international literature shows that there is no consensus among scholars on the definition of corporate innovation performance. Some scholars argue that corporate innovation performance is simply the result of bringing innovative products to market ^[4] (Yang Yating, 2024). For example, Ahuja (2001) ^[7] defines innovation performance as the outcome of corporate innovation activities, such as the introduction of research patents and new products to the market. A domestic scholar (Dang Jianbing, 2014) ^[8] also believes that innovation performance is the result of corporate innovation activities in a cooperative network, which helps expand and enhance market share, reduce corporate costs, and ultimately achieve excess profits, thereby improving corporate competitiveness. Other scholars argue that corporate innovation performance is not just the result of bringing innovative products to market but also includes the overall gains and achievements from the entire process, from the conception and incubation of products to their final creation ^[9] (Zhang Xi Yu, 2024).

4.2 Influencing Factors of Corporate Innovation Performance

The academic community has conducted in-depth research on the factors influencing corporate innovation performance. A comprehensive review of existing literature reveals that there are many factors affecting corporate innovation performance. This paper mainly discusses external factors such as government subsidies and internal factors such as executive backgrounds.

4.2.1 External Factors.

From an external perspective, there are many factors influencing corporate innovation performance. Government subsidies are an important factor affecting corporate innovation performance. The impact of government subsidies on corporate innovation performance varies under different conditions and environments. In state-owned enterprises, government subsidies have a significantly negative correlation with corporate innovation performance, meaning that the more government subsidies a company receives, the less likely it is to improve innovation. However, in enterprises with relatively less experience, government subsidies have a more significant impact on corporate innovation performance. Additionally, government subsidies play a significantly negative moderating role between corporate R&D investment and corporate innovation performance, a role that is less evident in regions with more advantageous external environments, such as economically developed areas ^[10] (Wang Yihui, 2013).

4.2.2 Internal Factors.

There are also many internal factors that influence corporate innovation performance, including executive incentives, R&D activities, and corporate size. Executive incentives are key factors in internal corporate governance. By implementing ESOPs and establishing reasonable compensation and promotion mechanisms, companies can stimulate employees' creativity and enthusiasm, thereby improving corporate innovation performance^[9] (Zhang Xi Yu, 2024). The career background of executives also plays a significant role in enhancing corporate innovation performance. A rich career experience helps improve the diversified thinking structure of corporate executives, form a broader management perspective, and provide more extensive social resources and greater courage. Scholars have constructed a diversified executive background index by refining five dimensions of executive career experience: functional departments, companies served, industries, organizational structures, and regional types. They found that the richness of executives' career experience significantly enhances corporate innovation performance^[11] (He Ying, Yu Wenlei, et al., 2019). Additionally, the overseas background of executives also affects corporate innovation performance. Domestic scholars, from a structural perspective and combining upper-echelons theory, team conflict theory, and demographic statistics, have empirically analyzed the impact of executives' overseas background on corporate innovation performance. The results show that executives with overseas experience have a positive impact on corporate innovation performance. This is mainly because their overseas experience endows them with more international and market-oriented characteristics, leading them to advocate for increased R&D investment in corporate strategy. Moreover, executives with overseas backgrounds can leverage a dual-network structure of domestic and international connections, giving their companies a significant innovation advantage compared to those without such backgrounds^[12] (Liu Fengchao, Mo Jiabin, et al., 2017).

5 The Impact of Employee Stock Ownership Plans on Corporate Innovation Performance

Currently, the academic community has mixed opinions on the impact of ESOPs on corporate innovation performance. Domestic scholars generally believe that ESOPs have a significant positive impact on corporate innovation performance, but there are also scholars who hold the opposite view.

On the one hand, from the perspective of corporate atmosphere, ESOPs closely link personal interests with corporate interests, allowing employees to devote more energy to the prosperity and development of the enterprise, thereby laying a solid foundation for corporate innovation. Additionally, the implementation of ESOPs creates a more harmonious and mutually supportive corporate culture. Employees, as both promoters and implementers of innovation activities, make significant contributions to corporate innovation performance. Lastly, the implementation of ESOPs injects new vitality into corporate talent strategies. By implementing ESOPs, companies retain core talents

within the enterprise and attract outstanding external talents, increasing their willingness to stay with or join the company ^[4] (Yang Yating, 2024).

On the other hand, from the perspective of talent and innovation culture, the implementation of ESOPs by listed companies can maximize the potential and value of talents, promoting employee enthusiasm and enhancing corporate cohesion. Domestic scholars have empirically found that the implementation of ESOPs can effectively improve corporate innovation performance, and one of the ways ESOPs enhance corporate innovation performance is by encouraging the improvement of innovation culture. Guided by a culture that encourages risk-taking and challenges, ESOPs empower corporate innovation culture, thereby positively impacting corporate innovation performance ^[13] (Wang Wenhua, He Hangjuan, et al., 2023).

Foreign scholars, through empirical research on data from non-financial A-share listed companies from 2014 to 2018, found that companies implementing ESOPs invest more in innovation compared to those that do not. Further research revealed that the positive impact of ESOPs on innovation performance is more significant in non-state-owned enterprises compared to state-owned enterprises ^[14] (Dan J., 2020). (Chang, X., et al., 2015) ^[15] also concluded through empirical analysis that non-executive employee stock options have a positive impact on corporate innovation. This positive impact is more evident when employees play a more critical role in corporate innovation, there is less free-riding behavior among employees, stock options are widely granted to most employees, the average exercise period of options is longer, and the proportion of employee stock ownership is lower.

6 Conclusion

Innovation is an essential element for the generation and development of enterprises and is a core driving force for their sustainable development and competitive advantage. Based on principal-agent theory and two-factor theory, this paper reviews relevant domestic and international literature on ESOPs and corporate innovation performance. It finds that the main motives for implementing ESOPs are to enhance corporate financial performance and alleviate corporate financing costs. The factors influencing corporate innovation performance mainly include external government subsidies and internal executive backgrounds. Finally, through a review of the literature, it is found that most scholars believe that ESOPs have a significant positive impact on corporate innovation performance. The above research aims to provide suggestions and insights for enterprises to implement ESOPs to improve corporate innovation performance and ultimately achieve sustainable corporate development.

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