

Research and Theoretical Review of Equity Incentive Performance of Listed Companies

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Abstract: Equity incentive is an incentive method for listed companies to promote the alignment of key management personnel and enterprise interests, and scientific and reasonable equity incentive methods can promote managers and core employees to better serve the company, promote the formation of a community of interests between shareholders, management and employees of the company, and contribute more to the development of the company. At the same time, due to the serious differences between shareholders and corporate executives in the pursuit of interests, it is difficult to establish a full relationship of trust between shareholders and corporate executives, which seriously affects the enthusiasm of corporate executives and leads to low company performance. In order to avoid similar phenomena, the equity incentive mechanism came into being, becoming an indispensable part of listed companies and an important prerequisite for listed companies to improve their governance structure. In recent years, with the development of the market, China's listed companies have gradually realized the importance of equity incentives for the development of enterprises, and more and more listed companies have begun to apply the tool of equity incentives. In this field, scholars have also achieved fruitful results in theoretical research and performance analysis of equity incentives. This paper sorts out the literature on equity incentives of listed companies by clarifying the significance of equity incentives for listed companies, the main models and main theories of equity incentives. Based on the existing literature and company data, this paper also theoretically explains the current situation of equity incentives in China from multiple perspectives in combination with relevant theories.

Keywords: Listed companies; Equity incentives; Performance; Theoretical explanation.

1. Background and Significance of The Study

1.1. Background of the study

The separation of ownership and operation rights has generated the principal-agent problem in modern companies, and how to mitigate the agency conflict is the core issue of corporate governance research (Jensen and Meckling, 1976). There is a general consensus among academics that, in addition to the establishment of a sound regulatory mechanism, the design of an effective incentive mechanism is an important means of mitigating agency conflicts. At the same time, the implementation of the equity incentive system can prompt the incentivized employees to pay more attention to the long-term stable development of the company while focusing on their personal interests, so as to realize the sharing of benefits and risks between the two. With the rapid development of the economic market, the number of listed companies has jumped, and the equity incentive system has been applied by more and more listed companies, so the research on the equity incentive system has been increasing.

2. The Importance of Equity Incentives for Listed Companies

Equity incentives are of great significance to the development of listed companies, mainly in the following aspects.

2.1. Enabling long-term development planning

Due to the separation of ownership and operation of listed companies, the long-term development of listed companies and the short-term performance appraisal faced by employees will inevitably lead to the problem of inconsistency of

interests —— listed companies are more concerned about the long-term development goals and long-term earnings, but for listed companies' employees and management personnel, most of the performance appraisal standards are based on the actual earnings of the current account, the contribution of the management personnel in the long-term development of the company cannot be reflected in a timely manner, so it is difficult to accurately assess the contribution of the company's long-term development. Therefore, focusing on the individual earnings and the company's short-term earnings reflected in the personal value of the company becomes more prevalent.

Through the equity incentive policy, it can establish a close connection between talents and the company, form a consistent strategic orientation, enable the managers to view the problem from the perspective of long-term development of the listed company, and then promote the long-term profits of the listed company to steadily improve.

2.2. Preventing brain drain

Through the use of equity incentive system, incentive recipients can intuitively feel the impact of the listed company's development on their own, and stimulate the staff's sense of belonging and enthusiasm for work. In addition to the corresponding reward will be given to the incentive targets, the equity incentive system will also develop a corresponding penalty system to restrain the behavior of the equity incentive targets. Once the equity incentive targets jeopardize the listed company or leave the listed company, the listed company will recover the equity incentive income, which increases the cost of making mistakes or leaving the listed company of the incentive targets, thus making the incentive targets to think more about making mistakes and leaving the company [23]. And good equity

incentives can also attract more talents to join the listed company.

2.3. Optimizing corporate governance structures

In some joint-stock limited companies, a large number of controlling shareholders are likely to lead to dispersed shareholdings. In the case of complex internal structure of the company, some of the company's employees are overly pursuing personal interests, which is likely to lead to moral hazard, and even market blackmail, internal manipulation and other security risks. Thus, Shareholders are unable to form an effective supervision and control of the company's operation and management, which will in turn cause damage to the development of the company. By adopting a suitable equity incentive system, the equity structure of the company can be optimized.

2.4. Playing a guiding role to stimulate the development of listed companies

The company's operators align their personal interests with the company's interests under the equity incentive system, and they are able to conduct the development planning of the listed company in the interests of the company, which will greatly enhance the employees' work initiative. At the same time, when the interests of the employees are aligned with the interests of the company, it also avoids the management costs caused by the conflict of personal interests among the employees. In the daily operation activities, employees can pay more attention to the reform of technology and management innovation, which can improve the efficiency and stimulate the vitality of the development of the listed company by reducing the operation cost [24]

3. Main Modes of Equity Incentive Shares of Listed Companies

Equity incentive means that the company takes the company's stocks as the subject, through the granting of a certain number of shares to the incentive targets (directors, supervisors, senior management personnel and other employees) and so on, to stimulate the targets' sense of ownership, so as to promote the convergence of the interests of the shareholders and the incentive targets, and ultimately to achieve the enhancement of the value of the shareholders' wealth and the long-term development of the company's goals.

There are many kinds of modes of equity incentives, which can be divided according to the nature of the stocks as well as the function of the stocks. When choosing the share incentive mode, listed companies need to take into account their own realities and make a reasonable choice.

Division is done according to the nature of the stocks.

The division of equity incentive shares according to the nature of the stocks mainly includes three incentive modes: virtual shares, actual shares, and shares combining virtual and real. Under the virtual share incentive mode, the incentive recipients have the right to dividends, and some companies will give the incentive recipients the right to increase the value of net assets, and this kind of equity incentive does not change the overall equity structure of the company, so it is also called post shares. Under this mode, the incentive recipients have no transfer of equity inheritance and other rights, and they don't have ownership and voting rights, but they can get the right to dividends after they achieve the

business performance [3] [25] Share incentive model of equity incentives, is to provide real shares to the incentive recipients, which means that the shareholders not only have the right to dividends, but also have the right to ownership of the stock and decision-making power, which will have a direct impact on the company's shareholding structure. Therefore, it will also have an impact on the company's governance structure and help optimize of the company's governance structure. The equity incentive under the combination of virtual and real share incentive model, on the other hand, first adopts the virtual stock incentive model, and then converts the virtual stocks into real stocks after expiration.

Division is done according to the function of the stocks.

Incentive shares can be divided into stock appreciation rights, virtual shares, restricted shares and stock options according to the function of the stocks. Under stock appreciation rights, the incentive recipients don't have the right to dividends, decision-making rights, and ownership, but only a share of the proceeds of the stock, which is subject to the completion of specified performance by the incentive recipients. In the case of equity incentives under restricted shares, the incentive recipients can purchase the company's stocks at no cost or at a price lower than the market price, but there are certain restrictions on the quantity, sale period, unlocking conditions, etc. For example, when the sale period is two years, the incentive recipients can only sell the purchased stocks two years after achieving the incentive goals, and once the goals are not achieved, the stocks cannot be sold, and the incentive recipients themselves will suffer losses. Stock options under the equity incentives, are to use options tools. Compared with restricted shares, they are more friendly. The incentive recipients can be agreed in the form of pre-set the purchase price of the company's stocks. After the completion of the incentive goals, they can purchase the company's stocks at the original price. If the company's stock price is higher than the agreed price, the incentive recipients can obtain the price spread of the stock as a gain. If it is lower than the price of the pre-determined, they may give up the right to purchase.

4. Effect of the Implementation of The Equity Incentive Scheme

People's views on the effect of the implementation of equity incentives still vary from person to person. In this paper, we will review the literature on the positive incentive effect, negative incentive effect and ineffective incentive of equity incentives.

In terms of positive incentive effects, existing studies are mainly based on the optimal contract theory, which argues that equity incentives are a long-lasting mechanism for solving the agency problem, which can effectively reduce the agency cost and enhance corporate performance (Chourou et al. 2008; Fang et al. 2015; Shen Xiaoyan and Wang Yuetang 2015; Zhang Yan and Fan Xiaoxia 2015). Some scholars focus on promoting corporate innovation (Marianna et al. 2006; Zhai Shengbao and Chen Ziwei 2016; Jiang Yingbing and Yu Yaping 2017), enhancing corporate risk-taking (Li Xiaorong and Zhang Ruijun 2014; Su Kun 2015; Shue and Townsend 2017) and suppressing inefficient investment (Lv Changjiang and Zhang Haiping 2011; Meng Xueying and Song Xiliang, 2018) and other perspectives confirm the positive motivational effects of equity incentives.

Regarding the negative incentive effects, most of the existing studies are based on the perspective of managers' self-seeking benefits, confirming that in order to meet the performance appraisal requirements of equity incentives, senior executives manipulate the corporate performance by means of surplus management and other means, so as to maximize their own interests (Bergstresser, 2006; Benmelech et al. 2010; Xie Deren et al. 2019; Shen Hongbo et al. 2019.). Chen Hong and Guo Dan (2017) found that short-term performance-based equity incentives exacerbate management self-interested behaviors, and that management may obtain private benefits by paying cash dividends. These studies suggest that equity incentives may become a self-interested welfare behavior of management and do not realize the effect of mitigating agency conflicts.

In addition, some studies have found that equity incentives do not exert incentive effects and cannot effectively enhance corporate performance (Demsetz and Lehn, 1985; Immelberg and Palia, 1999). Some other scholars have found that equity incentives and corporate value are a nonlinear interval effect relationship (Griffith, 1999; Zhang Yan and Fan Xiaoxia, 2015).

Overall, although a large number of academic studies have examined the design of equity incentive programs and the effects of equity incentives based on Chinese data, and some scholars have conducted separate studies on firms with different ownership properties in different sectors, there is still controversy about the effectiveness of the implementation of equity incentives. Some of the literature finds that equity incentives can effectively solve the agency problem, while some of the literature finds that the design of equity incentive programs is problematic to the extent that equity incentives become a tool for executives to seek personal benefits and lose the role of constraints and incentives.

5. Explanation of Equity Incentive Practices of Chinese Listed Companies

5.1. Equity incentive effects

As a long-term incentive mechanism, equity incentive is theoretically an important institutional design to alleviate the principal-agent problem of enterprises, which can effectively bind the interests of shareholders and incentive recipients, and realize the synergy of interests of both parties. However, according to the previous literature, the practical operation of equity incentives is not completely consistent with the theory, and the equity incentives of listed companies in China are generally characterized by low incentive intensity, loose exercise conditions, and short incentive period, etc. More and more corporate practices show that the equity incentives are "welfare". In this case, equity incentives are not only ineffective in alleviating the agency problem, but also may become self-serving benefits under the leadership of managers. The reason for this is that, on the one hand, the autonomy of performance appraisal indexes in practice leaves some discretionary space for companies implementing equity incentives. Although the Securities and Futures Commission issued the "listed company equity incentive management approach" which clearly requires listed companies to set assessment indicators when they implement equity incentives, but most of the listed companies take the company's performance as a benchmark and set a single indicator, so

equity incentives fail to exert its incentive and constraint effects on the executives. On the other hand, equity incentives are set for a shorter period of time, which is not fully consistent with its role as a long-term incentive mechanism. According to the research of Lv Changjiang et al. (2009), the shorter incentive period cannot fully reflect the fundamental purpose of equity incentives, which makes equity incentives "welfare" and leads to the alienation of the effect of equity incentives.

5.2. Equity incentive intensity

Jensen and Meckling (1976) pointed out that managers holding equity in the company can alleviate the agency problem, promote the convergence of their personal interests and the interests of the company's shareholders, and jointly help maximize corporate value. However, too much incentive intensity can easily lead to insider control and aggravate the agency problem. The current academic literature around the scope of incentive intensity has launched a broader discussion. Although there is no agreement on the optimal range of incentive intensity, the general consensus is: within a certain range of equity incentives, the greater the intensity of incentives, the better the incentive effect. However, attention should be paid to the degree of the intensity of executive equity incentives to prevent executives' self-interested behaviors triggered by the increase in control that ultimately damage the value of the corporate. Most of the listed companies in China that have implemented equity incentives have only implemented a single equity incentive, and the intensity of equity incentives is much lower than the level of incentives in western countries. This phenomenon may be related to the prevalence of majority shareholders in Chinese companies. Previous studies have found that the higher the shareholding of majority shareholders, the more power they have, and the stronger the supervision of management, which can better inhibit management self-interested behaviors, so the prevalence of majority shareholders in Chinese firms has led to a relatively low proportion of equity incentives. In addition, many executives in SOEs appointed and dismissed by government departments, are politically charged, which dilutes the preference for compensation incentives. Moreover, equity incentives in SOEs require the approval of the State-owned Assets Supervision and Administration Commission (SASAC), which is a relatively complicated process, and the intensity of equity incentives is generally relatively small. The majority of non-state-owned enterprises are family-owned enterprises, which are generally managed by family members, who generally hold equity in the company without additional equity incentives. Thus, China's special institutional background makes the intensity of equity incentives relatively small.

5.3. Coverage of incentive targets

Equity incentive targets mainly include executives and employees. At present, scholars' research on equity incentives mainly focuses on executives, and the literature on employee equity incentives is relatively small. As for the target of equity incentives, most scholars believe that the coverage of the target of equity incentives should be expanded to include as many employees as possible in the scope of equity incentives, and at the same time, emphasis should be placed on the incentives for core employees. The starting point of this conclusion is mainly based on the agency theory and human capital theory, and the targets of the equity incentive cover all

(executives and employees), which not only can alleviate the agency problem between shareholders and executives and achieve convergence of interests between shareholders and executives, but also bind the interests of shareholders and employees, so that the interests of shareholders, executives and employees are aligned to maximize the incentive effect of human capital, and jointly maximize the corporate value. In practice, the U.S. basically follows this logic, and the selection of incentive targets is relatively broader. In addition to the company's management and core employees, but also it includes ordinary employees, in order to maximize the needs of employees (Wang Bin and Li Min, 2021). However, in terms of coverage, most of the listed companies in China that have implemented equity incentives in practice only include the management and some core employees, and do not cover all employees. In addition to the existence of executive self-interest factors, the deeper level is the lack of corporate trust culture (Wang, Bin and Li, Min, 2021), which is also the root of the agency problem. Since it is difficult for shareholders and managers, managers and employees, as well as shareholders and employees to trust each other, shareholders and the management layer are doubtful whether employees will work harder to create more value for the enterprise after they hold shares, and how to improve the trust between shareholders, management and employees is also the difficulty of full coverage of equity incentives.

5.4. Choice of equity incentive model

The research literature on equity incentive model basically confirms that restricted share is a kind of "welfare" incentive with a large profit margin (Xiao Shufang et al., 2016; Chen Wenzhe et al., 2021). Compared with restricted shares, stock options can improve the innovation ability, risk-taking level, and corporate value, and show better incentive effects (Lambert and Larcker, 2004; Kadan and Swinkels, 2008; Jiang Yingbing, and Yu Yaping, 2017; Jiang Yingbing, and Shi Yiran, 2018; Xu Juanjuan, and Chen Zhiyang, 2019; Chen Wenzhe, et al. (et al., 2021).

Nowadays, restricted shares have become the mainstream mode of equity incentives for Chinese listed companies. The reasons why most of the listed companies in China tend to choose restricted shares are listed as follows. First, the listed companies do not formulate equity incentive plans entirely from the perspective of maximizing the corporate value. Although from the perspective of shareholders, stock options require incentive recipients to have higher risk-bearing ability, which can better promote corporate innovation and thus maximize enterprise value (Chen et al., 2021). However, from the perspective of the management as the incentive targets, restricted shares are relatively less costly and are more convenient for tax avoidance and dividend protection (Xiao Shufang et al., 2016). At the same time, executives of Chinese listed companies have greater power and are responsible for the design and implementation of equity incentive programs. Therefore, from the viewpoint of management power, as the designers of equity incentive programs for listed companies, executives tend to choose restricted shares that are more favorable to their own interests when setting up equity incentive models. Secondly, stock options are more closely linked to the company's stock price information, and an effective capital market is an important prerequisite for stock option incentives to be effective. Compared with mature capital markets abroad, as an emerging market, China's capital market mechanism has yet to be perfected, which leads

to stock option incentives being limited in China. Moreover, given the characteristics of performance-based equity incentives in China, the sensitivity between restricted shares and company performance is higher, which also determines that the current market environment in China is more compatible with restricted shares.

5.5. Terms of exercise of rights

In order to safeguard the effect of equity incentives, the West, due to its market effectiveness, generally uses share price as a condition for the exercise of options. However, unlike the mature markets in the West, which are dominated by institutional investors, China's capital market is dominated by small shareholders, with a relatively small proportion of mature institutional investors, and the market is characterized by a high degree of speculative behavior. Therefore, it is common for companies to design the exercise conditions of equity incentives to be based on performance indicators rather than share price, which is why equity incentives in China are also called "performance-based equity incentives".

6. Summary

Equity incentives have been widely used and developed in Chinese listed companies after a long period of practice, and there are many academic literatures analyzing the implementation effects of equity incentives from the dimensions of executives' behavior, company's financial behavior, and accounting policies. At the same time, regarding the effects of equity incentives, a number of scholars at home and abroad have conducted research on this, and the conclusions of the researchers are different. Therefore, this paper reviews the existing scholars' theories and research results, tries to show the whole picture of the theory of equity incentives for listed companies in China, discusses the classification of the theory of equity incentives for listed companies in China and summarizes its characteristics, so as to provide reference for the design and implementation of listed companies' equity incentive programs.

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