Employee Stock Option Plan and Firm Performance:

A Regression Approach on Malaysian Firm

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DECLARATION

I hereby declare that the case study is based on my original work except for quotations and citations that have been duly acknowledged. I also declare it has not been previously or concurrently submitted for any other degree at Universiti Tun Abdul Razak (UNIRAZAK) or other institution.

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Date : 26 October 2022

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بِسْمِ اللَّهِ الرَّحْمَٰنِ الرَّحِيمِ

In the name of Allah s.w.t, the Most Gracious, the Most Merciful.

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Abbreviations:

ESOS	Employee Stock Option Scheme
ROE	Return on Equity
NPM	Net Profit Margin
ROS	Return on Sales
ESOP	Employee Stock Option Plan
SPSS	Statistical Package for Social Science
KS	Kolgomorov-Smirnoff
PCC	Pearson Correlation Coefficient
MSEB	Malaysian Securities Exchange Berhad
SC	Securities Commission
CMSA	Capital Markets and Services Act

Abstract of the project paper submitted to the Senate of Universiti Tun Abdul Razak in partialfulfilment of the requirements for the Master of Business Administration

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By

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Abstract: Proliferation of stock adoption plan in Malaysia has been going for more than several decades. Based on the theory from Jensen and Meckling (1976) it is suggested that adoption of employee stock option scheme in a company can alleviate the agency issue. The study is conducted to examine the effect of employee stock option against firm performance of public listed company in Malaysia from 2015 until 2021. This study uses regression analysis for model to investigate the effect it has on 210 companies. The finding from the result suggested that the effect of equity-based compensation scheme do not significantly associated with the firm performance. It is hoped that the result might shed some light to any company who wanted to adopt an equity-based compensation as an alternative way to increase the firm performance. However, it is suggested that further research need to be conducted on the impact of stock option with firm performance for the result to be conclusive as there is a variation of result based on industries, countries, and firm size. The research aims to provide contribution to existing literature on the equity-based payment system and its relationship in Malaysia.

Keywords: Employee Stock Option, Firm Performance, Equity based compensation

CHAPTER 1
INTRODUCTION

1.1. Background of the study

The adoption of Employee Stock Option Plan has been gaining popularity among public listed companies to increase company performance via human capital. It is an alternative way to different payment scheme and structure. Employee stock option plan is corporate exercise to allow employee to purchase the stock at a discounted price than the market price. One of the reasons why Employee Stock Option Plan are frequently suggested to be part of the compensation regime is due to the conflict of agency theory, of which the separation of ownership do not align with the company best interest as compare to the owners themselves. To reduce the conflict of agency theory employee stock option is introduced as an incentive to the employees as the offer provide a prospect of a financial gain in the form of capital appreciation and dividend. Research has shown that ESOPs built on information, equity, and influence are more successful than systems solely built on equity (Pierce and Furo 1990). The use of ESOS in Malaysia is prevalent in the early 90's the earliest adoption recorded in 1989 of which 9 companies adopting the ESO scheme for the first time. In 2000, the number of companies issuing ESOS have since increase to 4 folds, around 40 company issues ESOS in 2000.

History of ESOS

The first adoption of ESOS issuance can be traced back since 1956 from a company called Peninsula Newspaper Inc. The owner of the company both in their 80's is soon to be retired and wanted to hand over the company to their employee instead of selling it off to large conglomerates. It was proposed an ESOS like structure to pay out

the capital invested in buying the company as they could not afford to buy the company on their own. The ESOS in this scenario is trying to perpetuate a business

Even before 1956, large US corporation such as JC Penney, Sears, Pillsbury and Proctor and Gamble have already adopted employee ownership plan. ESOS

How ESOS Saves Failing Company

In 1979, Chrysler Corporation, United Airlines and Wharton Steel issues ESOS in exchange for salary reduction. These 3 companies are drowning in dept. To save the company, the employee is offered stock option plan in replacement of their salary cut. The exercise was a success that they are able to pull themselves out of debt and manage to repay their debt ahead of time. These 3 companies however didn't last long as they went into bankruptcy several decades later and become insolvent.

ESOS was given as an incentive scheme from employer to employee as a form of incentive, different from bonus or another monetary scheme. It was considered as a broad-based scheme as previously it was only offered to executive level employee only otherwise known as c-suite. While ESOS adoption has been gaining popularity all over the world. The adoption in Malaysia is still considered as infancy stage. In a view of an employee, ESOS provides an opportunity for them to acquire their company at a fraction of price.

There are many ways where a firm may raise capital. A company can raise equity capital by issuing shares in the stock exchange, company can also issue bond and raise debt capital, additionally company can raise capital via retained earnings. Another way to raise capital for a company is through ESOS. ESOS exercise is granting an option to the employee of the company itself to purchase the option at a discounted price.

In the perspective of an employer, the ESOS issuance scheme is another form

of raising capital needed for company growth. The capital raise can be used for working capital as well as for cash flow purposes.

The reason why Employee Stock Option Plan has been gaining a lot of interest is to create a culture of ownership. Fostering an ownership culture is key to keep the employee highly engaged and motivated. The ideas of having part of the organization will motivates the employee to work harder to, willing to either take more risk or less risk based on their risk appetite to increase company performance.

Exercising the stock option plan to the public company will go via corporate action. An employee will be offered to subscription of stock option at the fair price of the share issuance is by using the closing price of the company stock in the respective exchange.

Some of the common reason why company adopt ESOS is to alleviate the issue of agency problem. Agency problem can be described as a party or in this context an employee will be able to act fully at the best interest of the company and to alleviate the conflict of agency, issuance of ESOS or broad-based compensation plan is suggested as to fix the issue. The theory behind this is the employee will be motivated to work if they feel they are part or belong to the company. The conflict of agency is reduced due to the alignment of interest between principal and agent.

Additionally, the second advantages of ESOS are by reducing the risk-taking behavior of an employee. It is with the hope that employee who own part of the company are more risk averse than an employee who act as an agent to the company. Employee which is more risk averse might would be more cautious and careful in the executing their work as compare to employee who is contractually obligated.

Besides that, the third advantages of issuing ESOS for the company is to be able

to offer equity-based remuneration scheme aside from the usual salary and bonus structure. The discounted price of a share option scheme without no additional tax ramification along with the potential gain from the capital appreciation will help to retain existing employee as well as attracting newcomers.

The cons associated with the granting of ESOS is related to disclosure of the cost of the accounting exercise are not adequately accounted for. Additionally, the discounted price of granting of ESOS are also seen as loss of not truly reflecting the ESOS at a fair price.

Often, it is suggested that reported profit are usually overstated. This happens due to the dilutive effects of ESOS towards outstanding shares while overstates the earning per share. This have caused a debate on how ESOS should be accounted, the recent update on the accounting treatment for ESOS is to expense the ESOS for the likes of other types of compensation and benefit while the corresponding entry is recognized in equity.

Human Capital or Employee are the asset of the organization that help drives the performance of the company. In order to manage the performance of the company, employee have to be adequately rewarded, mentored and motivated at the same time. Retention of specialist and experienced employee are also keys to the effective organization and help companies' growth. It is suggested that one of the ways to help in the employee retention is by offering ESOS to them.

ESOS is scheme offered by Employer to their Employee by giving them the ability to purchase company shares at a pre-determined price called as exercise price or offer price.

Important Term Related to ESOS

i. Grant Date: Date when ESOS is offered to the employee

ii. Vesting Period: A period between grant date and vesting date of which an employee must met certain condition to be eligible for the offer.

iii. Vesting Date: Date where employee is able to purchase the shares from the company.

iv. Exercisable Period: A period starting from vesting date until the end of the offer period.

v. Exercisable Date: Date where employee choose to exercise the option or purchase the option

vi. Offer price or Exercise Price: Price of the share which employee need to pay.

Regulatory and Framework

Employer cannot simply issue share option scheme to their employee. The ESOS apply to both listed and non-listed company. To issue ESOS from a listed company the company do not require approval but will need to follow regulatory parameter set by Malaysian Securities Exchange Berhad (MSEB). For an unlisted company to issue ESOS they do not require approval under Securities Commission (SC). The requirement for public listed company under Malaysian Companies Act 1965 is to keep a record or register of the employee who taken up the ESOS offer. Inland Revenue Board (IRB) also designated the employer to notify within 30 days upon the acceptance. Inability to comply will be an offence under the act. The issuance of ESOS is governed under Capital Markets and Services Act 2007 (CMSA).

Tax Implication

An employee holding a ESOS from company is treated as an employment income thus an employee needs to file this as their chargeable income. The calculation of the ESOS is in accordance with the market value during the vesting period. The payment of the tax will follow according to the monthly tax deduction rate. Any gain received upon option exercise are non-taxable as it is considered as capital gain.

Difference between ESOS and Shares

An ESOS is investment vehicles for the likes of shares however ESOS is derivatives unlike shares. ESOS also have expiration date while share do not have expiration date. Share's owner has right such as voting and dividend while ESOS do not have the right.

Accounting Treatment for ESOS

There have been numerous debates on the treatment for ESOS in a company. The argument raises due to in availability of such standard it was omitted in the accounting book which have cause economic distortion and increase in corporate governance issue. Majority of financial statement user have strong support to provide as much transparency as possible towards the application or treatment of ESOS. Some of the argument raised that these plans were different of remuneration plan hence it should be omitted or exempted. It was then concluded unanimously that this plan is indeed part of the remuneration plan hence should be accounted as part of the accounting standard. The impact when ESOS is treated as expenses that it reduces the amount of profit reported in the income statement. It can also reduce the retained earnings of the company. Some of the argument raised when it is considered as expense recognition is the transaction happen between shareholder and not the company, employee in questions do not provide services which is inconsistent with the basis of recognition of expenses

in the accounting book, the exercise was merely to dilute the interest of shareholder no actual cost is spent, the cost is recognized over reduction in earning per share when it was taken into account as expenses it considers as double dip. It was argued that the implication will have adverse effect on the adoption of such scheme towards economic consequence.

Determinant of Firm performance

A firm performance is a coalescence of economic and operational performance. Luo et al. (2012) who conducted a meta-analysis on organization performance describe organization performance should consist of 2 elements albeit financial and operational aspect. Economic performance looking at the outcome based on profit and other types of metrics. Operational performance is looking into external indicator such as customer satisfaction, competitive edge, and employee retention. Knies, Jacobsen and Tummers, 2016, describe organizational performance measure different level of hierarchy. Richard et all conduct a study on organization performance and found that within 213 journals publish there are over 207 different metrics to assess organizational performance. The reason why organization performance is crucial to be measure is due to the growth and survival of the firm (Etzioni, 1960; Chandler and Hanks, 1993). Lorsh (1970) depict the organization performance is a measure of a good fit with environment. Lupton, Gribbin and Warmington (1977) defined high performance organization can achieve high productivity, employee satisfaction and low attrition. The performance of the organization itself justify their relevancy (Jenatabadi,2015). Organization nowadays is demanded to fulfil appease entire gamut of stakeholder (Adam Jr, 1994; Harrison and Freeman, 1999). It was with this notion that the adoption of ESOS is highly regarded as it is perceived to be motivating on employee.

Types of remuneration scheme

As the objective of this study to motivates employee via remuneration scheme we look at several plausible option available to reward employee. Remuneration scheme or in other words compensation policy can be salary, commissions, allowance, bonus, equity package, non-monetary compensation, benefit, and stock option. It is varied between hierarchy level, monetary and non-monetary as well as short term and long term.

What motivates the employees?

Based on research conducted by Abraham Maslow, people need level are unique.so in order to keep the employee long enough the companies need to motivate them (Javitich, 2004). Fredrick Hertzberg's theory of Hygiene and Motivational Factors identified that fulfilling one survival need does not translate to job fulfillment. Gunkel (2006), describe motivation as one willingness to exert high level of efforts towards organization goals condition by the ability of the company to satisfy individual needs. Victor Vroom, Lyman Porter and Edward Lawler conclude that individual action is always goal oriented. Which means when the compensation is performance oriented the employee will perform better. In a study by Negash, 2014 it found a positive correlation between employee compensations and employees' motivation. In this context of ESOS the compensation supposedly will motivate the employee to perform better. David Mclelland achievement theory is understanding between needs, drives and incentives. Ketut et all study found that compensation have a positive strong relationship with motivation.

1.2. Problem Statement

Companies are looking at myriad of ways to increase the employee performance. Employee are considered as part of the company's assets and to be able to gain loyalty and trust to the employee is by providing them the option or the capability to own or acquire part of the company stake via employee stock option. The option stock option exercise is considered as two prong strategies whereby the company can offer the employee to prospect of future capital appreciation without tax ramification while the company are able to gain additional capital via the offering. It is however needed to note that to be able to exercise this right and to entice the employee in subscribing to the stock option scheme the motivation comes from the discounted price the company can offer in comparison to purchase it directly from the exchange. Obiyathulla et all states that Malaysian companies deliberately initiate ESOS when the market valuation towards their stock is low.

The questions the study would like to investigate are whether the employee stock option scheme is able to drive the performance of the company. The study would like to prove a theory that the performance driver of an employee can be increase by diminishing the conflict of agency and at the same time creating a culture of ownership amongst employees.

Our independent variable in this research is ESOS as our predictor variable in regression analysis while to examine the performance of the company we are using 3 financial ratio analysis and selected them as our dependent variable: ROE (Return on Equity), NPM (Net Profit Margin (NPM) and ROS (Return on Sales). ROE ratio analysis measures the ability of a company to generate profit and how efficiently the profit is generating. The formula to calculate ROE is by dividing the net profit against shareholder equity. A reasonable ROE stands at around 15% to 20% respectively. It is however needed to consider that different industry has also different average standard.

Net Profit Margin on the other hand is a measurement of how much income is generated from the overall revenue. The formula to calculate Net Profit Margin is Net Profit divided by Net Sales. The average net profit margin is around 10% varies by industry. The final ratio uses to calculate the performance of the company is by using Return on Sales, these ratios will evaluate how the company turn the sales into profit. The formula to calculate return on sales is by dividing the operating income to net sales. A good average ROS is around 5% to 10% and this varies between industry.

1.3. Research Objectives

The fundamental aim of this study is to prove if there is a relationship between employee stock option scheme and firm performance. Additionally, the study wanted to gain insight as to whether the motivation behind issuing of ESOS is achieved. Besides that, this study would like to verify whether the financial performance of a company can be improved post ESOS exercise.

Thus, the objective of this research is to study:

RO1: To examine the relationship between ESOS and ROE?

RO2: To examine the relationship between ESOS and NPM?

RO3: To examine the relationship between ESOS and ROS?

1.4. Research Questions

Based on the objective of the studies, the research questions are formulated specifically as follow:

RQ1: What is the relationship between ESOS and ROE?

RQ2: What is the relationship between ESOS and NPM?

RQ3: What is the relationship between ESOS and ROS?

1.5. Significance of the Research

The explorative study is trying to prove the rationalization of issuing ESOS towards improving the firm performance. The implication of these finding would help to provide alternative insight on the theoretical application and practical application on the organizations. They are many factors that contribute towards the performance of the company such market share, competitive edge, and cost leadership. However, to be able to prove on of these many factors would help company make an inform decision as to adopt such practice or not.

CHAPTER 2
LITERATURE REVIEW

2. Introduction

Chapter 2 of the literature review is examination of several past research and notable gap from the previous research conducted that might be able to support and strengthen the existing body of knowledge. The study might add to theories or otherwise provide a contradicting result as compare to the previous research.

2.1. Definition of Key Terms

Employee Stock Option: Form of equity compensation offered by organization to their employees and executives.

Firm Performance: Porter et all 1986 describe firm performance can be describe as its ability to create value for its clients (Porter, 1986).

Equity based compensation: Compensation paid to an employee based on the value of specified stock

2.2. Theoretical Foundation

Agency theory is a widely known concept made popular by Jensen and Meckling (1976) in his study Theory of the Firm: Managerial Behavior, Agency cost and Ownership structure. The theory of agency stresses the importance of the agency cost in the separation and control issue. In this study, Jensen and Meckling noted that by establishing appropriate incentive the principal or owner of the company might limit agent divergence interest by incurring monitoring to reduce the aberrant activities of agent. This cost is called the agency cost. This study describes an organization is

merely legal fiction that serves as a nexus amongst individual.

Agency Cost

Agency costs arise in the following ways:

i. Moral Hazard: The theory suggests that if party is expose to the risk, they might incline to avoid receiving benefit from his position which is prevalent in large company.

ii. Effort Level: Manager are seen to work less than the senior manager due to less compensation.

iii. Earning Retention: Remuneration is correlate with size of the company rather than its profit.

iv. Risk Aversion: Manager are inclined to be risk averse due to company stability while owner is more than willing to take risk if the return is high.

v. Time Horizon: Shareholder is interested in long term prospect while manager is interested in short term.

Agency cost do not present when owner and managers is the same persons. The cost rise when there is a split between owner and managers. The cost of this cost is extremely high in large corporations. Agency cost can be divided into 3 which is cost of monitoring, residual lost and bonding cost.

Solutions to the Agency Problem

i. Remuneration package designed for executive and senior managers to achieve long term and short-term company goal

ii. Have debt capital structure invested for expansion and company growth

iii. Have board to monitor the decision taken by executive and top level.

Based on the above study, it was suggested that ESOS issuance will be able to reduce the theory of agency issue

The concept of employee shareholders engaging in a type of "worker capitalism" where cooperation flourishes and everyone wants the same thing a higher stock price and growing corporate profits is intuitively appealing. Unfortunately, the ESOP fable of enhanced firm performance may often be based more on wishful thinking than hard analysis as quoted by Davidson and Worrell (1994). In Davidson and Worrell research they tested 48 firm which offer ESOP as part of the employee benefit. The study found that there are no significant changes in the company performance in the long run.

Previously published work related to ESOS in Malaysia in 2009 and 2013 respectively. In 2009, the study conducted by examining 52 companies in Malaysia against 26 ESO firms and their industry peer over 12 years. The result of this study conducted have mixed outcome where ESOS is seen to be having better effect to the large company as compare to the smaller company. There is notable impact on the performance of the stock of the large company post ESOS announcement while for smaller company only marginally effected. The study in 2013 conducted to only one company for the span of 11 years. It was concluded in this study that the performance of the company is not dependent of ESOS. Obiyathulla et al. 2009 studies found that the size of the firm also play an important role as the mediating effect between ESOS and firm performance.

Conte, Blasi, Kruse and Jampani (1996) in their research have found that ESOS adoption have better performance in compare to the non ESOS adopter. Matsunaga (1995), study 123 firm over 11 years period and found that there is a weak

correlation between ESOS and company performance. The study also add that the result was sensitive and are not consistent over time.

A study from Singapore conducted by Gillian et al (1999) found that there is weak evidence and correlation between ESOS and company performance. The discussion has gone as far as ESOS being a tool for wealth appropriation.

In a study conducted by Duffhues et al. (2002) in Netherland the finding found a positive relationship between stock option and firm performance. It is based on 113 company which adopt ESOS in 1997. The result however was not based on long-term performance but was rather short. Apparently, majority of company found a spike in public interest and increase in share price post announcement of ESOS. However longer horizon does not indicate any impact or magnitude it has on the performance of a company.

Jones and Kato (1995) studies on ESOS impact on Japanese firm found that the introduction of ESOS lead to an increase of productivity. Fang et al (2015), found that the issuance of ESOS to be an effective substitute to cash compensation. In Taiwan, the adoption of ESOS is much welcome as noted in the study by Morton (1998).

While a lot of company are trying to adopt ESOS, company specifically in US have very high adoption of ESOS, an Airline Company United Airlines did attribute their achievement and profit due to exercise of ESOS in 1995.

Ibrahimy et al 2012 study noted a significant positive relationship between ESOS and value of the firm the following year it has been granted. Oyer & Schaefer (2005) cross sectional study reject the broad-based incentive plan based on the result. Yermack (1995) Black-Scholes approach found weak support on company

performance optimization. Triki and Ureche-Rangau (2012) study the impact on ESOS on French firm and conclude that ESOS has significant relationship with Return on Equity.

Stewardship theory defines the actions and attitudes that put a group's long-term interests above one person's short-term goals (Hernandez, 2008). If the interest is aligned there will be less self-serving behaviors (Brooks and Dunn, 2010).

2.3. Proposed Conceptual Framework

Very few studies conducted on ESOS in Malaysia based on past search it is conducted in a different viewpoint Bacha et all 2019, conducted the study based on market reaction towards the announcement of ESOS, Ghazali&Taib, 2011 used the announcement effect of ESOS based on firm size

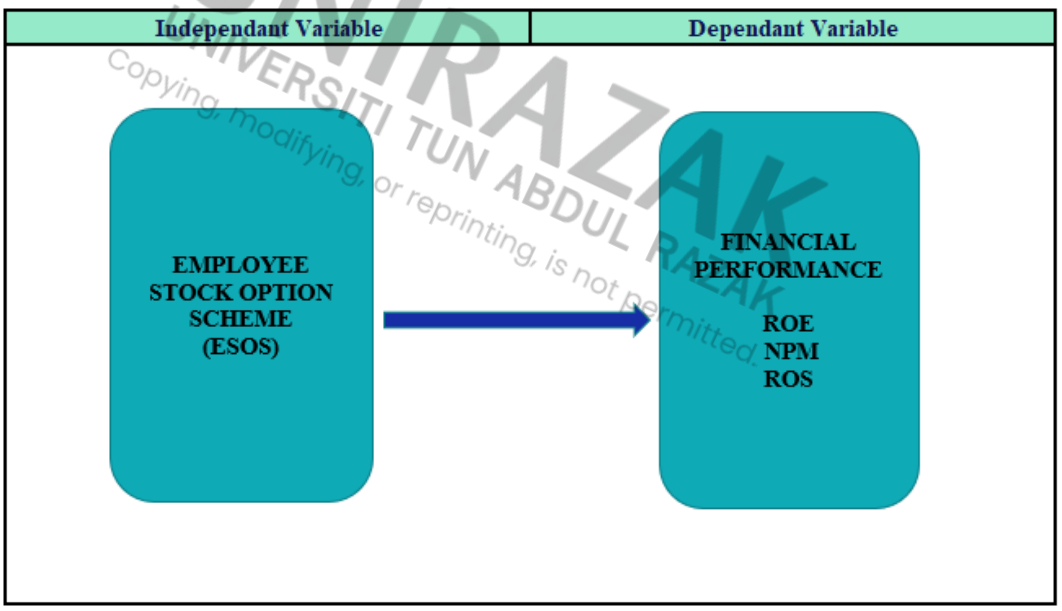

Figure 1: Theoretical framework for the relationship between independent variable employee stock option scheme and dependent variable ROE, NPM and ROS.

2.4. Hypothesis Development

To measure company Based on the proposed conceptual framework, hypothesis of the research is given as follow:

2.5. Hypothesis

Based on the proposed conceptual framework, hypothesis of the research is given as follow:

Hypothesis 1

H0: There is no significant relationship between ESOS and ROE

HA: There is a significant relationship between ESOS and ROE

Hypothesis 2

H0: There is no significant relationship between ESOS and NPM

HA: There is a significant relationship between ESOS and NPM

Hypothesis 3

H0: There is no significant relationship between ESOS and ROS

HA: There is a significant relationship between ESOS and ROS

CHAPTER 3

RESEARCH METHODOLOGY

3.1. Chapter Review

This chapter will discuss the methodology and process adopted on how the research is conducted. Detail such research design, population of study, sample, sampling technique, data collection method, data analysis and type of testing selected to derive the result that will answer the hypothesis in questions. The main objective is to provide a proper frame and guideline to conduct the research to derive to a reliable conclusion.

3.2. Research Design

Based on the proposed conceptual framework in chapter 2.4. the sample data used in analyzing the ESOS is taken from secondary data which Bursa Malaysia Data Subscription package, company's annual report and data streamer. The historical data subscription package is obtained under corporate information summary of new capital increase under market information.

The research will use quantitative method to test the suggested hypothesis to statistically examine the cause relationship between the variable.

Table 1: Research Design summary

No	Detail	Hypothesis	Data	Collection and Analysis
1	Research Questions RQ1 : What is the relationship between ESOS and firm performance (ROE, NPM and ROS) Objective Research RO1 : To examine the relationship between ESOS and firm performance (ROE, NPM and ROS)	H0: There is no significant relationship between ESOS and firm performance HA: There is significant relationship between ESOS and firm performance	Type of Data - Secondary Data Collection Source of Data - Bursa Saham - Company Website - Annual Reports - Books - Journals - Articles - Report - Trade Publication - Market Research	Collection Method - Data Streamer - Document Analysis - Manual Analysis Technique - Normalised Test - Descriptive Analysis - Pearson Correlation Coefficient Analysis - Regression Analysis

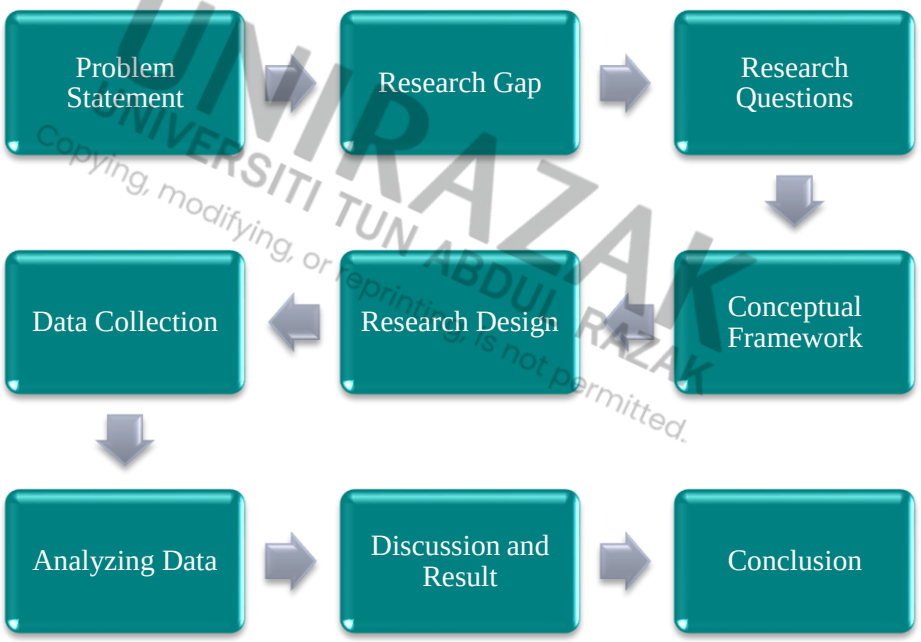

Figure 2: Research Process Flow

3.3. Population, Sample & Sampling Technique

The research is using purposive sampling method. Reason why purposive sampling is chosen is due to the nature of the research design which aim to see the relationship between ESOS and firm performance. The research project component is conclusive research as the purpose is very specific and the data selection aids in selecting the course of action. Data is clear and published, the sources is well defined as well, data collection form is usually structured, rigid, and well laid out and the analysis is typically quantitative in nature.

The sample size which is selected is around 210 companies to represent the sample size. Roughly the issuance of ESOS in Malaysia is still within less than a 100 company annually. We have around 936 companies in Malaysia. Based on Krejic and Morgan. A good sample size should have roughly around 274 sample. However, it was suggested that a sample size of 200 is considered as acceptable. The reason why I limit the data up to 210 is due to the frequency of ESOS issued in 2018 is only 30. To have enough sample I need to obtain 7 years' worth of ESOS issuance from Bursa Malaysia. Additionally, most of the published annual reports in the company website as well as the secondary web only publish around 10 years financial information. The limitation to obtain the info also restrict the amount of data collected.

Table 2: Krejic and Morgan Sampling Table (1970)

Table for Determining Sample size of a Known Population							
Population	Sample	Population	Sample	Population	Sample	Population	Sample
10	10	150	108	460	210	2200	327
15	14	160	113	480	214	2400	331
20	19	170	118	500	217	2600	335

25	24	180	123	600	226	2800	338
30	29	190	127	600	234	3000	341
35	32	200	132	650	242	3500	346
40	36	210	136	700	248	4000	351
45	40	220	140	750	254	4500	354
50	44	230	144	800	260	5000	357
55	48	240	148	850	265	6000	361
60	52	250	152	900	269	7000	364
65	56	260	155	950	274	8000	367
70	59	270	159	1000	278	9000	368
75	63	280	162	1100	285	10000	370
80	66	290	165	1200	291	15000	375
85	70	300	169	1300	297	20000	377
90	73	320	175	1400	302	30000	379
95	76	340	181	1500	306	40000	380
100	80	360	186	1600	310	5000	381
110	86	380	191	1700	313	75000	382
120	92	400	196	1800	317	100000	384
130	97	420	201	1900	320	250000	384
140	103	440	205	2000	322	500000	384

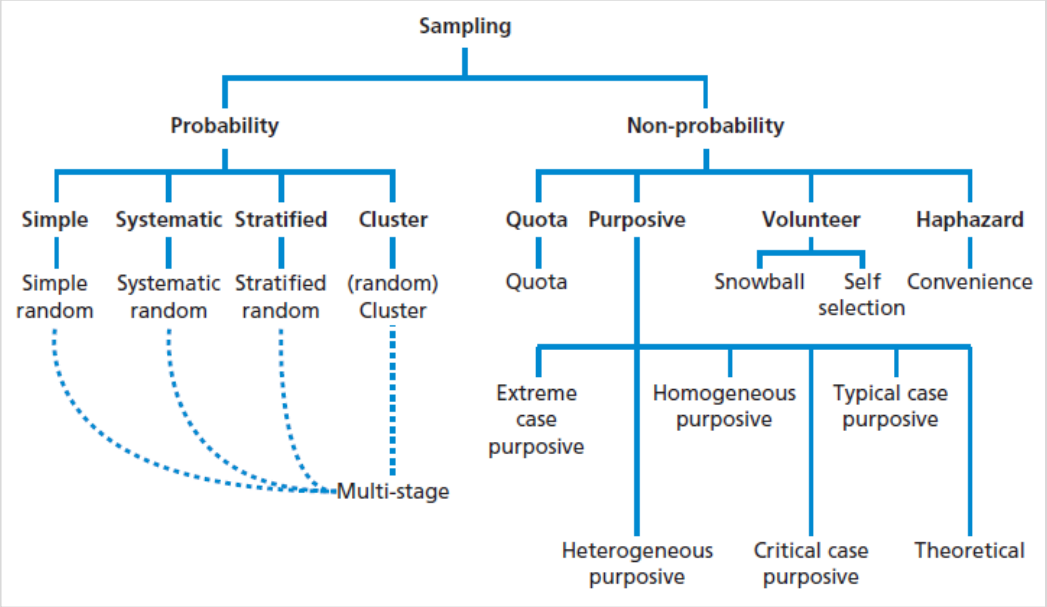

Figure 3: Sampling Type Source: Business Research Methodology

3.4. Measurement of Variable

In a research, measurement of variable can be categorized into 4 types. Nominal, ordinal, interval, and ratio. In this study the level of measurement taken is in ratio (continuous). The numbers are rounded up to mil as to maintain consistency and ease when trying to run the analysis.

3.5. Data Collection Method

The data collection use in this research are obtain through Bursa Malaysia data package subscriptions. Data is requested from 2015 until 2021 around 6 years' worth of ESOS. The sample is collected both electronically and manually populated.

3.6. Data Analysis Technique

3.6.1. Statistical Package

Data that has been collected are prep and structured in a way that it is easily to load and run the interpretation via SPSS a Statistical Package for Social Science (SPSS). The data analysis package is widely used and recommended for research purpose. Using SPSS, we run different type of analysis to measure the reliability of a data, to measure the skewness of data and the significant of the independent variable towards the dependent variable.

3.6.2. Normality Test

In this study, we are using the widely used normality test which is the Shapiro-Wilk test and Kolmogorov-Smirnof Test (KS). The test is used to test if the set of data comes from a normal distribution.

Shapiro-Wilk test is the most frequently used test to check the normality of the data. It is considered the most superior test as compared to other data however it is recommended for observation or sample below than 50. In Shapiro-Wilk test the P-value of the test if below 0.05 it is considered as significant. Hence it is considered as non-gaussian. Shapiro will be recommended for observation below than < 50 but are able to manage a data as large as 2000.

Additionally, a graphical representation of a Q-Q plot is used for visual reference and ease of understanding.

3.6.3.Descriptive Statistic

Descriptive statistic helps to organize the data in a way it is easily to comprehend and understandable. However, it is not in a way to allow us to derive any conclusion from the presented data. It is helpful to help researcher to visualize the data.

3.6.4.Pearson Product-Moment Correlation Coefficient (PCC)

The PCC analysis test is a measure of strength between 2 variables in a linear model. This linear relationship is represented by *r*. The value can be either from +1 or -1. A value of 0 indicates there is no association between variable tested. A value greater than 0 indicates a positive relationship while a value below than 0 indicates -0 a negative relationship.

3.6.5.Multiple Regression Model

The type of analysis use by this study is multiple regression analysis to examine the relationship between the firm ESOS against ROE, NPM and ROS. The used of this ratio is to identify factors that are likely to have explanatory power towards firm performance. The model of the study is as followed.

Firm Performance (FP) = f (ROE, NPM, ROS)

Hence our function can be estimated under the following model:

$FPi,t = \alpha + \beta 1ROEi,t + \beta 2NPMi,t + \beta 3ROSi,t$

Independent variable

FP which is expressed in the following terms:

ROE = The firm return of equity

NPM= The firm net profit margin

ROS = The firm return of sales

Dependent variable

FP = Firm Performance

CHAPTER 4

RESULTS AND DISCUSSION

4.1. Introduction

In this chapter we will discuss further on the result obtain from the outcome of the analysis. We will also discuss an interpret the result and finding from SPSS. The component and industry analysis will be given to provide additional info to assist reader to comprehend the data provided.

4.2. Data

4.2.1.Employee Stock Option Scheme

In this study we have taken 210 public listed company in Malaysia from various industry, the number of ESOS issuance are listed as below. As we wanted to maintain the number of companies across 7 years study, we have decided to select 30 company from 2015 until 2021. The research is conducted within 7 years also due to the access of information financial report and information from most of the company website is around 7 years.

Figure 4: Number of public listed company issuing ESOS from 2015 until 2021

(Source: Bursa Malaysia)

4.2.2. Overall ESOS issuance in KLSE

Based on the data, the adoption in Malaysia is relatively low around 3% to 5% of company adopted ESOS every year. Which mean majority of the firm in Malaysia do not adopt the broad-based compensation scheme. Low adoption might be an indicative that the scheme does not support firm performance as compare to the US and UK firm.

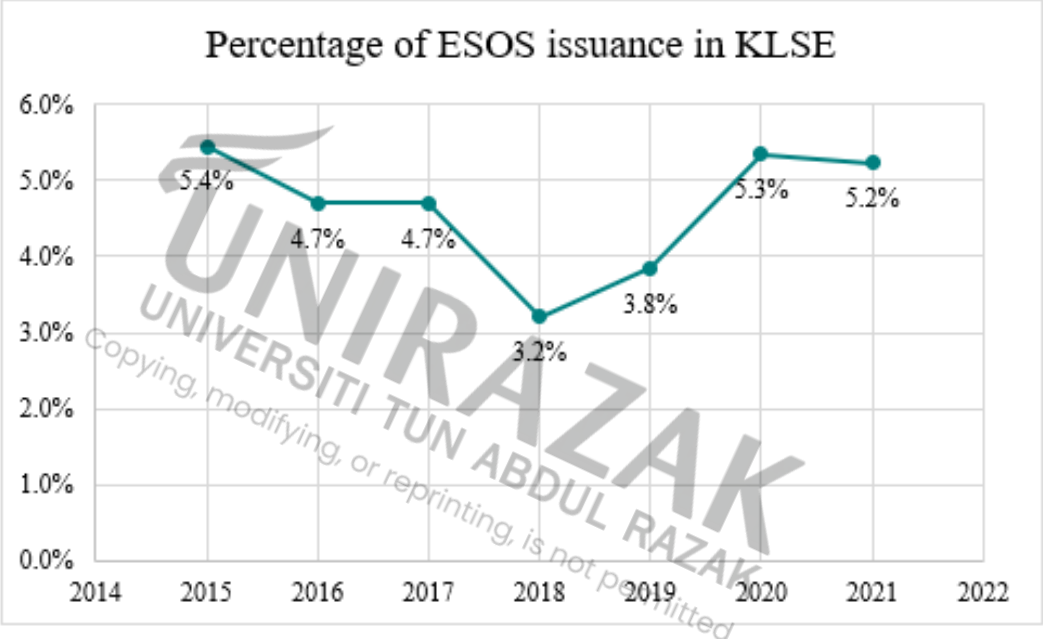

Figure 5: Percentage of company issuing ESOS against total public listed company from 2015 until 2021 (Source: Bursa Malaysia)

4.2.3.Industry

Based on the industry from the list of company which issue ESOS we have found that industrial product & services, technology, healthcare, constructions, and consumer product frequented the issue of ESOS. It is not suggestive that some industry favor against others. Surprisingly the adoption of ESOS from local bank specifically is very low as compared to the international bank.

Table 3: Number of companies issuing ESOS by categorized by industry and percentage against grand total.

Type of Industry	No of Company	%
INDUSTRIAL PRODUCTS & SERVICES	36	17.14%
TECHNOLOGY	29	13.81%
HEALTH CARE	20	9.52%
CONSTRUCTIONS	17	8.10%
CONSUMER PRODUCTS & SERVICES	13	6.19%
TELECOMMUNICATION	13	6.19%
PROPERTY	9	4.29%
SEMICONDUCTORS	9	4.29%
FOOD AND TOBACCO	7	3.33%
PLANTATION	6	2.86%
REAL ESTATE OPERATIONS	6	2.86%
FINANCIAL SERVICES	6	2.86%

ELECTRONIC EQUIPMENT & PARTS	4	1.90%
ENERGY	4	1.90%
PHARMACEUTICALS	4	1.90%
SPECIALTY RETAILERS	3	1.43%
TRANSPORT INFRASTRUCTURE	3	1.43%
CHEMICALS	3	1.43%
UTILITIES	3	1.43%
TRANSPORTATION & LOGISTICS	2	0.95%
HOTELS & ENTERTAINMENT SERVICES	2	0.95%
AGRICULTURAL PRODUCTS	2	0.95%
TRAVEL, LEISURE & HOSPITALITY	1	0.48%
ELECTRICITY	1	0.48%
AUTOMOTIVE	1	0.48%
MACHINERY, EQUIPMENT & COMPONENTS	1	0.48%
TRANSPORTATION & LOGISTICS SERVICES	1	0.48%
BANKING SERVICES	1	0.48%
HOUSEHOLD GOODS	1	0.48%

DIGITAL SERVICES	1	0.48%
PROFESSIONAL & COMMERCIAL SERVICES	1	0.48%
Grand Total	**210**	**100.00%**

4.3. Normality Test

Before we run the regression analysis to test our hypothesis, we need to test the data to check whether it is normally distributed or not which mean null hypothesis. For this study we are testing to type of normality test which is widely used via Shapiro-Wilk and Kolmogorov-Smirnof. The result of the test is as below.

Based on the result the p-value for ROE and ESOS is greater than 0.05 which is indicative that the value is normally distributed. However, the p-value for NPM and ROS is less than 0.05 which indicates that the data significantly deviate from a normal distribution.

Table 4: Normality Test Kolmogorov-Smirnoff and Shapiro-Wilk

Tests of Normality

	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
ROE	.205	7	.200*	.880	7	.228
NPM	.323	7	.026	.771	7	.021
ROS	.338	7	.015	.756	7	.015
ESOS	.232	7	.200*	.877	7	.215

*. This is a lower bound of the true significance.

a. Lilliefors Significance Correction

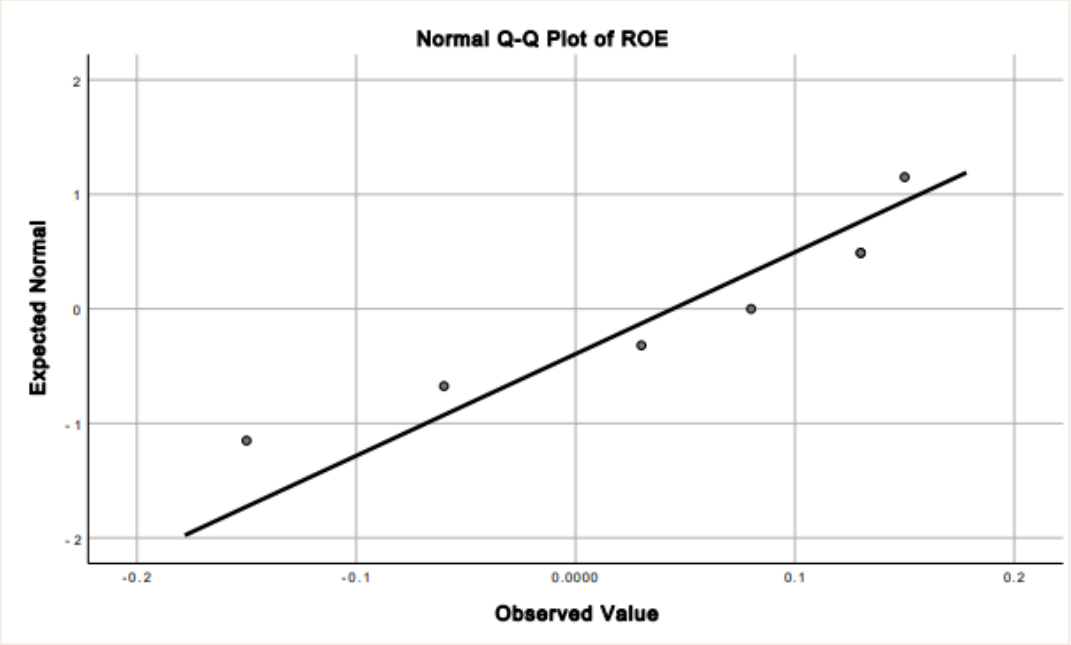

Figure 6: Normal Q-Q Plot of ROE

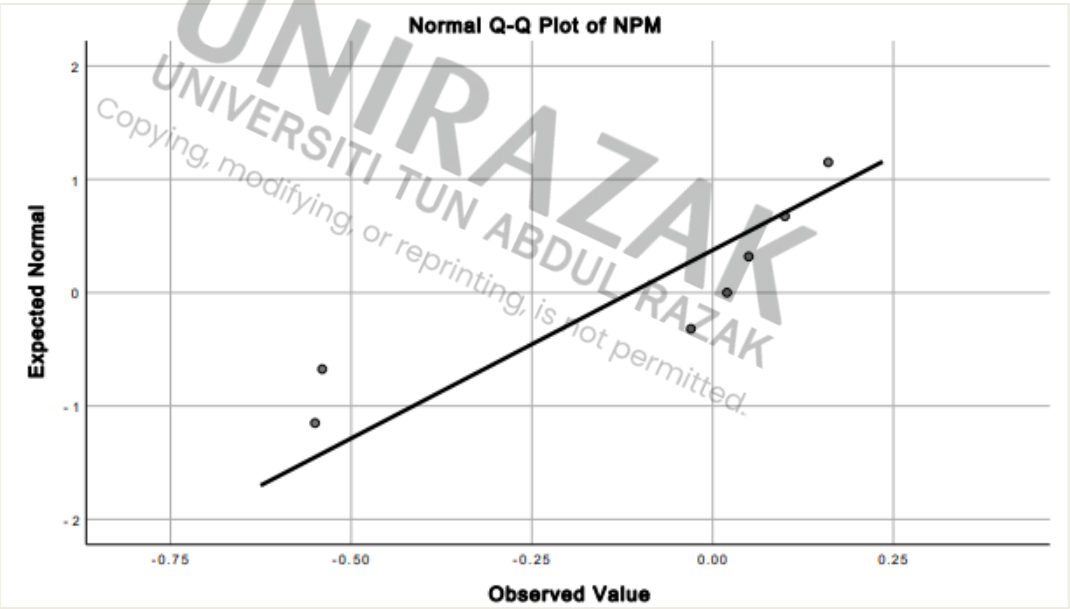

Figure 7: Normal Q-Q Plot of NPM

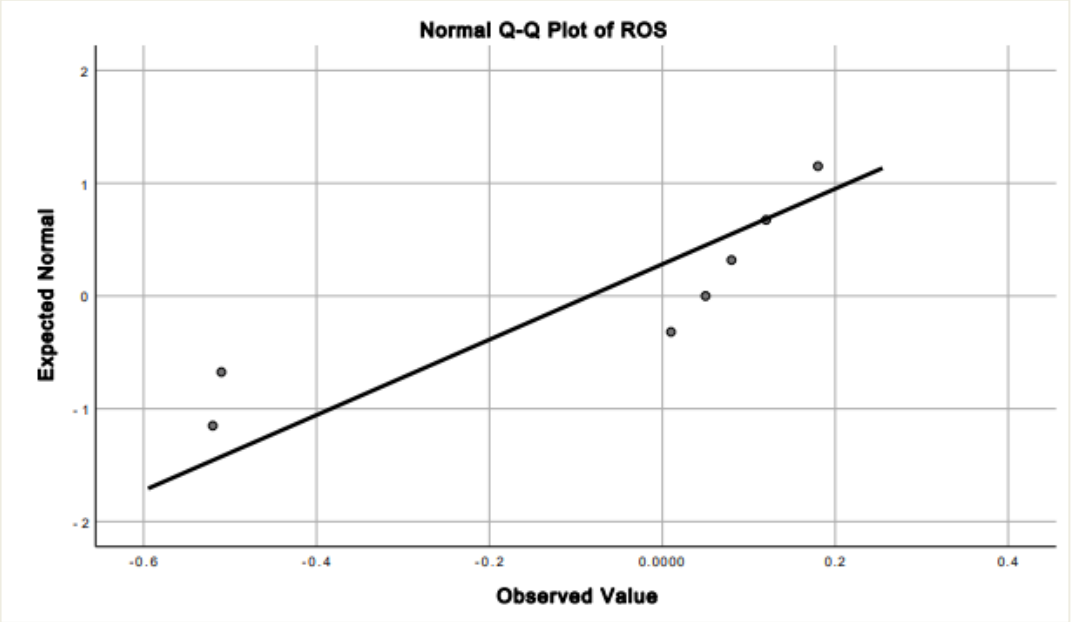

Figure 8: Normal Q-Q Plot of ROS

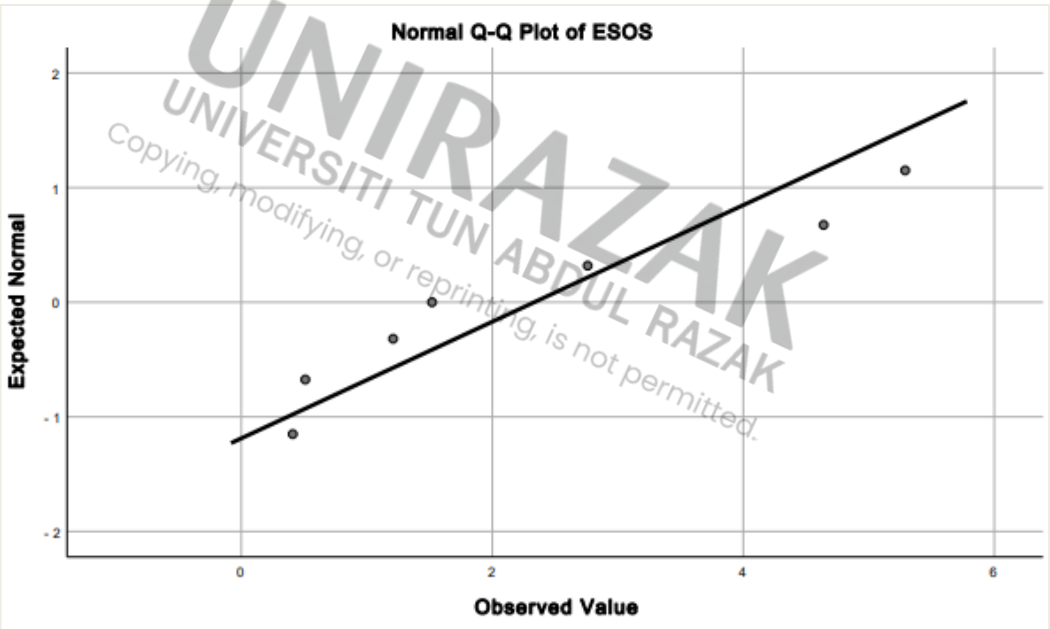

Figure 9: Normal Q-Q Plot of ESOS

4.4. Pearson's Correlation Analysis

The next step in performing the analysis is to check the relationship between the variable which ROE, NPM and ROS against ESOS. To check the relationship between these 2 variables we run the test separately with ESOS to check on the correlation between these variables. To check the correlation using PCC analysis we need to satisfy 4 assumption and condition which the first one variable need to be continuous (ratio or interval), a linear relationship exist (refer to graphical q-q plot), there is no significant outlier, and your variable should be normally distributed. The previous test provided enough evidence that we can run the PCC test as the 4 condition above are met.

High correlation means that the variable has good relationship which mean any changes of the other variable will impact another. Weak correlation means the variable are not closely related which indicates less significant result towards the hypothesis that we are trying to prove. A perfect correlation will be denoted by 1 while no correlation is denoted by 0.

Based on the result, the study observed that all variables are have significant relationship with ESOS. The degree of correlation of variable is perfect and positive if value if 1 or near 1 while it is negative if value is -1. The result concludes that the relationship between the independent variable and dependent variable is strong.

- Perfect: +1 or -1, where one variable increases the other will also move in accordance with the degree of correlation as denotes *r*.
- High degree of coefficient if the value is around 0.5 to 1
- Moderate degree of coefficient if the value is around 0.30 to 0.49
- Low degree of coefficient if the value is around 0.29

- No correlation: 0

Table 5: Summary of Degree of Correlation with ESOS

Summary of Degree of Correlation with ESOS		
	Degree of correlation (*r*)	Significant Level (*p*-value)
ROE	High degree of negative correlation with ESOS	>0.05 Correlation observed exist in the population (Statistically Significant)
NPM	High degree of negative correlation with ESOS	>0.05 Correlation observed exist in the population (Statistically Significant)
ROS	High degree of negative correlation with ESOS	>0.05 Correlation observed exist in the population (Statistically Significant)

Table 6: Pearson Correlation Coefficient Analysis

Correlations

		ESOS	ROS	ROE	NPM
ESOS	Pearson Correlation	1	-.943**	-.971**	-.948**
	Sig. (2-tailed)		.001	.000	.001
	N	7	7	7	7
ROS	Pearson Correlation	-.943**	1	.929**	1.000**
	Sig. (2-tailed)	.001		.002	.000
	N	7	7	7	7
ROE	Pearson Correlation	-.971**	.929**	1	.935**
	Sig. (2-tailed)	.000	.002		.002
	N	7	7	7	7
NPM	Pearson Correlation	-.948**	1.000**	.935**	1
	Sig. (2-tailed)	.001	.000	.002	
	N	7	7	7	7

**. Correlation is significant at the 0.01 level (2-tailed).

4.5. Linear Regression Analysis

When we have proved that there is indeed a correlation between the selected variable. We can proceed to perform multiple regression analysis. Regression analysis is a test to measure the effect of one variable have against another. Of which in this study we are testing the effect of ESOS have against ROE, NPM and ROS. The selection of regression test is due to the ability of the test to model multiple variable which used continuous data and the ability of this test to isolate and control the other variable.

The ANOVA result when we run the regression analysis indicate that our model is a significant predictor of the outcome variable which in our case whether ROE, NPM and ROS. As the *P*-values is less than 0.05. We can conclude that the regression model significantly predicts the ROE, NPM and ROS of a company.

The second analysis is based on table 8 of the model summary on the R square value. The *r* value in model summary table examines the strength between the outcome variable and the predictor combined. In this test the *r* value is around 0.94 to 0.97 which is strong.

The third analysis is on the R square value. R square value tell us the proportion of the variation in the outcome variable. In other word how well, the data fit the regression model. Our R square value is 94% for ROE and 89% for both NPM and ROS of the variance can be explained by the predictor variable.

The fourth analysis is on the Coefficient, the Coefficient tell us to what extent the individual predictor variable contributes to this model. Based on the *p*-values we can conclude that ESOS significantly contribute towards the ROE, NPM and ROS as the significance is below 0.05. It implies as the increase in ESOS by a million there will be a decrease in ROE, NPM and ROS respectively.

Table 7: ANOVA

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.072	1	.072	81.703	.000[b]
	Residual	.004	5	.001		
	Total	.076	6			

a. Dependent Variable: ROE

b. Predictors: (Constant), ESOS

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.489	1	.489	44.027	.001[b]
	Residual	.056	5	.011		
	Total	.544	6			

a. Dependent Variable: NPM

b. Predictors: (Constant), ESOS

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.477	1	.477	40.197	.001[b]
	Residual	.059	5	.012		
	Total	.537	6			

a. Dependent Variable: ROS

b. Predictors: (Constant), ESOS

Table 8: Model Summary

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.971[a]	.942	.931	.02960	2.861

a. Predictors: (Constant), ESOS

b. Dependent Variable: ROE

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.948[a]	.898	.878	.10537	2.630

a. Predictors: (Constant), ESOS

b. Dependent Variable: NPM

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.943[a]	.889	.867	.10896	2.583

a. Predictors: (Constant), ESOS

b. Dependent Variable: ROS

Table 9: Coefficient

Coefficients[a]

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	.174	.018		9.562	.000
	ESOS	-.056	.006	-.971	-9.039	.000

Coefficients[a]

Model		Collinearity Statistics Tolerance	Collinearity Statistics VIF
1	(Constant)		
	ESOS	1.000	1.000

a. Dependent Variable: ROE

Coefficients[a]

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	.226	.065		3.490	.017
	ESOS	-.145	.022	-.948	-6.635	.001

Coefficients[a]

Model		Collinearity Statistics Tolerance	Collinearity Statistics VIF
1	(Constant)		
	ESOS	1.000	1.000

a. Dependent Variable: NPM

Coefficients[a]

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	.251	.067		3.741	.013
	ESOS	-.143	.023	-.943	-6.340	.001

Coefficients[a]

Model		Collinearity Statistics Tolerance	Collinearity Statistics VIF
1	(Constant)		
	ESOS	1.000	1.000

a. Dependent Variable: ROS

4.6. Discussion of Results

Based on the statistical test the result indicates that there is a strong negative relationship between ESOS and ROE, NPM and ROS. The summary of the result is tabulated in the table below.

It is found that there is a significant relationship between 3 of the dependent variables. However, it is negatively correlated. Based on the study we can assume that the effect of issuing ESOS by a company can potentially reduce the profit instead of increasing the profit.

Table 10: Summary of Hypothesis and Result

No	Hypothesis	Result	Supported	Interpretation
1	HA: There is a significant relationship between ESOS and ROE?	*β :-0.056* *p* : 0.000 (>0.05)	Yes Negative relationship	As ESOS increase by 1million ROE will reduce by MYR56,000
2	HA: There is a significant relationship between ESOS and NPM?	*β :-0.145* *p* : 0.001 *(>0.05)*	Yes Negative relationship	As ESOS increase by 1million NPM will reduce by MYR145,000
3	HA: There is a significant relationship between ESOS and ROS?	*β :-0.143* *p* : 0.001 *(>0.05)*	Yes Negative relationship	As ESOS increase by 1million ROS will reduce by MYR143,000

CHAPTER 5

FINDING AND CONCLUSION

5.1. Conclusion

The objective of the study is to examine the impact of ESOS in Malaysian Public Listed Company. It has been proposed that there is a negative but weak relationship between ESOS and company performance. Instead increasing the profit of the company, ESOS has been found to reduce the profit of the company. Thus, it is to conclude that indeed there is a relationship between ESOS and company performance. The issuance of ESOS has been found to dilute the value of the ordinary share due to the issuance of ESOS at below fair value.

The study finds that some of the company issuing ESOS are companies in financial distress. The motivation to issue ESOS internally and not to public probably due to inability to entice the public with weak fundamental as public are more keen to buy shares with company who have very strong and sound financial. These company can be seen at a growth level because most of the capital are invested in either R&D or expansion. Company which issues ESOS internally also do not want the share price of the company to be undervalued hence the reason why offering the option would enable the company to provide discount at a fair price instead of relying demand from the exchange where it was undervalued. ESOS scheme can also arguably be found to shift the risk and expose the risk of the company akin to the shareholder with much lesser values and right. Instead of using it as effective retention tool the benefit weigh more to the company itself. Some of the cases previously noted that the issuance of the ESOS subscriber is more beneficial to the executive level with more subscriber coming from the group. This indirectly diminish the objective of issuing ESOS to dilute the agency conflict.

Additionally, previous study also finds that ESOS exercise do not simply increase the company performance other supplementing attributes related to management of worker need to be improved to attain the benefit of productivity. A supportive worker practice coupled with good policy, mentoring, employee involvement and job security is are more important in retaining the employee as well as keeping them highly motivated.

5.2. Recommendation

ESOS exercise can be improved by scheduling yearly offering of ESOS after bonus payout or payment through salary deduction. This will increase employee participation rate due to additional allocation of fund received from the company. In a way, it circulates the profit shared amongst the employee to invest in the company.

Company can also offer bigger discount and timed the ESOS offering during market downtime, so the company do not have to absorb too much loss due to the discount offered. Additionally, company can use ESOS issuance strategically to invest in internal strategy and communicate to the employee the intended reason which allow employee reason to partake in the ideas this to provide employee to have a role in the company decision making.

As this is a broad-based stock option scheme, company are advised to provide eligibility to all employee regardless of their tenure and level so there is no element of bias between working level and executive level employee. As it is common for executive to received stock option scheme as part of their compensation.

5.3. Limitation and Future Research Directions

Notwithstanding the finding, the current study suffers the following limitations. However, these limitations potentially represent opportunities for further investigation Some of the major limitation of the studies is to obtain enough sample size for the research to provide a satisfactory result. Although there has been an increase in the adoption all around the globe the result was not consistent across country, organization, and industry. Besides limiting factors, we can assume there is indeed a mediating factor that also play a role in the success of employee stock option scheme not only on the offering of the scheme itself.

Triangulation of analysis can also be done not limited to the empirical data but also an interview to be conducted amongst company who offered the employee stock option scheme on the effectiveness of these exercise and the perception of employee motivation itself on ESOS need to be understood.

A study on the long-term effect on the company performance can also be done as well as the study on the comparison of ESOS, pre and post implementation. Additional variable that measures company performance can also be included in the future study to look at other angle of the firm performance to evaluate the effectiveness of ESOS.

Additionally, further research can be exploring against ESOS effect toward industry performance A more robust statistical analysis, like the multivariate analysis and with larger sample size, could be employed to determine the determinants of ESOS against firm performance.

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APPROVAL PAGE

TITLE OF PROJECT PAPER: **EMPLOYEE STOCK OPTION SCHEME AND FIRM PERFORMANCE: A REGRESSION APPROACH ON MALAYSIAN FIRM**

NAME OF AUTHOR : MARIANA BINTI AB MAJID

The undersigned certify that the above candidate has fulfilled the condition of the project paper prepared in partial fulfillment for the degree of Master of Business Administration.

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