

# COMPANY PROFITABILITY BEFORE AND AFTER EMPLOYEE STOCK OWNERSHIP PROGRAM IN 2011-2014

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**Abstract**—This study aims to determine the differences in the company's financial performance before and after the Employee Stock Ownership Program (ESOP). The population in this study are all companies listed on the Indonesia Stock Exchange (IDX) that implement ESOP from 2011-2014. The sample consists of 12 companies. The hypotheses are tested using the Wilcoxon Signed Rank Test. The results of this study indicate that there is no difference of three examined variables, return on assets, return on equity, and net profit margin between before and after the company conducts ESOP.

**Keywords**—Employee Stock Ownership Program, ROA, ROE, NPM

## I. INTRODUCTION

Every company has different policies to be able to progress and develop. Many policies that can be applied to develop a company depend on the decision of the owner of the company. One policy that can be implemented by companies is ESOP (Employee Stock Ownership Program) ESOP is a special program for employees of companies in the form of share ownership. Shares and cash will be donated in trust accounts every year by companies that carry out ESOP programs. Trust itself is an account that is used by individual employees to receive shares from companies where employees work based on employee salaries, hours of work, and seniority (McHugh et al., 2005), so that the number of employees is limited. When it was first introduced, there were not many companies operating the program. This is due to the absence of provisions that provide benefits and convenience for companies that implement the ESOP program at that time. ESOP was implemented in some developed countries in 1921, and in 1951 the ESOP program became familiar (Ngambi and Oulome, 2013). Many developed countries have already carried out the ESOP program, and are followed by other countries including Indonesia.

Bapepam (2002) states that since 1998 and afterwards ESOP conducted by companies is more

likely to be an option program. So, the employees are first given warrants by the company before the company goes public. Stock purchases can be made by employees in the future and in the specified period. This is different from the beginning of the development of ESOP in Indonesia, which was still in the form of a Stock Allocation, the company guarantees subsidies or loans to employees. Until 1999, there were only three public companies in Indonesia that applied ESOP, and that number continued to increase to 90 companies in 2009 (Asyik, 2013).

One of the benefits of ESOP is that it can retain employees who have skills in developing the company, motivate employees more, increase cash flow, reduce conflicts that may arise between principals and agents, prevent the transfer of share ownership, and increase the value of the company due to stock returns company (Baridwan and Azwar, 2006). The aim of the ESOP program in a company is to provide rewards for increasing performance in the company to all employees, directors, and certain parties who contribute (Study Team for the Implementation of Indonesian Capital Market ESOP-BAPEPAM, 2002). Freeman (2007) states that ESOP increases employee job satisfaction, organizational commitment, identification, work motivation, and participation in the work environment. This effect is because employees participate in decision making. Alignment of mission objectives occurs between employees, officials, and shareholders so that there will not be a clash of goals, because employees are also owners of the company, directly or indirectly it is a motivation so that the company's performance is also expected to increase. ESOP is also useful for attracting employees, retaining employees, and motivating employees to increase shareholder's value. The description above implies that one of the objectives of the ESOP is to improve company performance. The ESOP program can be linked to agency theory. Agency theory explains the relationship between ESOP and company performance. Agency theory explains the relationship between principals (shareholders) and agents (managers) (Jensen and Meckling, 1976). Principal or owner in the company is the party that authorizes the manager or agent to carry the day to day business activities. The

Agent is defined as the party that receives authority, namely the manager. The existence of differences in interests between the principal and agent will cause problems in agency theory. Problems that arise are possible because the agent does not carry out or execute in accordance with the authority given by the principal, so that unbalanced information between the principal as the authorizer and the agent as the receiver of authority from the principal. The unbalanced information in agency theory is called asymmetric information.

Companies need high costs to supervise and verify actions taken by the agent because they do not operate according to the authority given. The existence of these costs incurred by the principal which is to monitor the agent is called the agency cost (Jensen and Meckling, 1976). The company conducts an ESOP to reduce the potential agency costs incurred as a result of a conflict of interest between the principal and the agent. As explained above, by implementing ESOP, there is an alignment between the principal and the agent. Because the employee is also the owner of the company, Putra (2011) states that the sense of ownership of the company owned by employees motivates employees to do something that can increase company profits that directly affect company performance which can be seen from the analysis of the company's financial ratios.

In previous studies there were debate about the results of research related to the implementation of ESOP. Davidson and Worrell (1994) examined market reactions and operational performance of 48 companies in America that carry out ESOP. They interpreted that there was no increase after ESOP on Return on Assets (ROA), Net Profit Margin (NPM), and Debt-to-Assets (DAR) even worse in the second year, only Asset Turnover had increased after ESOP. In Indonesia, Putra (2011) found there were significant differences in the variables Return on assets, Return on equity, Net profit margin, Debt to assets ratio, and Total assets turn over, except the Current ratio. Setyaningrum (2012) reported no difference before and after the application of the ESOP on Return on assets, Return on equity, Price to Book Value and dividends.

The difference in research results makes it interesting to re-examine the effects of the application of ESOP on the company's financial performance using the latest data. This study examines three variables, namely return on assets (ROA), return on equity (ROE), and net profit margin (NPM). This study uses a longer period of time compared to previous studies, namely three years before and three years after ESOP. The use of the three-year period is intended to enable to further analyze the company's performance related to the ESOP program carried out by the company.

## II. METHOD

### A. Data, Population and Samples

This study is an empirical study using secondary data. Secondary data sources, namely in the form of annual financial reports published by companies listed on the Indonesia Stock Exchange (IDX) three years before and three years after ESOP. The data is obtained through the IDX website at [www.idx.co.id](http://www.idx.co.id) and the websites of each company. Companies listed on the IDX in particular in 2014 were the population in this study, except for companies engaged in Finance. The research technique used is a purpose sampling technique where the sample is determined based on the criteria by the researcher, with the following criteria:

- a. Companies that conduct Employee Stock Ownership Programs (ESOP) in the period 2011-2014.
- b. Companies that publish complete annual financial reports within 3 years prior to ESOP implementation and after the application of ESOP.

The data analysis method used in this study is to use profitability ratio analysis, namely the ratio of ROA, ROE, and NPM. Then, the results of the analysis were tested for data normality using the Kolmogorov Smirnov test to determine the different test equipment used. The results of the normality test of the data determine the different tests used, using different tests Paired t-test for data that is normally distributed or the Wilcoxon Signed Rank Test for data that is not normally distributed.

## III. RESULTS AND DISCUSSION

### A. Results

A total of 12 companies met the sample selection criteria. This study uses the Kolmogorov-Smirnov test in testing the distribution of the data. Test criteria, the sample is normally distributed if the p-value is lower than 0.05. Conversely it is said to be abnormal if the p-value is higher than 0.05. The result of normality test data is shown in Table 1.

**Table 1.** Results of Normality Data Test

| Variable | Kolmogorov-Smirnov |         | Note                     |
|----------|--------------------|---------|--------------------------|
|          | Z                  | p-value |                          |
| ROA      | 0,333              | 0,000   | Not normally distributed |
| ROE      | 0,232              | 0,000   | Not normally distributed |
| NPM      | 0,225              | 0,000   | Not normally distributed |

The normality test in Table 1 shows that the research data are not normally distributed. It can be seen that the significance value of the variables ROA, ROE, and NPM is smaller than  $\alpha = 0.05$ . As a consequence, the hypothesis testing is based on the non-parametric test, which is the Wilcoxon Signed Rank Test. Table 2 shows the summary of test for the existence of differences between variables.

**Table 2. Wilcoxon Signed Rank Test**

| Variable | Median      |            | Median Different | Wilcoxon Signed Rank Test |         | Note                      |
|----------|-------------|------------|------------------|---------------------------|---------|---------------------------|
|          | Before ESOP | After ESOP |                  | Z                         | p-value |                           |
| ROA      | 4.35        | 4.90       | 0.55             | -0.896                    | 0.371   | No significant difference |
| ROE      | 8.09        | 11.22      | 3.13             | -0.377                    | 0.706   | No significant difference |
| NPM      | 13.20       | 5.99       | -7.21            | -0.173                    | 0.863   | No significant difference |

Based on the Wilcoxon Test shown in Table 2 above, it can be seen that all the p-values are above the traditional significant level (i.e., 5%). Thus, the study finds no significant difference of ROA, ROE, and NPM, between before and after the application of ESOP.

### B. Discussion

Based on the hypothesis testing that has been done, it can be seen that there is no difference in the ROA before the implementation of ESOP and after the implementation of ESOP. This result is in line with several previous studies which stated that there were differences between before and after ESOP implementation. For example, Setyaningrum (2012) documented that there is no difference in company ROE before conducting ESOP with after conducting ESOP. This result is in contrast to Putra (2011) and Santhi and Astika (2015) who reported that there are differences of profitability between companies that do ESOP and companies that do not do ESOP.

In this study the results of the data are known to be not normally distributed, then the reference is the value of the median. In this study it can be seen also that the value of the ROA in the company between before and after ESOP value increases. That is, the company conducting an ESOP gives positive results, the value of ROA increased, which is similar to Setyaningrum (2012). However, it is in contrast to Davidson and Worrell (1994) who shown that there is no increase of ROA after ESOP implementation. Putra (2011) documented the decrease of ROA after the implementation of ESOP. This research is in line with Sesil and Kroumova (2005) who suggested that the performance of companies applying ESOP compared to non-implementing ones.

Return on equity was found to be unchanged between before and after the implementation of ESOP. Thus, there is no difference between before and after ESOP implementation. The median ROE ratio before ESOP is greater than the median value after ESOP. This means that by implementing the ESOP program the value of the ROE ratio has increased. It is in contrast to the results of Sesil and Kroumova (2005). The results of this study are in line with the research conducted by Setyaningrum (2012) stating there is no difference in ROE before and after ESOP. Contrary to the results of this study, Putra (2011) stated that there

are differences in ROE of companies that do ESOP with those who do not implement ESOP.

Similar to the ROA and ROE, the NPM ratio is not significantly different between before and after the implementation of ESOP. Similar to the ROA and ROE, the finding of NPMtest is contrary to Putra (2011). But, it is in line with by Setyaningrum (2012), that there was no difference in NPM between before and after ESOP implementation.

The median NPM ratio of the company before ESOP is greater than after ESOP. This means that the value of the NPM ratio has decreased after the company conducted ESOP. different from the ROA ratio, this shows the same results from the results of the study of Davidson and Worrell (1994) which states that there is no increase in NPM variables between before and after ESOP implementation and contrary to research conducted by Sesil and Maya (2005).

### IV. CONCLUSION

This study aims to determine the differences in the company's financial performance before and after the Employee Stock Ownership Program (ESOP). The population in this study were all companies listed on the Indonesia Stock Exchange (IDX) that conducted ESOP in 2011-2014. While the sample of this study is 12 companies. The results of this study which were tested by the Wilcoxon Signed Rank Test showed that there was no difference of three ratios, namely ROA, ROE, and NPM between before and after the company conducted ESOP.

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