

EVALUATING THE FINANCIAL IMPLICATIONS OF EMPLOYEE STOCK OPTION PLANS: COSTS AND BENEFITS FOR FINANCIAL INSTITUTIONS

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Abstract

This research investigates the costs and benefits associated with the Employee Stock Option Plan (ESOP) as a non-salary benefit package aimed at motivating and retaining employees within financial institutions. The study highlights that while ESOPs incur direct costs, such as the purchase of shares and administrative expenses, they also present indirect costs related to employee performance and market fluctuations. The findings reveal that ESOPs not only serve as a financial incentive but also foster a sense of ownership among employees, enhancing their motivation and commitment to the organisation. This alignment of employee interests with company performance can lead to improved productivity and retention rates. Furthermore, the transparency and communication fostered by ESOPs contribute to a positive corporate culture, which is crucial for long-term sustainability. The research also identifies potential risks, including market volatility and the psychological costs associated with unsuccessful implementation and ineffective costs. The study emphasizes that while the costs of implementing an ESOP can be significant, the potential benefits, such as enhanced employee motivation, retention, and overall organisational performance, can outweigh these costs.

Keywords

ESOP, Cost, Employee benefits, Financial institution

JEL Classification

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Introduction

Financial institutions need truly attractive non-legal benefits to retain staff and attract new talent, as this is a stressful and resource-intensive field for employees. An Employee Stock Ownership Plan (ESOP) is a very good tool for them, as it aligns with the industry and the life perspectives of those choosing this profession (Zhang and Rong, 2015). If the benefits are clear, implementing such an ESOP plan can be

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considered. The benefits are clearly defined for the non-legal package offered to each individual, depending on the structure of the activity and their level in the organisational hierarchy (Ranta and Ylinen, 2024).

The costs for such an ESOP plan are not typical of classic non-legal benefits, such as meal vouchers, health insurance, vacation vouchers, or any immediate benefit (Norberg, 2017). The ESOP plan is a long-term benefit. Its effects are not immediate and depend on the actions and decisions of employees, who then become shareholders. The financial impact of this tool is realised when an employee becomes a shareholder and receives dividends, which depend heavily on the performance of the financial institution. Similarly, the price of shares will fluctuate based on profits and the future outlook of the financial institution (Kuswati, 2020). A higher share price compared to when the ESOP plan was implemented will lead to a profit for the employee-turned-shareholder if they decide to sell the shares at some point (Qabajeh et al, 2024).

The gap in the literature is that ESOP is an increasingly common employee reward model, but a higher frequency has been observed within technology companies or newly emerging sectors. Thus, the study aims to capture the possibility of implementing the ESOP plan within a traditional and well-regulated field. This is the gap identified in the literature and even in implementations (Cheng et al, 2017).

The costs for implementation can be direct and indirect. The subscription costs will be the highest that the financial institution has to bear for employees. Additionally, there are costs for the teams of consultants and specialists involved in implementing and executing this plan legally and in accordance with regulations based on the countries where it applies. The indirect cost mainly consists of the time that this category within the financial institution spends on this project for its design and completion (Zhang and Rong, 2015). The salaries of employees involved in the ESOP application process are considered an indirect cost, as their core activities are not strictly based on implementing the plan – it is just a new task for a defined period (Laux, 2012). However, the most important cost for the financial institution, which needs careful analysis, is the cost incurred when all the activities and methodologies discussed are applied, and the ESOP plan fails, meaning there is no interest in subscribing among employees. At that moment, it represents a cost without effect for the financial institution, as well as a question for the public as to why insiders chose not to participate in this stock subscription plan (Dhingra et al, 2024).

Organisational culture grows through the application of such non-legal benefits. Transparency among employees leads to growth based on sustainability and durability.

1. Review of the scientific literature

Any non-salary benefit provided to motivate and retain employees comes with a cost for the company (Ranta and Ylinen, 2024). Specifically, this cost is represented by the price the company pays for the benefits chosen by employees (Gu, 2018). According to organisational culture, entities choose to set a budget that each employee can spend as they wish on flexible benefits that suit each individual (Kurland, 2018). Benefits may include meal vouchers, vacation vouchers, private or medical insurance packages, cultural vouchers, etc (Norberg, 2017).

The direct costs of these non-salary benefit packages, encountered within salaries, consist of the actual purchase of the service on behalf of the employee (Haaswijk et al, 2018).

However, these costs are recurring and are assimilated into the monthly salary package. These costs represent direct costs for companies, costs for compensating and rewarding employees. From a cost analysis perspective, the Employee Stock Option Plan (ESOP) is chosen because it is much more complex and addresses both sides: direct and indirect costs (Zhang and Rong, 2015).

In addition to these monthly costs, occasional costs may arise related to management decisions for rewarding employees and retaining talent within the company (El Ghouli et al, 2011). One such cost may be the cost of implementing a stock option plan. This employee compensation plan can be considered a mixed cost, as it consists of a one-time fixed cost and a variable part over multiple financial cycles (Angrist and Pischke, 2008).

ESOP consists of two direct costs incurred upon the issuance and distribution of shares according to the plan (Faleye and Trahan, 2011). The costs are mainly composed of fees and expenses for implementing all legislative norms, and then, most importantly, the cost of the issued shares (Cheng et al, 2017).

The variable cost is characterised by the dividends that companies will issue in the future for the respective financial cycles. The company's profile will be divided into several parts; even though the minority portion will go to ESOP shareholders, it is characterised as a variable cost (Chen et al, 2020a). Employee income will vary based on the company's performance; each year or period can be very subjective depending on the company's market performance (Chen et al, 2020b).

The Employee Stock Option Plan (ESOP) is a tool for compensating the staff of an entity. This tool applies over a medium to long-term horizon, as its implications extend beyond distribution, until the dissolution of the enterprise (Cheng et al, 2024).

ESOP represents a way to reward employees, especially those in key positions and management of the enterprise (Kong et al, 2023). The actual effect consists of increasing the shareholders' portfolio of the enterprise with the employees of the enterprise. The equity-based compensation plan is organised based on several factors, such as assigning individuals, exercising and implementing it, maturity, and fulfilling all requirements, ultimately leading to the sale (Palcic and Reeves, 2011).

The main stages of designing the ESOP plan within companies are characterised by positioning it within the market-accepted parameters and the sector to which the company belongs (Xu and Duan, 2023). Thus, the first stage consists of establishing the capital (ESOP pool), capital that will be allocated to the plan (Jensen and Meckling, 1976). There are two possibilities to fulfil such a function: first, by reducing the share of each shareholder and gathering the participation that will be distributed within the bonus instrument, or increasing the share capital by issuing new shares, which the company will distribute to employees who qualify for this procedure (Ivanov and Zaima, 2011).

A secondary but also very important procedure consists of identifying the target audience, the individuals who can enter the plan and become shareholders (Gilmore, 2022).

From a corporate governance perspective, this is very important, as these new individuals will have the rights and obligations specific to company owners. Thus, those responsible for implementing the plan must select individuals who contribute to and develop the company (Kruse et al, 2004).

A crucial point within the plan is to establish the price at which each share will be allocated, as ESOP does not involve issuing shares exclusively for free. Thus, share allocation can be done at a preferential price, but it can also be zero as a gift. Before publishing the ESOP allocation prospectus, an analysis must be conducted to identify the degree of support for the company's financial position. If the total value of capital growth can be supported by the company or if shares need to be sold at a preferential price, it is attractive for employees to apply, as well as for the company.

Maturity, or the vesting period, refers to the transition period from the plan to its implementation (Laux, 2012). Thus, it resembles a call option; from the appearance of the prospectus until the exercise of the purchase right, a buffer period must pass. Additionally, objectives may arise for the individuals involved, and the exercise of the right should occur when the objectives are met (Edmans, 2017).

The conditions and terms of the Employee Stock Option Plan can be adapted according to the market and the needs of those it applies to (Edmans et al, 2024).

In addition to implementation costs and variable costs, ESOP also presents multiple benefits for both employees and employers. The main benefits for the employer include the well-being and retention of talent within financial institutions. Employee motivation significantly increases in achieving objectives and personal growth within a company, as well as the financial goals set by the financial institution (Kuswati, 2020). Employee retention and the development of an organisational culture of belonging will be enhanced with such an ESOP plan.

Moreover, it increases competitiveness among employees and in the local market where the financial institution operates. Competitiveness is characterised by employees' attitudes towards the objectives set by top management in the Employee Stock Option Plan to be achieved and to enter the circle of employees benefiting from such non-salary benefits within the organisation they belong to (Zhou and Wei, 2024)

Thus, an ESOP plan can lead to the development of sustainable corporate governance based on transparency and the potential for growth and development of the banking and financial institution. Sustainable growth relies on the conducive environment created between top management and executive staff (D'Amato et al, 2024).

Employee benefits are of two types: financial in nature, as well as organisational and corporate culture. From a financial perspective, the employee is also eligible for dividends based on the future financial performance of the financial institution (Liu et al, 2019). The financial advantage for the employee comes from the appreciation of shares and their sale.

Through ESOP, employees of the financial institution actively participate in the decision-making process of the organisation, thus being the main participants in the general meetings of shareholders and in the decisions made in these meetings, depending on the package each employee holds. The employee will be motivated to make the best decisions, being directly affected by market conditions and decisions that may not have been the best.

Non-salary benefits, in addition to their actual cost, also carry tax costs. Tax costs are generally borne by the employee through the payment of taxes and contributions according to the tax code (Bonke, 2010). The tax benefits of ESOP are comparable to other non-salary benefits in Romania. According to legislation, any benefit offered above a set threshold must have social and health contributions applied according to the current tax code. However, in exchange for ESOP, no social or health contribution rates are applied. The only tax implications are related to the gain obtained from the sale of shares and the preferential price or zero, depending on how the shares were issued. However, this tax is applied only at the time of sale. Additionally, another tax obligation is represented by the tax on dividends from options over the years (Wirama, 2024).

The cost analysis regarding the implementation of the non-salary benefit is conditioned by how the subscription is intended to be made. If the subscription of shares is done at a preferential price that the employee must pay for a share, this being lower than the market price of a share (Qabajeh et al, 2024). Besides the lower implementation cost, certain risks also arise. Employees may not be as motivated to participate in such a plan, as it involves a risk. The main risk identified by the employee is that the market price of the shares may fall below the price paid by the employee, especially if the plan includes a period during which the employee cannot sell (Quang, 2025). This condition is essential, as if it is not included in the plan, it leads to a possibility of speculation, where the employee may sell immediately just out of a desire for profit, potentially destabilising the confidence of other participants in the capital market. Similarly, the number of shares an employee can subscribe to at a preferential price or receive for free must be limited, due to market volatility considerations (Dhingra et al, 2024).

One aspect that the financial institution should consider is the number of subscribed shares, as it must operate under a maximum scenario, where all employees meeting the criteria wish to participate in this Employee Stock Option Plan (Fan et al, 2022).

2. Research methodology

Information was collected through interviews. These interviews were subsequently transcribed for processing within qualitative research. The main purpose of the interviews was to query people's perceptions of the ESOP plan and associated costs. The interviewees were individuals from banks in Romania. Dispersion was achieved through interviews at various hierarchical levels, from middle management to directors. Additionally, to gain a broader overview, interviews were conducted with individuals from different banks. The structure of the interview was the same for all participants, based on 13 discussion topics. Each topic was developed more or less depending on the interviewee.

The total number of interviews is six, all of whom are from the financial-banking environment, specific to the research in question.

The cost of employee stock option plan (ESOP) was a key topic in the interviews, highlighting its impact on talent retention in the banking sector. Participants discussed their willingness to engage in such programs, the optimal structure of the stock option package, and the appropriate target audience for distribution. Conditions for participation and the voting rights associated with the shares were also important themes, emphasising the need for transparency and organisational accountability.

Additionally, perceptions of risks and the influence of ESOPs on organisational culture and financial performance were crucial for understanding the benefits and challenges associated with this compensation model.

NVivo is the software that helps researchers adopt qualitative research to analyse and organise information to identify unstructured information. The software allows for identifying connections between terms modelled through its examination and search functions. The version of the software used is NVivo 15.

Each interview was transcribed and subsequently coded for use with NVivo software. The first step was to create a Mind Map in NVivo based on the nodes that will be used in coding. Queries after import consisted of using Word Cloud and Tree Map, graphical query functions with the help of NVivo software, for a perspective on keywords in qualitative research. After creating and analysing the terms, they were extracted for use and interpretation.

3. Results and discussion

Based on the interviews and the overview created from them, the results are conclusive; individuals in the sample have similar opinions. The interview results showed a very high openness to participating in an ESOP plan. This plan is seen as a very attractive alternative for the staff of a financial institution, especially for the transparency and much better communication between employees and top management. The development of corporate governance within financial institutions seems to be a primary aspect that employees observe, as they want to be informed about management decisions and well-informed about future perspectives. Sustainability and continuity of operations appear to be subjects of interest, and ESOP can be a way to address this need. Thus, this bonus method has a long-term business improvement perspective by addressing and basing itself on two aspects. Staff is much more motivated, and talent retention within the company is higher, but it also addresses the issue of transparency and good communication at any hierarchical level.

Most respondents believe that an ESOP plan improves employee retention; however, for stable, long-term employees, it may not be a solution, as they are already loyal to the financial institution. Nevertheless, all respondents were open to participating in such an ESOP plan.

Respondents hold positions ranging from middle management to top management. They believe that the individuals who should be in the target group are top management staff and key employees for the development of the financial institution.

The costs of implementing such a plan are high; in addition to the subscribed amounts that the financial institution must bear, administrative costs are also added. The administrative process can be very costly, depending on the scale and size of the participants. Administrative costs consist of costs from the initiation of the plan to its implementation.

Most interviewed employees preferred not to be required to sell shares when they leave the financial institution. The obtained shares are seen as a passive income source through future dividends in which they will participate, as well as the increase in value and profit from selling them after a period, even if this situation is closely linked to the performance of the enterprise. Thus, employees desire shares with voting rights in the

General Shareholders Meeting and not preferential shares. This condition is important for them, as it actively contributes to the decision-making within the institution and can lead the company to greater profits. Additionally, from the perspective of increasing transparency and developing sustainable governance of the enterprise, based on communication and employee participation in board decisions, organisational culture grows as there is a trajectory and growth perspective within the financial institution.

The risks of implementing such a plan are significant. The greatest risk identified in the interviews is the risk that employees will not subscribe to the shares provided in the plan. Target group employees identify the risk that the period during which they are not allowed to sell the shares purchased at the preferential price may be so long that the market price may drop below the preferential price. They assess this risk before deciding whether to participate in this human resources department project, which aims to retain and engage employees.

Additionally, for the financial institution, such a project, if realised, can be a significant signal for other investors. Besides the costs borne by the company for implementation, these costs can be significant for the results of the cycle in which implementation is proposed.

Implementing an ESOP plan thus encompasses two costs: a financial-administrative cost and a psychological cost if it is unsuccessful among employees. Regardless of the success rate of implementing this employee bonus model, the costs remain stand-alone and are not directly proportional to the project's success rate. Fixed costs do not change based on participants; the only directly proportional costs are direct costs, which, however, do not carry significant weight in the implementation.

Moreover, the effect in case the plan is unsuccessful is very important; this endeavour is referred to as the psychological cost. If the company is listed on a market, the share price may suffer. All this information is public, so existing investors are aware of the success or failure rate of the new capital subscription through the ESOP plan. If the company's own employees, who have "in-house" information about the situation and performance of the company in the medium and long term, can be a red flag for them. This event can lead to a decrease in confidence in the solidity of the shares, and a large supply in the market will automatically lead to a depreciation of the price.



Figure no. 1: Word Cloud export

Source: Author's own elaboration, export NVivo 15

The graphical representation of the Word Cloud shows the distribution of words collected through the interviews. The most frequent words refer to the financial institution, employee, risk, and costs. While the words related to the financial institution and employee were as expected, as they represent the subject of all discussions, the words cost and risk lead to the possibility of implementing the ESOP plan within financial institutions. The costs associated with implementation can be very high, depending on the size of the project and the possibility of implementation based on the shares that will be subscribed. Fixed costs are mainly composed of the consultant hired for implementation. This consultant is the current workforce support within the company, which has a cost in terms of salaries. The smallest costs are represented by the fees related to the procedures carried out for the legality of the project according to the legislation of each country where it is to be implemented. Another significant but variable cost is represented by the amount to be subscribed. If the model of distributing shares for free is chosen, the financial institution must fully cover the subscription amount of the shares. If the shares are sold at a preferential price, the institution must compensate the difference between the preferential price and the price of a share at the time of subscription. Additionally, at the time of designing the plan, it cannot be clearly identified who will be chosen to participate, so the number of participants depends on each employee's preferences. Thus, from these two perspectives, the cost of subscribing to shares represents a variable cost. The correlation found through the use of NVivo software shows that the most frequently used words are: employee, costs, risk, shares, and financial institution. These words best define what an Employee Stock Ownership Plan (ESOP) means for a bank or financial institution. Implementing this plan, which is a type of non-salary benefit, primarily involves costs and risks. Resources and time must be invested first, along with all the associated risks, before reaching implementation. After this stage, a financial institution can discuss shares and the benefits for individuals involved in such a project. Interviewees emphasised the importance of understanding what implementation means and the situations the company faces to achieve expected results. This is evident in the graphical representation, as all benefits related to transparency and improved corporate governance are directly linked. The most significant benefits noted by interviewees were retention and performance. From this, we see a connection between implementing an ESOP plan, with all its mentioned requirements, and the performance it brings to the company through its employees. Participants defined company performance in terms of visible financial results in financial statements and the overall well-being created within the banking institution. Besides these two critical components, shareholders are directly interested in profits, while employees focus on their financial situation and workplace well-being. An aspect that lies between these two perspectives is corporate governance, which, in the case of an ESOP, relies on transparency and shared decision-making for performance and the development of the financial institution.

esop	company	employee	program	condition	long	stock	contrib	culture	direct	distrib	dividen	essent	genera
				consider	optimal	accept	hierar	motiva	objecti	opinion	opportu	particip	particip
	costs	financial	retention				appropri	implem	pensic	retirem	rights	role	sell
				decision	organiza								stability
institution		performanc	sector			assemb	incom	plan	strateg	transp	voting	way	willing
	risk			external	perspect	audienc							
		banking	sharehol	feel	source	capital	influen	proport	talent	yes	align	areas	arose
											balanc	benefic	clear
employees	shares						leave	regard	target	additi	base	com	consi
		internal	believe	impact	sources		commit			advan	beco	com	consi
						contribu	level	requir	term	advan	beco	com	consi
										aligne	benef	con	corre
													critical
													data

Figure no. 2: Tree map export

Source: Author's own elaboration, export NVivo 15

For a clearer identification of the words used in the research, a Tree Map graphical analysis was also generated using NVivo. This graphical representation shows much more clearly that, in addition to the words related to the subject, the aspects addressed in the interviews were linked to costs and the risks that such an ESOP carries. Additionally, the word performance can be identified with a significant weight; thus, according to the interviews held, a causal relationship is identified between the implementation costs and the increase in the performance of the institution, as well as of each employee participating in such a plan. The Tree Map illustrates the spread of the most commonly used terms and shows the correlation between costs and benefits of ESOPs in financial companies. One of the frequently mentioned words by interviewees was risk. Risk was defined from two perspectives: first, the risk that the ESOP may not succeed and that people may not want to participate, and second, a personal risk. This personal risk is seen as possible when it comes to a stock package at a preferential price. The details and implications of the ESOP plan can decisively influence individuals' decisions to participate or not. Interviewees stated that they cannot conduct a detailed market analysis over a medium-term horizon, defined as five years. During this period, the shares of a listed company can drop significantly, potentially leading to a price in five years that is lower than the price at the time of employee subscription. Throughout this time, participants in the plan cannot decide to sell their purchased shares to avoid creating speculation around these stocks, focusing instead on the company's development. When a financial company wants to implement such a project within its organisational culture, interviewees believe it would be beneficial to also present a development plan for this period. A budget for each participant should show how the funds raised through this external source are invested. This budget and plan must include an analysis of the cash flow generated from the attracted investments. This strategy can help employees decide whether to buy shares at a preferential price in the medium and long term. The only risk that neither the employee nor the issuing company can control remains the market and economic conditions during the execution of this

plan. The topics discussed in the interviews were concise to address the research questions. However, participants raised a point that was not covered by the research question. An ESOP can serve as a tool for salary growth through dividends for targeted staff. This tool can lead to reduced costs for a company by comparing salary contributions and taxes with the lower taxes imposed on dividends. Besides implementation costs, there is also a perspective of reducing expenses while increasing employee compensation, which leads to higher productivity and talent retention within the company.

Conclusions

The study conducted on the Employee Stock Ownership Plan (ESOP) highlights the complexity and importance of this tool as part of the non-salary benefits package aimed at motivating and retaining employees in financial institutions. Although implementing an ESOP involves direct costs, such as subscribing to new shares and administrative expenses, these costs are offset by the long-term benefits it brings. The ESOP not only provides a financial incentive but also contributes to creating a sense of belonging and ownership among employees, which can significantly improve productivity and retention rates. All interview participants were open to joining such a plan. They believe it can positively influence both individual and company performance. They view the ESOP as a non-salary benefit that could convince them to stay with the financial company in the long term.

An essential aspect of the research is that transparency and effective communication between management and employees, facilitated by the ESOP, contribute to the development of a positive organisational culture. This is crucial for the long-term sustainability of the institution. However, there are associated risks, such as market volatility and costs related to unsuccessful implementation, which can influence employees' decisions to participate in the program.

The study emphasizes that while the initial costs of implementing an ESOP can be significant, the benefits can outweigh these expenses. Strategic management of this program can create a win-win situation for both parties, where both employees and the organisation benefit, thus contributing to sustainable growth and gaining a competitive advantage in the market. In conclusion, the ESOP represents a valuable opportunity for financial institutions to motivate their employees and strengthen their market position through an approach that integrates both financial and cultural aspects. Interview participants were very attentive to the implementation costs and were concerned about the conditions that the employer might impose at some point for an ESOP.

Future research could analyse the performance of financial institutions that implement such a project. While the current analysis has focused on the costs of implementation, future research could quantitatively assess the results of financial institutions where the ESOP has been implemented, compared to similar institutions that have not adopted this type of incentive. Additionally, it could quantitatively examine how performance has evolved year by year to see the comparative impact of the implementation moment.

In a banking interview focused on employee stock option plans (ESOPs), several research limitations can arise. One major challenge is finding suitable participants, as banking professionals often have busy schedules that make it difficult to arrange

interviews. Furthermore, potential interviewees may hesitate to participate due to worries about confidentiality and the sensitive nature of the topics being discussed, which can result in a reluctance to share their insights.

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