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Effect of Employ Stock Option Plan (ESOP) on Company Performance with Good Corporate Governance as Moderation

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Abstract:

This study aims to obtain empirical evidence regarding the effect of execution prices and employee stock option plan (ESOP) on Corporate Performance with GCG as Moderation. The inconsistency of the results of research conducted on execution prices and employee stock option plan (ESOP) on Corporate Performance motivates to conduct research again. Inconsistent research is due to other variables that moderate the relationship between execution prices and employee stock option plan (ESOP) on Corporate Performance, namely GCG. The population in this study were manufacturing companies listed on the Indonesia Stock Exchange (Highlights Company OJK publication Profile) throughout 2002 - 2016. The sample collection technique used purposive sampling. The number of companies sampled is 13 companies with 39 years of observation. The analysis technique used is Moderated Regression Analysis (MRA). Before being analyzed using MRA, the GCG factor section was analyzed using factor analysis, and obtained managerial ownership was a variable that was able to represent GCG. The regression model has also passed the classic assumption test. The test results show empirical evidence that (1) the price of execution has a positive effect on company performance; (2) employee stock option plan (ESOP) has a positive effect on company performance; (3) managerial ownership is not able to moderate the relationship between execution prices on company performance; (4) managerial ownership strengthens the influence of ESOP on company performance.

Keywords: Execution prices, employe stock option plan, GCG, corporate performance

1. Introduction

Company performance is an important issue, especially in the era of globalization, where information is needed by the company's stakeholders, and this information can be seen from financial statements. Companies are required to continue to improve their performance not only to maintain their going concern but also to be able to win increasingly fierce business competition.

Indicators that are often used to assess company performance are the rate of return to the owner and the value of the company. Achieving high returns and increasing company value can be realized if there is good cooperation between shareholders (principals) and management (agents). But in practice, the integration of the interests of both parties is difficult to achieve so that problems arise, known as agency problems.

Conflicts of interest between principals (shareholders) and agents (managers) can affect company performance. To minimize the conflict, the owner must be willing to pay monitoring fees or prevent costs from management. In addition, owners can limit their divergence of interests by providing them with a decent level of incentives. One of the many examples of providing decent incentives as a prevention of conflicts of interest between owners and management is the implementation of employee stock ownership programs or often referred to as the Employee Stock Option Plan (ESOP).

The ESOP program provides rights or options for employees to be able to buy or obtain company shares at the specified time, in a certain amount and at a certain price (hereinafter referred to as execution price), which was determined at the beginning of the adoption of the program (Putro, 2009). According to the research of Irmadaryani and Dian (2012), with the ESOP the employee works with his best performance not only as an employee but also as a company owner. Supported by Santhi and Astika's research (2015) there were differences in company performance before and after the ESOP grant.

In addition, the owner of the new stock option can buy the shares of the entity at the execution stage with prices that have been set up in advance or at the time of the announcement (Kartikasari, 2015). When granted to employees, stock options have a value, namely the strike price or the price of execution. The price of execution is the price of

implementing a stock option at the execution stage.

One of the ESOP functions is to support the occurrence of Good Corporate Governance (GCG). This is because there is one mechanism in Good Corporate Governance (GCG), namely managerial ownership, and ESOP is one form of managerial ownership (Wikrami, 2016). ESOP ownership raises feelings of belonging within employees, so that performance will increase. This has an impact on the thinking of employees not only seeing short-term earnings, but also maintaining the company's image and going concern. In order for the company's operations to continue well, the company also implemented other GCG mechanisms, namely the audit committee. The existence of an audit committee keeps employees under control when running the company's operations.

The mechanism of good corporate governance is an indirect tool for the principal to control agency costs incurred by the agent. This is so that the company is able to produce financial reports that contain quality earnings information. According to Velnampy (2013) even though management has ownership of the company with the ESOP, management will not always act in accordance with the interests of the owner of the company. Therefore, a control is needed where the role of monitoring (monitoring) and controlling (supervision) can direct the objectives accordingly. GCG is one of the ways that company owners do to ensure that management manages the company well and works in accordance with the right governance mechanism.

The population used in this study are all manufacturing companies listed on the IDX. The manufacturing company was chosen as the population in this study because the manufacturing company is a type of business that is growing rapidly and is the most listed on the IDX. Manufacturing companies are also required to be more effective in publishing their company's financial statements in the face of the era of free competition, to facilitate financial statement users who have an interest in this matter (Ambarwati et al., 2015).

2. Literatur Review

2.1. Agency Theory

This research focuses on the relationship between the two parties, namely the relationship between the shareholders (principal) and the manager (agent). Agency relationships require agents to account for their efforts to shareholders by providing periodic reports to the principal regarding the business being carried out and superiors in this case stakeholders will assess the performance of the manager through annual report that has been done. The purpose of agency theory is to create efficient contracts between shareholders and management. Cooperation agreements between principals and agents contain rules regarding the way the distribution of results between the two parties, in the form of profits or in the form of losses, returns and risks in every business transaction carried out. Based on human nature, conflicts of interest between management and owners make agents present untrue information. In the conditions of the work bond, the annual report is a suggestion of transparency and accountability of management to shareholders. The essence of this theory is the design of the right contract to harmonize the interests of management and shareholders when there is a conflict of interest.

2.2. Execution Prices

The price of execution is the price that will be set at one hundred percent of the fair market price of the stock on the date the option is given. This means that employees will realize the value of the option only if the company's stock price increases beyond the level generated by the entire growth of the stock market economy (Bapepam, 2002). The price of execution is the price of executing stock options at the execution stage. Execution prices are generally not much different from the company's stock price at the time of the announcement of stock options (Astika, 2012). This program is carried out to respect the long-term performance of employees (in a broad sense) towards the company (Astika, 2007). Giving option rights to be able to buy company shares in accordance with the amount and price of execution that has been determined, can motivate employees to perform better over time (Wiratma and Rudi, 2010). Giving option rights to be able to buy company shares at execution prices which are generally lower than the market price of the company's shares, becomes a more motivator than cash bonuses. Option rights granted to employees, can bind them to perform optimally over time, because continuous options apply as an incentive whose true value will be determined by the company's future performance.

2.3. Employee Stock Option Plan (ESOP)

The ESOP program provides rights / options for employees to be able to buy / obtain company shares at the specified time, in a certain amount and at a certain price (hereinafter referred to as execution price), which was determined at the beginning of the adoption of the program (Putro, 2009). , ESOP can be interpreted as a plan to postpone employee profits by obtaining company shares (Klein, 1987). According to Wikrami (2016) ESOP is a program of share ownership by company employees through option issuance, and option holder employees can purchase company shares at agreed prices. The currently popular Employee Stock Option Plan (ESOP) is defined by Asyik (2006) as a form of compensation given to employees, especially executive employees, to reward executives for the company's long-term performance. In general, the purpose of implementing an Employee Stock Option Plan (ESOP) according to Bapepam (2002), namely: (1) Providing rewards (rewards) to all employees, directors and certain parties for their contribution to improving company performance. (2) Creating alignment of interests and mission of employees and executive officers with the interests and mission of shareholders, so that there is no conflict of interest between shareholders and parties that run the company's business activities. (3) Increasing employee motivation and commitment to the company because

they are also the owners of the company, so it is expected to increase productivity and company performance.

2.4. *Corporate Performance*

Financial performance can be said as a formal business carried out by the company to evaluate the efficiency and effectiveness of company activities that have been carried out for a certain period of time. According to Sucipto (2003) the notion of financial performance is the determination of certain measures that can measure the success of an organization or company in generating profits. Financial ratios are the most frequently used financial analysis tools. Financial ratios connect various accounts in financial statements so that financial conditions and results of operations can be interpreted. According to Djarwanto (2001), what is meant by 'ratio' in the analysis of financial statements is a number that shows the relationship between an element and other elements in finance. According to Harahap (2008), financial ratios are numbers obtained from the comparison of one post to the financial statement post with other posts that have a relevant and significant relationship. From this definition, financial ratios must show a systematic relationship in the form of a comparison between financial statement accounts. In order for the results of the calculation of financial ratios to be interpreted, the accounts that are compared must lead to important economic relationships. In this study the company's performance is measured using the ROA indicator. ROA is one of the profitability ratios. In financial statements, this ratio is most often highlighted because it is able to show the success of the company in generating profits (Riyanto, 2001). If ROA in a company is high, it means that the company has the ability to generate profits so investors will be more confident to invest. A high ROA will result in an increase in stock prices. Return on Assets (ROA) is a ratio used to measure a company's ability to generate profits derived from investment activities. In addition, the ROA ratio is very important to assess management effectiveness in asset returns while the ROE ratio provides the extent to which investment profitability is carried out. ROA is also used to measure a company's financial performance, because this ratio has a very important meaning, which is one of the comprehensive analysis techniques. ROA ratio analysis is an analysis technique that is commonly used to measure the effectiveness of the overall operation of the company.

2.5. *Good Corporate Governance*

Good corporate governance is a system, process, and set of rules that regulate relations between various stakeholders (stakeholders), especially in the narrow sense of the relationship between shareholders, board of commissioners, and the board of directors to achieve corporate goals. While the purpose of good corporate governance is to create added value (value added) for all interested parties (stakeholders). According to Iskander & Chamlou (2000) in Lastanti (2004), mechanisms in corporate governance supervision are divided into two groups, namely internal and external mechanisms. There are several corporate governance mechanisms that are often used in research to determine their effects on earnings management, including the concentration of ownership, the proportion of independent commissioners and audit committees. The concentration of ownership in the company will make shareholders in a strong position. This shows that shareholders have control of management to demand that they report financial statements accurately. Similar to the role of the board of commissioners in carrying out the supervisory function, the composition of the board can influence management in preparing financial statements so that a quality earnings report can be obtained (Boediono, 2005).

3. Hypothesis

- H₁: The effect of execution prices on corporate performance.
- H₂: The effect of employee stock option plan on corporate performance
- H₃: The Effect of Price Execution on Company Performance with GCG as a moderating variable
- H₄: The Effect of Employee Stock Option Plan (ESOP) on Corporate Performance with GCG as a moderating variable.

4. Research Methods

The study was conducted by taking data from the annual report contained in the website of the Indonesia Stock Exchange, Highlight Company Profile published by the OJK, and the implementation time of 2002 to 2016. The selection of samples in this study used purposive sampling, where the criteria used in determining the sample of this study are: (1) Manufacturing companies listed on the Indonesia Stock Exchange which have implemented ESOP / (Employee / Management stock ownership program) in 2002-2016. (2) The company has data needed in research. Based on these criteria, there are 13 companies with 35 observation companies selected as samples.

Model 1 in this test uses multiple linear regression analysis techniques. This is done to test the direct effect of factor X (independent) on the Y factor (dependent). Model 2 testing uses the data analysis technique Moderated Regression Analysis (MRA) that maintains sample integrity and provides a basis for controlling the influence of moderator variables (Ghozali, 2016).

5. Result Discussion

Before being tested by regression, factor analysis was carried out first to determine which GCG factors were the strongest showing their influence on the dependent variable (company performance). In factor analysis is carried out 5 steps, testing KMO and Bartlett's Test, Anti-image matrices; Communalities; Total variance explained; and Component Matrix. The fourth step is shown in Table 1. It shows only managerial ownership that is able to represent the overall GCG component.

| Variable | Initial | Extraction |
|-------------------------|---------|------------|
| Managerial Ownership | 1,637 | 1,637 |
| Institutional Ownership | 0,959 | - |
| Board of Commissioners | 0,836 | - |
| Audit Committee | 0,586 | - |

Tabel 1: Total Variance Explained
Source: Primary Data, 2019

If all the initial factors are summed up, show the number of variables ($1.637 + 0.959 + 0.836 + 0.586 = 4$ variables). In the extraction section shows the number of variations or the number of factors that can be formed, in the output there is only one factor that can be formed which is 1.637. Requirements to be a factor, the value of eigenvalues must be greater than 1. The values of institutional ownership, board of commissioners, and audit committees cannot be calculated because the eigenvalues value is <1 so it cannot be a factor.

Model 1 testing is done to determine the effect of variable X (free) on variable Y (bound), this test uses multiple linear regression analysis techniques. The test results are shown in Table 2 as follows:

| Model | Unstandardized Coefficients | t | Sig. |
|-------------------|-----------------------------|-------|-------|
| | Beta | | |
| (Constant) | 0,223 | 7,014 | 0,000 |
| HE | 0,006 | 1,572 | 0,025 |
| ESOP | 0,060 | 3,477 | 0,001 |
| KM | 0,001 | 0,051 | 0,959 |
| Sig. F | 0,010 | | |
| Adjusted R Square | 0,213 | | |

Tabel 2: Multiple Regression Analysis
Source: Primary Data, 2019

Based on Table 2 the constant coefficient value of 0.223 indicates that if the value of the variable HE, ESOP, and KM is zero, then the value of the KP is 0.223. HE regression coefficient value of 0.006 indicates that the value of HE rises 1 percent, KP increases by 0.6 percent. The ESOP regression coefficient of 0.060 indicates that if the ESOP value rises 1 percent then the KP rises by 6 percent. The coefficient value of KM of 0.001 shows that if the value of KM rises 1 percent, KP food rises 0.1 percent. In Table 2 seen unstandardized beta HE value 0.006 with a significance value of 0.25 smaller than $\alpha = 0.05$, which means that HE partially influences the performance of the company. ESOP variable is positive which is equal to 0.006 with a significance value of 0.003 smaller than $\alpha = 0.05$, which means that partially ESOP has an effect on company performance. The KM variable is positive 0.001 with a significance value of 0.959 greater than $\alpha = 0.05$, which means that KM partially has no effect on company performance. The results showed a significance value of F of 0.010 smaller than $\alpha = 0.05$, which means the model used in this study was fit (fit). This shows that HE, ESOP, and KM together are able to predict or explain company performance. The amount of the Adjusted R Square value is 0.213. This shows that the company's performance can be explained by the execution price, employee stock option plan, and managerial ownership of 21.3 percent, while the remaining 78.7 percent is explained by other variables outside the research model. The results showed a significance value of F of 0.018 smaller than $\alpha = 0.05$, which means the model used in this study was fit (fit). This shows that LK, KM, and KA, together are able to predict or explain earnings management. The amount of the Adjusted R Square value is 0.219. This shows that earnings management can be explained by financial statement disclosure, managerial skills, and audit quality by 21.9 percent, while the remaining 78.1 percent is represented by other factors not listed in this study.

Model 3 testing shows the effect of moderating variables namely managerial ownership on the direct influence of the dependent variable on the independent variable. Previously, the determination of the moderating variable was determined through factor analysis.

| Model | Unstandardized Coefficients | t | Sig. |
|-------------------|-----------------------------|-------|-------|
| | Beta | | |
| (Constant) | 0,241 | 0,881 | 0,085 |
| HE | 0,007 | 0,166 | 0,049 |
| ESOP | 0,309 | 1,861 | 0,032 |
| KM | 0,015 | 0,058 | 0,054 |
| HE*KM | 0,001 | 0,019 | 0,085 |
| ESOP*KM | 0,241 | 1,507 | 0,041 |
| Sig. F | 0,020 | | |
| Adjusted R Square | 0,220 | | |

Table 3: Model 2 (Path Analysis)
Source: Primary data, 2019

Table 3. shows the results that H3 is accepted and H4 is rejected. Managerial ownership is said to be able to provide an influence that is strengthening the ESOP relationship on company performance, but is not able to moderate the effect of execution prices on financial performance.

When granted to employees, stock options have a value, namely the strike price or the price of execution. The price of execution is the price of implementing a stock option at the execution stage. This means that employees will realize the value of the option only if the company's stock price rises above the level produced by the entire growth of the stock market economy. During the waiting period from one stage to the next, the rights holders tend to make various efforts to increase the market price of the company's stock so that the potential profitability of stock options becomes even greater. The price of execution will greatly affect the potential profits earned. The high and low prices of execution will be responded by employees. If the company's stock price increases in the year after the grant, then the employee has the potential profit because it will buy shares at a price below the market price. For employees, this execution price provides incentives to improve their performance which has an impact on improving company performance. The application of ESOP can reduce agency cost, by increasing the company's share ownership in employees, then employees will be able to directly feel the consequences of the actions taken by them towards the company. This ownership can indirectly align the interests of employees with the interests of shareholders.

The execution price set by the company will be of concern to employees, because the high and low prices of execution affect the profits they receive. The results of this study are not able to prove the moderation of managerial ownership on the effect of execution prices on company performance. The high and low execution prices given by the company affect the shares executed by the employee, the higher the price set by the company, the employee will delay the execution and vice versa if the execution price is low then the employee will execute the given stock option. The average execution price above 50 percent is able to influence the performance of the company, but the managerial ownership level of only 1.47 percent is not able to provide an influence on the direct influence. The level of managerial ownership that is not high enough is not able to provide the effect of strengthening or weakening the direct influence given by the execution price on the company's performance.

A conflict of interest between the owner and management can affect the company's performance. To minimize the conflict, the owner must be willing to pay monitoring fees or prevent costs from management. In addition, owners can limit their divergence of interests by providing them with a decent level of incentives. In positive accounting theory it is stated that bonuses that will be given to agents from principals can motivate agents to work better. But on the other hand, this concept can also bring managerial fraud in the form of earnings management.

Earnings management arises because of the emergence of opportunistic attitudes of managers towards bonus compensation programs. This manager's opportunistic attitude leads to a potential profit or expected return called the intrinsic value of stock options. With the ESOP the manager feels that he already has a company so he tries to increase his potential ownership by influencing the market price of the company's shares (Wikarmi, 2016). Employees who have adopted ESOP no longer act as employees but also act as owners or investors so that they will work as well as possible to improve company performance. With the ESOP program in the company, management's share ownership will increase. The higher the ownership of shares owned by management, the smaller it is possible for them to take deviant actions and harm the company because they feel they own the company too. Then it can be concluded that the higher managerial ownership will strengthen the influence of ESOP on company performance.

6. Conclusion and Recommendation

Based on (1) the hypothesis and (2) the results of the test, a number of important things can be concluded. First, the researcher conducted a factor analysis to find out which variable was the strongest to represent the other variables. From the four GCG mechanisms, namely managerial ownership, institutional ownership, board of commissioners, and audit committee, researchers found that managerial ownership is a variable that can represent the overall GCG mechanism.

Execution Prices have a positive effect on company performance. Low execution prices make employees more interested in participating in the ESOP program. Employees will be increasingly motivated to improve their performance if the execution price set by the company is low, whereas if the execution price set by the company is high, the employee's interest in participating in the ESOP program will decrease. ESOP has a positive effect on company performance. The existence of a stock ownership program by these employees, will motivate employees to improve the quality of their performance, companies will feel they have a company so that the level of labor productivity in the company will increase in accordance with the desired target of the company.

Managerial ownership is not able to moderate the effect of execution prices on company performance. The existence of high managerial ownership does not affect the direct effect caused by the existence of high execution prices on company performance. Managerial ownership strengthens the influence of ESOP on company performance. ESOP is one form of managerial ownership that can be done by the company. In addition to increasing ownership in employees, ESOP is also able to make employees have more adequate productivity which will ultimately improve company performance.

There are several limitations in this study so that development and improvement are still needed to obtain better research results in subsequent studies. Some suggestions that can be submitted are as follows. (1) The implementation of the ESOP will attract many investors to invest. In addition, it will encourage employees to perform more in a long period of time, namely during the implementation of ESOP, so that employees feel or become the owner of the manager, so they will work like taking care of their own. (2) This study uses moderating ownership managerial variables, further research can use other moderating variables such as audit quality, independent ownership and institutional ownership to get more results that have a more significant influence.

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