

Incentivization or Expropriation? All ESOPs are not Created Equal

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Abstract

Why do Chinese listed firms adopt Employee Stock Ownership Plans (ESOPs)? Chinese listed firms with high salaries experience improvement in productivity and shareholder value, but those with high leverage, intercorporate loans, and separation of ownership and control have increased financial distress risk after ESOP adoptions. Firms with deteriorating performance are smaller and tend to announce ESOP adoptions when market sentiment is high. Their controlling shareholders tend to use earnings management, leveraged ESOPs, and ESOPs with high participation rates to inflate the stock prices and then cash out soon after ESOP adoption announcements, siphoning billions of RMB from minority investors.

Keywords: Employee stock ownership plan; Minority shareholder expropriation; Incentive; Insider trading; Pump and dump; Tunneling

JEL classification: G15; G38; K22

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