Employee Equity Plans: Do They Have a Future?

A Collaborative Research Initiative Among PARC, WorldatWork and Hewitt New Bridge Street
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Rewarding employees with equity through share plans has been a cornerstone for many companies in the past several decades. Recent economic events have, however, once again demonstrated that investing in equities is not for the fainthearted. Indeed, as the often-seen disclaimer says: Past performance is no guarantee of future performance.

Today, millions of workers are enrolled in broad-based share plans that take on many forms: options, restricted shares and stock purchase plans — to name just a few of the most common. How relevant are these plans today? Do they still represent good value — either for the employee or the company? Do these plans help align employee and shareholder interests?

Stock options come with a profit-and-loss (P&L) cost that places them on similar footing with cash compensation. While cash is easy to understand for employees, the movements in the value of equity-based compensation are usually outside of their control and may appear mysterious.

So, is there a future for employee stock plans? This report considers the arguments for and against the continued use — or even expansion — of these plans. The focus is on the use of share plans below the executive level, whether these are the tax-advantaged broad-based (or all-employee) plans available in some countries, or management plans that are extended to employees at lower levels in the organization. Three types of share plans are considered: options, restricted (or free) share awards and employee stock purchase plans (ESPPs).

This report provides a thorough assessment of the current state of broad-based plans: How did we get here? Where are we now? Has the external environment changed? Have employees lost (or will they soon lose) interest? Are companies losing enthusiasm?

The effectiveness of broad-based plans is considered as well as whether they provide efficient rewards. Also, how do companies view the plans going forward? Suggested actions are provided for those organizations wishing to enhance the perceived value of their offering.

The report draws on research conducted during the second quarter of 2009, including a survey of 800 companies’ practices, case study interviews with selected organizations and a review of published academic findings. The report also contains background histories of equity plans in the United States and United Kingdom and a schedule of the current tax incentives offered around the world.

This project has been a collaborative activity between U.S.-based WorldatWork, and two UK-based organizations: PARC and Hewitt New Bridge Street. Collectively, the three organizations have a substantial global client base and extensive experience of employee share plans from several different perspectives.

1 Although certainly part of the context for broad-based plans, executive stock-reward arrangements are not the focus of this study.
Executive Summary

The history of employee equity plans is a story of successive broadening of eligibility, from shareholders to managers, from managers to home-country employees, from home-country to overseas employees. Today, in excess of 35 million employees worldwide own shares in their employing companies.

The types of share plan can be grouped into three broad categories: options, restricted shares (aka free shares), and employee share purchase plans (ESPPs), including discount/matching plans and savings-based option arrangements. Each has its own characteristics including differing reward and risk profiles. The degree of employee risk also is affected by the applicable tax treatment.

The survey of company practice was conducted in the second quarter of 2009 and sought information on prevalence, rationale, application, performance links and future intent. The key finding was that, despite the current economic circumstances, most companies that operate stock plans have no current intention of substantially changing plan provisions or eligibility. Other findings indicate that eligibility has declined for option plans (with more than three-quarters of such option plans presently underwater), has increased for restricted shares, and is broadly constant for employee purchase plans.

The external environment is now less overtly supportive of broad-based plans. Governments, while continuing to be supportive, are unlikely to provide further initiatives to promote wider employee share ownership. Ensuring global share plan compliance can be costly, especially where there are large numbers of internationally mobile employees. Direct plan costs are charged to P&L and there is no longer a “free accounting ride” for share options. And, of course, companies must manage their cost priorities very carefully, especially during a time of recession.

Recent events have seen some employee shareholdings significantly reduced or even wiped out. They provide a reminder that:

- Investing in the stock of a single company is a high-risk venture.

- Most employees have no personal influence over the share price performance of their company.

- “Cash is king” for most employees.

- Global plans have exchange rate risk.

Regrettable though it undoubtedly is that the value of most employee share plans severely declined from November 2008 to November 2009, this largely reflects a global event — the financial crisis — rather than the failure of share plans per se. While these events have affected employee sentiment, it is important to remember that these plans are intended to generate participation over many years and short-term volatility (no matter how extreme) is a feature of any type of equity investment.

The case studies in Appendix I illustrate how companies value the benefits that equity plans bring to their businesses. They can help create alignment between the company and employees. They can promote identification with the employer and cohesion across businesses and countries. They may provide a useful way for employees to accumulate capital. Although research evidence that they directly affect behavior is mixed, companies report that the plans help educate employees about the need to perform well, adapt to the market and create shareholder value. In short, they give employees a stake in the future that cash rewards do not.

Broad-based stock plans currently have something of a “hybrid” role within the rewards package: They are part reward and part benefit. They have been around for some years and can become “part of the wallpaper” rather than a vibrant part of the package. In the current environment, employers may want to step back and consider how they wish to use them going forward. There are three potential outcomes of such a review:

- Withdrawing from broad-based plans
- Continuing “as is,” but ensuring effectiveness
- Enhancing their value and reach.

Each may be an appropriate and legitimate response to particular circumstances, the nature of
workforce, and employment offers and priorities.

Three main factors have been identified that may help inform the assessment. First, the context in which most plans were introduced has changed radically. Equity markets have stopped booming, and the effects of the recent financial crisis have diminished the value of plan holdings for many individuals. Second, many governments and companies are wrestling with how to reframe retirement provisions to address longevity and reduced capacity for both public- and company-funded pensions. This has thrown greater emphasis on the need for individuals to understand their new responsibilities and find ways to accumulate capital, with equity plans potentially playing a major part. Third, as companies have become more international and their workforces more interconnected, organizations need a framework within which to remunerate employees equitably. Do employee equity plans have a future in this new world?

While for some organizations a decision to discontinue stock plans may be appropriate, our conclusion for most is that broad-based plans can be more than just competitive market positioning. They can help create an aligned and receptive climate in which the various tools for motivating staff have stronger power. Various suggestions are made about how the value of the plans can be maximized: improving financial education, communicating plan performance, raising the value appreciation of shares and options and reviewing the critical mass of participation.

As stated, employee stock plans represent a good way of helping employees accumulate capital. This is particularly important in economies in which individuals are responsible for developing financial security. To do this effectively, employees need to understand the benefits and risks of the various savings vehicles open to them and be able to make appropriate investment choices. Given the market volatility of recent times, companies should re-examine whether they are equipping their people to carry the financial responsibilities being passed to them. Providing both the tools (a broad-based equity plan) and the know-how (financial education and communication) can benefit companies, economies and society as a whole.
1 | Background
How Did We Get Here?

The Growth of Employee Share Plans

The origin and growth of employee stock plans is largely a story of actions taken to bridge perceived gaps between the various parties involved in the performance of publicly owned companies. Initially, the primary focus was on the relationship between the company’s owners/shareholders and management. The aim was to address the “agency issue” and ensure that management actions were aligned with shareholder interests. The result was the inclusion of an equity element in executive compensation.

In the United States, stock options were first offered to executives in the 1920s. In the past 20 years, however, equity has become a global practice and now forms the largest element of the executive compensation package in many U.S. companies.

In more recent decades, equity has been used to address a perceived gap among shareholders, management and employees. It was still about shareholder alignment, but also included employee engagement. For the UK government, a stated rationale was to raise the productivity and efficiency of national industry. In France, a key theme was profit sharing and worker financial participation. In the United States, it also was about profit sharing and participation via ESPPs.

Underlying these perspectives was the belief that it was in the interests of shareholders, companies and the economy that employees at all levels identify more closely with the goals of their organizations. The vehicle for promoting such identification was employees acquiring shares in their company and thus themselves becoming owners.

The growth of broad-based share plans also was significantly encouraged by accounting and tax treatment. The accounting treatment of stock-based awards meant that, until recently, the cost was not fully reflected in the income statement. In addition, when funded by new shares, option plans would generate cash for the company at exercise. In a bull market — and perhaps more notably among high-growth technology companies — stock option plans became both an attractive feature of the rewards package and a way of conserving cash as constrained base salaries were augmented with option grants.

Tax breaks have applied to stock options in many jurisdictions (albeit at an increasingly modest level). Tax regulations also have been of prime importance in encouraging participation in stock plans by requiring employees to contribute or save on a regular basis. Among others, favorable provisions apply in the United States, France and the United Kingdom. National tax regulations have shaped the savings-plan vehicles in each of these countries. The combination of tax breaks, bull markets and privatization campaigns encouraged large numbers of employees to join the plans. As a result, by the 1990s broad-based share plans had become a regular part of the rewards package for larger private-sector employers and a primary tool for attracting and retaining employees.

By the millennium, the pace of globalization had quickened. Following the collapse of communism in Europe and the change of economic approach in countries like China and Vietnam, it became apparent to many companies that their principal growth markets now lay outside North America and Western Europe. New subsidiary companies would need to be formed in many territories and high-caliber employees recruited. At the same time, many industries were consolidating through mergers and acquisitions. These organizations would comprise employees from more than one firm and it would be important to speed up employee identification with the acquiring or merged company. Stock plans were seen as a good way of integrating employees from different legacy organizations.

Many global companies initiated programs to extend employee ownership beyond those few countries that initially championed it through tax breaks. Once ways were found to overcome the legal or securities issues of jurisdictions, employee stock ownership could become global. Innovative communications with prominent branding symbolizing the new organization often were a feature of such launches, which offered employees the opportunity to share in future success. Furthermore, given the increasing emphasis
on diversity and inclusion in the corporate environment, excluding a significant proportion of employees from becoming shareholders was no longer appropriate for many companies.

Through these programs, Western multinationals helped bridge the gap between employees in the home country and those in the rest of the world. As share plans were introduced into the local market by multinationals, prominent national companies in countries like India and China implemented their own plans — thus blurring a distinction between locally- and foreign-owned companies.

As a result of all these actions, employee share plans have become a common feature in the rewards package of public companies around the globe. The U.S.-based National Center for Employee Ownership (NCEO) estimates that in 2006 approximately 25 million Americans held stock in their employers. This represents approximately one-third of all employees working in for-profit organizations in the United States.

The 2008 survey by the European Federation of Employee Share Ownership estimates that, across Europe, approximately 9 million employees hold shares in the companies for which they work, with more than 3 million in France, 2.5 million in the United Kingdom, and 1 million in Germany.

Appendix III contains a more detailed description of the growth of share plans in the United States, the United Kingdom and internationally.

The Principal Types of Employee Plans

Although shape and participation rates vary across countries, share plans can be grouped into three broad categories:

- **Share options**
- **Restricted/free shares**
- Employee share purchase plans, including discount/matching plans and savings-based option arrangements.

Each plan category has advantages and disadvantages: plan complexity, tax treatment, cash flow impact, retention effect and so on. Specifically regarding four features:

- **Automatic or voluntary enrollment.** This affects the extent of participation across the eligible employee population. Where employees must choose to contribute or save on a regular basis to buy shares, a proportion of employees will decline the offer. As a result, assuming equivalent eligibility, coverage usually is narrower in the voluntary saving plan arrangements.

- **Risk to the employee.** Like any equity stake, employee plans contain an element of risk. Global plans also contain exchange rate risk. The degree of risk depends on several factors including whether the employee has had to contribute financially to the shares awarded, the size of any company discount or match, the availability of tax relief and the extent to which the plans are perceived as being a direct substitute for cash.

- **Shareholder experience.** Some plans make employees shareholders at the start of the plan cycle. In other plans, becoming a shareholder is the final stage of the process and may not happen at all if the employee decides to sell immediately or not to exercise. While all plans orient employees toward the performance of the share price, some plans also provide other aspects of the shareholder experience such as business communications and receipt of profits via dividends.

- **Cost to the employer.** The company now bears the expense of the share award (at fair value) in its income statement. There also are costs relating to communication, administration, governance and compliance.

Appendix II contains a table comparing the types of plans across these four features. For clarity, the ESPP category is split between discount/matching plans and savings related option plans.

In summary:

- Share option plans can have broad employee coverage and may be perceived as having little downside risk to the employee (i.e., although participants may not make money, as there is no compulsion to exercise, they can avoid losing money). Share price volatility can generate big swings in value. Options provide only a partial shareholder experience — at least until exercise and retention of shares. The company now bears the cost based on the fair value of the award.

- Restricted/free share plans also can have broad coverage and may be perceived as low risk to the employee because they do not involve employee contributions. The company bears the cost based on the fair value of shares awarded.
ESPPs tend to have narrower coverage as the requirement to contribute may deter a proportion of employees from participating:

- For savings-related option plans, employee downside risk is low if there is no requirement to exercise. The shareholder experience is likely to be partial during the plan cycle. The company bears the cost based on the fair value of the award, which takes account of any discount.

- For discount/matching plans, the degree of risk borne by the employee depends on the size of the discount or match. The shareholder experience is the most complete, as the employee has chosen to invest in the company and may receive shareholder communications and any dividends. The employer bears the cost of the discount/matching shares based on their fair value at award.

It should be noted that the degree of risk also is affected by the tax treatment in the relevant jurisdiction. Where tax treatment is favorable, it may moderate risk (and sometimes costs), and facilitate participation. Appendix IV contains a summary of tax efficient provisions by country.
The aim of the survey was to gather information about the current state of broad-based employee share plans: prevalence, reasons for them, type, extent to which they apply globally, use of performance conditions and, perhaps most importantly, companies’ intentions about future use. The survey focused on the three types of plans described in the first section (i.e., share options, restricted/free shares and ESPPs).

The survey was conducted in the second quarter of 2009 and completed by a total of 843 respondent companies across a broad array of industries. Nearly 75% of respondents worked in companies with headquarters in the United States, 13% with headquarters in the United Kingdom, and the remainder elsewhere (mostly Western Europe). About half of respondent companies had 10,000 or more employees. Almost three-quarters had annual revenue of more than $1 billion.

Overall, Which Organizations Are Most Likely to Have Broad-Based Plans and Why

More than 70% of the organizations able to operate some type of broad-based equity plan have chosen to do so. (More than 20% of respondents indicated they cannot operate an employee share plan because they are private companies, not-for-profit organizations or government agencies.) And, aside from demographic questions like total employment, industry and region of headquarters, the remaining questions were asked only of this subset of the overall sample.

Broad-Based Plans Are Most Common Among Technology Firms

“Industry” was more important than “region” in predicting the presence of some sort of broad-based plan among participants. The indices shown in Figure 2-1 reflects the percentage of companies in the listed industry with broad-based plans divided by the overall percentage in the survey, and can be read as “times as likely.” As shown in the figure, technology firms were more than 1.3 times as likely to have some form of broad-based plan, while consumer services, industrials and consumer goods were less likely than average to have some form of broad-based plan.

Presence of Broad-Based Stock Plans Is Related to Company Size

Overall, having some sort of broad-based plan was most common among the largest companies (62% of companies with 20,000 or more full-time employees have some sort of broad-based plan). Overall data and all three broad-based plan types show a U-shaped distribution, with the smallest companies (less than 2,500 FTEs) the next most likely after the largest employers to have each type of plan, including an almost identical share for broad-based stock options. (See Figure 2-2.)
Firms Offer Multiple Types of Broad-Based Plans

Forty-four respondents offered all three types of broad-based plans covered in the study. The number of respondents with only one of the three plan types varied between a low of 40 (restricted/free shares) to a high of 76 (ESPPs). Restricted/free share plans were the least common, both individually and in tandem. (See Figure 2-3.)

Broad-Based Plans Are an Integral Part of Total Rewards/Remuneration Strategy

The smallest organizations (both in terms of total employment and total revenue) were most likely to call broad-based stock options an integral part of their total rewards/remuneration strategy.

U.S. and UK respondents were about equally likely to consider broad-based options “an integral part of our total rewards/remuneration strategy” (73%-75%),

![Figure 2-2: Percentage of Companies with Some Sort of Broad-Based Stock Plan and Type, by Number of Employees](chart-image)
and more so than respondents with headquarters in other countries (mostly Western Europe, but a small total number of respondents from other countries outside of Europe). Technology and basic materials firms were the most likely to agree with this statement. The largest divergence from the overall average was among organizations in the industrials sector; however, note that only a small response rate was received for this question. (See Figure 2-4.)

Primary Purpose of Broad-Based Plans Is Alignment of Employee, Management and Shareholder Interests

Aligning the interests of employees, management and shareholders ranks first among respondents for all broad-based plan types, but was only chosen as the primary reason by a majority of ESPP respondents. And though the precise list of most common reasons was slightly different for ESPPs, more than three-quarters of all respondents picked one of the three top reasons in each category, as highlighted in Figure 2-5. While reasons like the plan being a part of the history and culture of the company, wealth creation for employees, being a tax efficient form of compensation, and aligning employee rewards with executive rewards are potentially important considerations of having broad-based plans, they didn’t tend to be chosen as the primary reasons for the plans.

Current Situation, Recent Changes and Expected Changes in Broad-Based Plans

To provide some context, the survey also explored a variety of topics within broad-based plans regarding past, present and future of certain topics (e.g., performance conditions, pricing and value of plans, changes to the eligible population).

Substantive Changes to Pricing Strategy of Broad-Based Plans Are Not Planned in the Next 24 Months

Less than 5% of respondents indicated intentions to change pricing strategy relative to market of either options or ESPPs. However, the pricing approaches in place did substantively vary between the types of programs. Most options are offered at market value, but most ESPP shares are offered at a discount to market. (See Figure 2-6.)
Current Eligibility for Broad-Based Plans; Changes in Eligible Population in the Past Five Years

While the majority of options plans (58%) had no changes in eligibility in the past five years, decreases in the eligible population were twice as likely as increases (28% vs. 14%) among respondents. Restricted/free shares were most likely to have had a change to the eligible population (55% indicated some sort of change), with increases just slightly more common than decreases. The vast majority of ESPPs (85%) had no change in eligible population, though increases were more than twice as common as decreases in the few cases where:

FIGURE 2-4: Which of the Following Best Describes Your Company’s Philosophy Regarding Broad-Based Stock Plans, by Employment, Revenue, Region of Headquarters and Industry

Response choices: Our broad-based stock plans are an integral part of our total rewards/remuneration strategy. (Shown in this figure.) We make broad-based stock plans available to employees, but they are not considered an integral part of our total rewards/remuneration strategy.

- Represents overall average of all respondents
they did occur. (See Figure 2-7.) Despite the prevalence of underwater options present at respondent companies, more than 80% of respondents indicated having underwater options currently, but more than 80% of that group has taken no action to address this situation.

Most Broad-Based Plans Have Eligibility Restrictions of Some Kind
Regardless of type, most broad-based plans have some sort of eligibility restrictions based on some combination of employee level and location. Restriction to certain countries was most common for ESPPs, and level was the most common restriction for both stock options and restricted/free shares. (See Figure 2-8.)

Most Broad-Based Plans Did Not Have Performance Conditions Attached
Although overall most broad-based plans did not have performance conditions attached, this was true only by a slight majority in the case of restricted/free shares. Where conditions are present, they were more commonly related to individual employee performance, but followed closely by company performance. (See Figure 2-9.)

FIGURE 2-6: Which of the Following Do You Believe Is the Primary Reason Your Company Offers a _____ Plan?

<table>
<thead>
<tr>
<th>Options (N=159)</th>
<th>Restricted/Free Shares (N=155)</th>
<th>ESPP (N=201)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Percent</td>
<td>Cumulative Percent</td>
</tr>
<tr>
<td>Aligns the interests of employees, management and shareholders; it generates employee focus on share price.</td>
<td>45.3%</td>
<td>45.3%</td>
</tr>
<tr>
<td>Attract and retain employees.</td>
<td>22.6%</td>
<td>67.9%</td>
</tr>
<tr>
<td>Are necessary for competitive rewards/benefits package.</td>
<td>14.5%</td>
<td>82.4%</td>
</tr>
<tr>
<td>Are part of the history and the culture of a company.</td>
<td>10.1%</td>
<td>92.5%</td>
</tr>
<tr>
<td>Are a good way of creating wealth for employees.</td>
<td>2.5%</td>
<td>95.0%</td>
</tr>
<tr>
<td>Are a tax efficient form of compensation/remuneration.</td>
<td>2.5%</td>
<td>97.5%</td>
</tr>
<tr>
<td>Align employee rewards and benefits with executive rewards and benefits.</td>
<td>0.6%</td>
<td>98.1%</td>
</tr>
<tr>
<td>Other</td>
<td>1.9%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Percent of all reasons in:

Top 2 | 67.9% | 77.4% | 70.6% |

Top 3 | 82.4% | 84.5% | 78.6% |

Note: Reasons sorted in descending order of percentage of respondents for the options choice. The top three responses in each category are shaded.
FIGURE 2-6: Pricing Strategy Relative to Market by Type

- Options (N=154)
  - At market value: 68%
  - Some at market, some at discount: 28%
  - At discount to market value: 8%

- ESPP (N=200)
  - At market value: 68%
  - Some at market, some at discount: 24%
  - At discount to market value: 12%

FIGURE 2-8: Eligibility for Broad-Based Plans by Type (Location and/or Level)

<table>
<thead>
<tr>
<th>Eligibility Type</th>
<th>Stock Options N=136</th>
<th>Restricted/Free Shares N=144</th>
<th>ESPP N=170</th>
</tr>
</thead>
<tbody>
<tr>
<td>All employees are eligible regardless of location or level</td>
<td>24%</td>
<td>24%</td>
<td>31%</td>
</tr>
<tr>
<td>Eligibility is based on employee level</td>
<td>35%</td>
<td>44%</td>
<td>2%</td>
</tr>
<tr>
<td>Eligibility is based on location (only employees in certain countries)</td>
<td>21%</td>
<td>11%</td>
<td>55%</td>
</tr>
<tr>
<td>Eligibility is based on location of employee and level of employee</td>
<td>12%</td>
<td>15%</td>
<td>2%</td>
</tr>
<tr>
<td>Other</td>
<td>8%</td>
<td>6%</td>
<td>10%</td>
</tr>
</tbody>
</table>

FIGURE 2-7: Changes to Eligible Employee Population by Broad-Based Plan Type

- Options (N=154)
  - Yes, decreased employee eligibility: 28%
  - No change: 58%
  - Yes, increased employee eligibility: 14%

- Restricted/Free Shares (N=154)
  - Yes, decreased employee eligibility: 25%
  - No change: 45%
  - Yes, increased employee eligibility: 30%

- ESPP (N=199)
  - Yes, decreased employee eligibility: 4%
  - No change: 85%
  - Yes, increased employee eligibility: 11%

FIGURE 2-9: Does Your ____ Broad-Based Plan Have Performance Conditions Attached by Type?

- Options (N=156)
  - Yes, before granted: 24%
  - Yes, before they can be exercised (or vest for restricted/free share program): 11%
  - No performance conditions: 65%

- Restricted/Free Shares (N=154)
  - Yes, before granted: 30%
  - Yes, before they can be exercised (or vest for restricted/free share program): 17%
  - No performance conditions: 53%
Most Eligible Employees Do Not Participate in the ESPP

ESPP participation was far from ubiquitous among eligible employees regardless of revenue category. In all cases, less than 10% of respondents indicated that more than three-quarters of eligible respondents were participating. This was highest (8%) in the middle revenue category (more than $1 billion to $5 billion). However, this category also was the one for which more than half of all respondent companies had participation rates of less than 25%. NCEO's recent U.S. survey on ESPP participation also found that about only half of respondents had more than 30% of eligible employees participating, and even lower participation rates for hourly employees. (See Figure 2-10.)

With the exception of the previously discussed pricing relative to market (whereby more than two-thirds of respondents indicated their ESPP share pricing was at a discount market value), the survey did not probe respondents for information about reasons for the level of participation in their organizations.

ROI Was Very Infrequently Measured

For all plan types in place, respondents were asked about attempts to measure the return on investment (ROI) of the particular program. Attempts to measure ROI were relatively uncommon (less than 20% in all cases) and of similar likelihood across all plan types. (See Figure 2-11.)

This is consistent with the findings of other studies, such as “Rewards Next Practices,” a 2008 WorldatWork/Hay Group project with respondents from 66 countries. This study found that just 20% of organizations agreed with the statement, “our organization regularly measures the return on total reward investment.”

Short of measurement, most companies that responded to a recent NCEO survey characterized ESPP ROI as positive (30.2% “beneficial,” 35.3% an “excellent investment”), with “not worth it” at 5.1%, and “mixed results” at 29.4% as other possible responses. And while ESPPs do not tend to make up a very large share of total compensation cost (76.3% indicated associated costs as 1% or less of total), more than half of all nonhourly employees contributed 5% or more of pay to their ESPP, making them a well-leveraged piece of the compensation puzzle for many employees in companies where such plans are present.

Broad-Based Plans in Organizations

Overall, about three-quarters of respondents with at least one type of broad-based plan indicated their
organization has employees in multiple countries (though, not necessarily eligible for one or all of the broad-based plans covered in this study).

For all types of broad-based plans, more than 80% of respondents have a single plan rather than multiple plans in different countries.5 (See Figure 2-12.) Within the single-plan umbrella, differences were common. For example:

- The majority of respondents (57% in the case of options and 54% for restricted/free shares) do not grant the same award size in all countries.
- As discussed and shown in Figure 2-8, location-based eligibility restrictions were common.6 For those not offering their broad-based plans in all countries, “local barriers (e.g., local securities laws, exchange control or tax reasons)” were indicated as the reason why by 60% to 80% of respondents in all categories, which the highest occurrence for ESPPs.7 But “other” reasons mentioned were most commonly “both” too few employees and local barriers, followed by having a single-country plan because of tax-advantaged treatment in a specific country.
- Modifying plans for local tax advantage was uncommon, but may be:

- More common for plans targeted at executive/senior-level populations than broad-based plans
- Of limited utility depending on the set of countries under consideration
- Exemplified by excluding some countries.

Methodology/About the Data

Respondents were recruited via a random representative sample of compensation practitioners from among current WorldatWork premier members and supplemented by select recruitment among existing clients by PARC and Hewitt. All respondents were recruited by e-mail to participate in an online survey, and the link was included in the message. Responses were collected between May 20, 2009 and June 23, 2009.

The typical WorldatWork premier member works at the managerial level or higher in the headquarters of a large company in North America. The demographics of the survey sample and the respondents are similar to the WorldatWork membership as a whole. So in some ways the survey results can be considered statistically representative of the membership. However, it should be acknowledged that the nature of the survey request (“Broad-Based Employee Stock Plans” was the subject line of the message to WorldatWork members) likely skewed responses toward firms that have such plans, or perhaps additionally use or are considering adding them.

Participant demographics shown in Figure 2-13 reflect all respondents who answered each question listed. Respondents who indicated having no broad-based plans also were asked these questions about their organizations.

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1 This should not be misconstrued as any statement about the presence of broad-based plans in the general population of organizations. The skew toward larger companies in the universe of potential participants available to all the partners and necessary interest in the topic to decide to participate in the survey indicate the actual percentage is almost certainly lower. In the United States, the National Center for Employee Ownership (NCEO) has estimated that in 2009 there were about 3,000 broad-based stock option plans, 4,000 stock purchase plans, and more than 11,000 ESOP, stock bonus and/or profit-sharing plans invested primarily in company stock covering 11 million, 9 million, and 13.7 million employees (as of the end of 2006) respectively. (Source: “A Statistical Profile of Employee Ownership.” Updated February 2009. NCEO.)


3 One obvious reaction to having any compensation program not perceived as a worthwhile investment would be to adjust or discontinue it.
The question about having employees in countries besides the headquarters country was not asked of respondents who did not indicate having any broad-based stock plans.

NCEO’s 2009 survey in the United States regarding ESPP indicated that, where non-U.S. employees are present and eligible to participate most (77.5%) of these employees are part of “the main plan” (rather than a “mirror” plan [17.4%] or a mixture [5.2%].) Further, while extending their ESPP to “all countries” was relatively uncommon (16.5%), most companies with non-U.S. employees extend their plan to “most” (32.3%) or “some” (25.3%) countries. Only about one-quarter (26%) of respondents with non-U.S. employees do not extend their ESPP to any non-U.S. employees.

Location or location and level restrictions were present in 33% of respondents for stock options plans, 28% for restricted/free shares, and 57% of ESPPs.

The other choices were “too few employees” and “other.”
The Debate
Have Employee Share Plans Had Their Day?

Given the growth of employee share plans internationally and the findings of the survey, it may seem strange to ask whether such plans still have a viable role. However, the accounting charge of running such plans is now comparable with cash, and recent events — especially in the financial sector — have seen some employees lose most or all of their stock plan holdings. So against this background, do the plans have a future?

Has the External Environment Changed?

Not long ago, it seemed that governments were eager to support the growth of employee stock plans through tax exemptions. Major supporters appear to have become somewhat cooler, for example, apparently freezing tax exemption limits (United Kingdom) or increasing social insurance payments (France).

Although Germany has tripled its exemption limit, this is still a very modest tax break. The governments of India and Australia enacted or tabled taxation changes harmful to the effective operation of employee stock plans in these countries — although these have now been withdrawn or amended. Given the current economic circumstances of many governments, it seems unlikely that there will be an increase in fiscal support for share plans.

Following the accounting changes of the past few years, the cost of equity itself is now reflected in the income statement. This caused many companies to review their programs. It also contributed to the recent shift toward restricted stock in the United States. Although the move to expense stock options was controversial and the performance and cost relationship is obscured (the accounting charge for underwater options is the same as for options ultimately in the money), transparency is probably a good thing and creates a more level playing field between the different types of stock plans.

However, if accounting practices now place equity on par with cash, it is increasingly important that companies determine whether equity rewards provide advantages that cash does not.

One major disadvantage is that in recent years the compliance requirements for operating equity plans have increased significantly. Fiscal authorities around the world are increasingly interested in obtaining an appropriate level of tax on equity awards. As share plans have become more common, so too have the arrangements for taxing them in various national tax codes. More countries are placing an obligation on the employer to deduct tax when an option is exercised or a grant is made, and/or to provide details directly to the fiscal authority rather than relying upon the employee to declare it in a tax return. Social insurance is now often payable on equity awards. Tax compliance is at its most daunting when it relates to the equity plans of internationally-mobile staff, especially options with exercise periods covering several years. Awards and exercises may generate a tax liability across two or more countries with the need to prorate or proportion across jurisdictions. Accurate returns not only require accurate employee data, but also a detailed understanding of the appropriate tax rules and treaties.

The good news regarding this is that the major accounting and consulting firms have developed automated tax calculation tools to help with this. Additionally, the Internet provides a way of linking the relevant parties to produce a timely process for most exercises and awards.

Securities laws also need to be followed. The requirements of the EU Prospectus Directive — although being mitigated — may have inhibited non-European companies from introducing or continuing employee share plans in Europe. Exchange controls have loosened in a number of countries but still remain issues or hard work in others (e.g., Russia and China). Legal issues may arise from time to time. For example, U.S. law allows companies to discriminate in favor of older employees in plan vesting arrangements, and this is common practice in the United States. But such an approach is now unlawful in the European Union, creating difficulties for U.S. companies wanting to apply a globally-consistent approach.
As a consequence, for multinational companies wanting to ensure that they are compliant around the world, share plan administration requires considerable time and expertise. But the current economic circumstances do not lend themselves to increasing expenditure on plan maintenance. Resources are stretched and all activities must usually play their part in cost savings. Companies can, however, help themselves by simplifying plan structures and seeking the most efficient ways of operating.

In conclusion, today’s environment is less friendly toward employee stock plans, especially those operated globally. Costs are transparent. Setting up and maintaining such arrangements require more than a passing commitment to the operation of equity plans. Whether the implementation or continued operation of such plans is now too much for a particular organization will depend upon that company’s belief in the value of promoting employee share ownership.

**Will Employees Lose Interest, Put Off By Risk and Volatility?**

Based on the results of this study, it seems as though employers are maintaining their commitment to facilitating employee shareholding. However will the recent market volatility affect employees’ attitudes to participate in share plans? Will employees still value these plans, especially those whose finances may have been significantly affected by the recent market crash?

Those who argue against employee share plans make several key points:

- **Investing in the shares of a single company is a high-risk venture.** Equity investors have no guarantee of dividend income, can face dilution of their interest if the company needs to raise capital, and are the last to be paid when a company is in trouble. In return, equity investors expect their portfolio to return a risk premium above bonds or cash deposits. This appetite for risk is exciting and sometimes very rewarding for those who can afford the chance of failure.

- **However, for the majority of employees who get by on incomes of $25,000-$50,000 (USD), the prevailing view is that it is unwise to trust even part of their modest savings to the fluctuations of a single stock.** This may help explain why participation rates for broad-based share plans are highest among the higher paid.

  Most employees have no personal influence over the share price of their companies. Share price movements frequently offer surprises. The stock market is subject to fads and fashions, which sometimes frustrate the efforts of executives to drive up share prices by focusing on delivering good financial results. The dot-com bubble around the turn of the century, and the banking sector and real estate bubbles in 2005-2007, are recent examples of irrational exuberance in markets. Even the executives deciding corporate strategy find that they have only limited influence over their own share price. Further down the chain of command, any line of sight that an individual employee might wish to have between his/her actions and the share price is extremely hazy.

  **Cash is king for most employees.** Employees understand cash. It is flexible. At a time when incomes are tight, it is natural that employees would prefer it, given a choice between cash and stock.

  **Exchange rate risk.** Unlike cash compensation, equity is normally denominated in a single currency. No major international company would entertain the idea of paying the salaries of all its employees around the world in one currency. Yet, in the case of equity plans some companies expect to be able to do this. Not surprisingly, this exchange-rate risk is either not understood by many employees, or is unacceptable to them.

  These are powerful arguments against investing scarce personal cash in employer stock by itself. However there can be additional factors that come into play.

  When the plans involve the granting of options or restricted shares, the employee is not putting up personal cash to secure initial participation. There is usually no choice between cash or equity reward, and the incidence of employees declining a grant is minimal. For practical purposes — from an employee perspective — the equity plan is an addition to cash rewards rather than a substitute for it.

  When the plans involve the employee saving on a regular basis to buy shares, there is usually some form of preferential treatment — either in the form of a discount/match or tax relief, or both. The size of the subsidy and the degree of tax relief may then work to mitigate — but not entirely eliminate — the risk factors.

  In considering these further, we should continue to distinguish between noncontributory plans (i.e.,
options and restricted shares) and those that require regular contributions (employee share savings plans). We should also take, as immediate context, a period of considerable share price volatility.

Options
In these circumstances, employees will reduce the perceived value of the options they already hold at a higher grant price. To the extent that the perceived value declines, any specific appreciation or motivation effect may decline. Where there is little realistic chance of prior grants achieving an exercisable value, employers may lose the retention effect of these long-term vehicles because of employee discontent. Employees also may start requesting a repricing or exchange arrangement.

Employees will not, of course, become shareholders if the options are underwater, although they will be aware of share price performance. Some employees also will downgrade the perceived value of future option grants based on this experience. However, others will recognize that new grants that reflect the lower share price may provide considerable upside if the share price rebounds. Such a rebound also may produce realizable value on prior grants. Different individuals will see this in different ways depending on their experience, financial awareness and possibly the size of their option portfolios. Employees with more substantial holdings and memory of previous cycles may be more likely to take this into account.

Often it has been reported that the cost of an option plan may well exceed the participants' perceived value of the plan. This is perhaps more likely now that the expensed cost bears little or no relationship to the actual performance of the share price and of the option over the exercise period.

Therefore, the perceived value of past and future option grants is likely to be affected by significant negative share price movement. While employees are unlikely to decline any new offer of options (no risk), the perceived value of those options may be downgraded. Options are probably most effective as a reward or engagement tool in a period of a sustained bull market or company over-performance and, despite the rebound potential, less effective in a bear or sideways market or — for many employees — following a major market adjustment.

Restricted Shares
The appreciation of restricted/free shares also will be negatively affected by falling share prices. However, unless the organization is declared bankrupt, employees still retain their shares that have some value and may still generate dividends. If the basis for the award is a monetary value, then a higher number of shares will be granted, providing a larger holding for the future. Because there is no immediate financial contribution required by these plans, employees will not decline to participate in them.

The nature of restricted shares means that, although the monetary worth of past awards will vary with the share price, such plans will work in all types of markets and may not suffer the stronger swings in perceived value associated with share option plans.

Savings-Related Options Plans
In these plans, such as UK Sharesave, the employee does not have to exercise at maturity. Savings-related option plans have a low risk of loss during the plan cycle. Even if there is no option exercise, these plans provide some form of return through the interest on savings. Although a significantly reduced share price may have some effect on participation rates, companies often report strong employee interest in terminating one plan to open up another at the new lower option price, where this is permitted. Some companies experienced this in 2009. Assuming that the employee population has sufficient financial understanding and some income to spare, participation rates may therefore be relatively stable through the economic cycle.

Discount and Matching Share Purchase Plans
These plans potentially carry the most risk as employees are contributing themselves and stand to lose on their investment. However, the extent of risk they carry often depends on the degree of employer subsidy. A 15% discount may not offset a major price adjustment; a one-for-one tax-free match will provide protection against a 50% fall in share price/currency.

As these types of ESPPs usually relate to the monetary value contributed, a reduced share price generates a higher number of shares purchased which may mitigate the psychological impact of a lower share price. Cost-averaging is the often cited feature emphasized by financial product providers during periods of low prices. As a result, where the employer subsidy is generous, participation rates may be less affected by changes in share price. This may not hold true for less
generous plans. It will be interesting to see the long-term effect on participation in the financial sector.

Additionally, for some parts of the employee population, owning shares in the company may have a psychological value in itself separate from considerations of employer subsidy and preferential tax treatment. There may be various reasons for this; for example, ownership may feature as one of several reasons for justifying the provision of discretionary time and effort.

In summary, employees in some companies or sectors will have been seriously burned by market events. As a result, some effect on employee perceptions of equity plans and their value should be expected. However plan features may operate to mitigate this. A rapid recovery with clear gains on recently-issued options and shares is a powerful influence. As a result, many employees will continue to see participation in equity plans as worthwhile — especially when they have a good understanding of the plan provisions, take a long-term perspective and have sufficient financial knowledge of how to mitigate risk.

Are Companies Losing Enthusiasm?

As shown in Chapter 2, the private sector respondents to the survey do not appear to be losing enthusiasm with offering stock plans. Admittedly, broad-based options plans were reduced in some firms after the change to expensing rules. However, most companies expect employee plans to continue at a broadly comparable level. Alignment with shareholders, the attraction and retention of staff, and market practice continue to be the three main reasons for operating share plans. This is a very different situation from that of many years ago when, for most employees, their employer’s share price was academic and did not really affect them.

An additional perspective is that employees’ understanding and acceptance of organizational change to raise shareholder returns has probably been facilitated by the existence of broad employee ownership within companies. This may be particularly important at times when the company is still making money, but performance has fallen behind competitors.

At a recent town-hall forum, the CEO of a top UK-based global corporation presented charts showing the company’s relative share price performance to explain why significant organizational change was needed. His message was understood and accepted in a way that might not have been the case prior to broader employee ownership. Employee share plans have probably provided an internal legitimacy for the more aggressive pursuit of relative returns.

Twenty years ago free-market capitalism had yet to reach many parts of the world. Employees in these countries had no experience with stock plan participation. When introduced, employee plans have played a role in educating such employees. Across many countries, share plans continue to provide an introduction to share ownership for new entrants to the workforce.

As discussed, the greatest operating complexity relates to plans operated across many countries. It used to be relatively easy to treat employees differently across the world. With the advent of the Internet, employees in many countries often have easy access to details of the programs offered elsewhere in the group. Additionally, as employees work together in multinational teams, understanding of what is available elsewhere grows. While levels of benefit, like salaries, will vary, the principle of facilitating employee ownership may be hard to deny — even when the country’s legal infrastructure is not very supportive. Issues of corporate identity, “group glue” and diversity and inclusion may come into play when balancing value versus cost.

As a result of all these perspectives, many companies continue to believe that ownership does affect employee attitudes and helps create the desired working environment.

Appendix I includes several case studies of organizations that value the employee ownership facilitated by their share plans. Starbucks views its plans as contributing to job satisfaction, generating attachment to the organization and helping reduce staff turnover. Standard Chartered views these plans as helping to create “one bank” around the world. GSK sees its broad-based plans as helping staff to generate long-term savings, which is increasingly important as the company’s traditional pension provision declines. Google has pioneered a way of helping employees perceive and realize the value inherent in share option grants.

Although changes may be necessary over time, where such plans have become part of the fabric it is difficult to see companies wanting to close them, especially if this runs the risk of potential disadvantage in a recovering labor market.

The comments above reflect the experience of those companies that have promoted employee share ownership. However, are these benefits borne out in the academic research conducted into such plans? Appendix V provides a review of the relevant
literature. Overall, the research supports the view that employee share schemes are beneficial to both the company and the individual. Key points are:

- Various papers have identified a positive or potentially positive effect on employee attitudes.

- A direct link with productivity is more difficult to prove — although one or two papers have indicated this to be in the region of 4% to 5%. Most conclude that any direct link solely attributable to share plans is elusive.

- The effectiveness of all-employee plans as incentives is probably low, as employee share ownership is usually proportionally small and most employees do not expect to influence management decisions.

- The effect on attitudes/behavior may be strongest in organizations in which managers and employees see ownership as a means of empowering employees, rather than a purely financial tool.

- The retention effect is probably situational. For example, option plans may work to retain employees when share prices are high and the potential gain from options is easy for the holder to see. They may be less effective when the current gain is minimal or the options are underwater.

- Where plans are contributory, full-time and higher-earning employees are more likely to participate. Therefore, higher levels of participation are found in certain occupations and age groups. Socio-economic and cultural differences help explain varying participation rates across countries.

- Individuals are primary beneficiaries, as the rewards from such plans can be significant and often have tended to be in addition to the main remuneration package rather than in place of part of it.

Conclusion

Integrating the perspectives of companies that sponsor plans, the case studies and the findings of the academic/external research, it appears that:

- Employee equity plans help create alignment between the company, its shareholders and individual employees. There is evidence that they affect employee behavior positively though, perhaps unsurprisingly, few studies demonstrate that such plans have a direct measurable effect on increased value creation. Reassuringly, however, there is minimal evidence to suggest that they systematically reduce value or cause undesirable behaviors (e.g., reduced propensity to take risk or more convoluted decision-making processes). Generally, companies report that such plans help educate employees about the need to perform well so that they can share in the success, be more appreciative of the strategic rationale for company actions, and become more financially aware to enhance their business acumen as well as the management of their personal financial affairs. In short, they provide a stake in the future that a simple cash reward does not.

- Market volatility may have changed some employees’ perceptions of the value of participating in their company’s equity plan. However, share plans can still provide a useful way for employees to accumulate capital. Tax advantages that paved the way for the original plans have not increased with inflation in jurisdictions like the United Kingdom, and so have diminished in real terms. But, as an adjunct to personal savings, the company contribution together with any tax concessions makes these plans a cheaper way for employees to benefit from long-term equity movements — subject, of course, to an appropriate degree of financial understanding and risk.

- Many employers believe that stock ownership increases cohesion — especially among global workforces — and helps employees identify with the organization. Companies operating internationally often consider it important that employees in most countries have the opportunity to acquire shares. Arguably, as business becomes increasingly global in nature, participation will increase unity and feelings of equitable treatment across diverse groups of employees. However there is additional cost in operating equity plans on a compliant global basis — especially if there are many internationally-mobile employees. While companies can streamline plans and implement process improvements, these costs need to be kept in mind when evaluating the overall efficiency and return on investment.

- Governments remain broadly supportive of share ownership by employees, although there may be some dimming enthusiasm for calls to create a “nation of shareholders.” Certainly, with huge
public-sector debts and weakened tax bases following the financial crisis, it seems unlikely that additional tax incentives will flow from governments in the immediate future.

■ There is no indication of a new wave of equity plans about to be launched. Most organizations remain committed to their programs, believing the combination of education and alignment between employees and the firm continues to offer sound reasons to persevere. The alternative of withdrawing such plans might not be an easy path to follow given the need to maintain market competitiveness and to explain why shareholder alignment and sharing in success are no longer appropriate.

■ However, given the widespread use of such plans and the costs associated with them, the recent period of financial turmoil may provide a useful catalyst to review their effectiveness from both company and employee perspectives. Should attempts be made to enhance the effect? Should they be withdrawn? Or should they simply be maintained as an established element of the total rewards package? These aspects are discussed in more detail in the next chapter.
4 | The Way Forward

The ‘Hybrid’ Part of the Package?

As seen, those companies that strongly support broad-based stock plans do so because they believe the plans provide something that other parts of the regular employee package do not. These aspects include:

- Alignment with shareholders and legitimization of shareholder value
- Education about strategic purpose, profit and business
- Corporate identification across divisions and countries
- Some retention effect (in some plans, in some situations)
- A way of helping employees build capital — often in a tax-effective but flexible manner.

This combination of attributes is not present in the other parts of the compensation or total rewards package that most employees receive. Base salary paid in cash usually is spent on regular employee expenses and is not aligned with business performance. Cash bonuses may focus employees’ minds on what needs to be achieved in a given year but, once awarded, has no continuing relationship to business performance. Employee benefits help attraction and retention, but provisions such as life insurance, health coverage and defined contribution plans do not build an internal sense of corporate identity.

Employee stock plans do, of course, have features in common with executive equity plans (e.g., shareholder alignment and an element of retention), although their financial value will be much smaller and the broad base of employees is less directly able to affect company performance. As a result, their effectiveness as incentives is diminished. However, having share price exposure does provide some alignment between employees and executives as well as with shareholders. Changes to eligibility and value aside, the costs of most broad-based plans are more likely to be relatively fixed than varied with company performance.

Employee share plans could be regarded as a hybrid element of the compensation package. They sit somewhere between a benefit and a reward. They often are represented as part of the benefits package and, as with other benefits, often feature voluntary participation. However they also are like a reward because the ultimate value to the employee is linked to the performance of the company (as expressed through the share price).

The Role of Equity Plans in the Package

As seen, respondent companies say that the reasons they have equity plans are to promote alignment and provide a competitive package that helps attract and retain employees. The research confirms that the plans themselves do not unambiguously motivate or incentivize people to achieve specific objectives or tasks. Their presence can help create the right climate in which the other tools for motivating staff have stronger power by providing better context and providing enhanced return for successful effort. Equity plans provide a means through which employees can share in the success of the companies.

Furthermore, if all goes well, employees also may build up some capital to help realize particular goals in their personal lives. Most individuals depend on their employment income to be able to achieve their aims outside work both currently and into retirement. The capital sum can be used for nearer term needs or longer term security. This reinforces the desired alignment. In this way, the plans complement the other rewards and benefits elements and help provide the rounded package necessary to attract and retain a skilled workforce.

Do Equity Plans Provide a Good ROI?

Stock plans can represent a major cost to an employer. As seen in the survey, most employers do not measure the success of their plans — probably because it is difficult to do. There is some research evidence that share plans are linked to business success, but a direct causal relationship is hard to prove. Even though it may not be feasible to undertake a formal

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ROI calculation as might be required for other business expenditures, it may be as productive to consider the various elements of return even if not measurable in the traditional sense.

Those employees who have gained from the plans would probably say they are a good part of the package and worth the employer’s money. If an employee is thinking of changing jobs, he/she may well look for an equivalent opportunity from another company. Not providing some form of employee equity plan may send its own message to prospective candidates about the commitment to shared values and shared returns.

Currently, it is unlikely that share plans are viewed as a primary element of the compensation package, such as base pay and bonus. If base pay and bonus are not competitive, it is better to fix them before introducing or enhancing a share plan. Similarly, other benefits also may have a higher ranking. The health plan is essential in some economies where the state-provided health plan is seen as sub-optimal. The retirement plan also will carry considerable weight. Most defined contribution pension plans have a higher participation rate than share plans and carry less risk by virtue of the diverse investment strategies. Any decision to spend more (or less) on equity plans should not be taken in isolation.

As always, companies need to manage the balance of the total rewards package as well as the individual components. Adjusting the mix over time is part of business management, and companies operate successfully with varying combinations according to the nature of their workforce, their engagement proposition, the labor market and their business context.

**Future Approaches**

Against this background, with many plans having been in place for some time and with the cost of plans affecting the bottom line, from time to time companies do need to consider the appropriateness of their broad-based equity offering: What is the role of the plan in your company? Is it doing this well? Are you using resources effectively? Should you be doing less? Should you be doing more? The current economic environment may prompt such a review.

There is, of course, no universal right answer. Each company needs to consider its own circumstances, objectives and opportunities. However the potential outcomes can be grouped into three broad categories:

- Continuing as-is, but constantly looking to improve effectiveness and efficiency
- Enhancing value and reach.

**Withdrawing from Broad-Based Plans**

As seen in the survey, a proportion of companies have declined to implement broad-based plans, considering them to be inappropriate for their organizations — possibly because of the nature of their workforce (e.g., very transient), business plan (e.g., buying and selling businesses short-term), ownership structure (e.g., illiquid, highly volatile or nontradable shares), or, simply, lack of critical mass. To remain competitive in the employment market place, the value of broad-based plans can be easily substituted — most readily by cash.

Other companies may have implemented plans in the past, but based on experience or current circumstance may now believe that the employee commitment and productivity returns are inadequate and that the cost/resources could be better used elsewhere. External events, such as a recession, can present a plausible opportunity to break with a program that has had low participation and/or low perceived value among employees. Of course, a decision to withdraw cannot be taken lightly. Although equity plans usually are a discretionary part of the package, appropriate arrangements need to be made for existing grants and awards. Communications need to be appropriately considered, if for no other reason than for the unintended messaging about the company’s view of the prospects for its future, and its share price. If the plan is replaced by some other benefit, this may make things easier.

Recent examples of the withdrawal from broad-based plans often appear when a company is taken over by private equity. In these circumstances there is a certain force majeure in that the shares are disappearing — usually temporarily — from the market. Further justification is likely to derive from the relatively short-term nature (+/- five years) of the private equity involvement and a need to drive down costs markedly as part of a recovery plan.

**Continue As-Is, Ensuring Effectiveness and Efficiency**

Some companies are comfortable with the current operation of their plans. They provide a competitive element in the total rewards package, and the plans may simply be seen as a necessary ingredient of the
Enhance Value and Reach

This may be the approach for the company that is a true believer in the alignment, identity and wealth creation aspects of employee plans (i.e., it is already convinced that there is some return on the investment). Here, the company may seek to increase both the benefits aspects (creation of employee capital and financial awareness) and the rewards aspects (alignment and identity) of these plans.

Companies adopting this approach may see employee equity plans as an important part of the employment deal that has emerged in recent years as careers for life, a sense of paternalism and defined benefit pension plans have become increasingly rare. It also may be viewed as a way of ensuring that a significant proportion of the workforce has some alignment with shareholders (and executives), identification with the wider corporation, and a level of financial awareness that helps them manage the personal risks that their employer and their government increasingly expect them to bear.

For these companies there are some potential channels that may enable the value or return of the plans to be augmented. These center around promoting financial education and awareness, valuation and facilitation tools, communications about plan performance, and reviewing the critical mass of employee share ownership within the company.

Financial Education and Awareness

Although the rewards package has become more sophisticated, individuals are now responsible for managing their financial futures. For example, 20 years ago in the United Kingdom most private-sector employees received a base salary, some low-level perks and service accruing in a defined benefit pension plan. Today, they are likely to receive a base salary, a modest cash bonus, an opportunity to contribute to a share plan, some low-level perks and company contributions to a defined contribution plan. The generosity of the defined contribution benefit is unlikely to be equivalent to that of its defined benefit predecessor. The employee has a much greater personal responsibility to consider and plan for his/her future income needs and manage market volatility that previously was absorbed by the employer.

Different countries are moving to this position at different rates, some much faster than others. The United States has been a predominantly defined contribution nation for some time. Many Asian countries also are in this position. The trend is less pronounced in Western European countries where a state pension provision is relatively more generous, though in many Eastern European nations the retirement provision from both state and employer is modest. In this new context, any previous perception of share plans as “a useful additional bonus” may need to be progressively repositioned as a means of building capital and creating a platform for personal financial planning alongside the pension plan and other savings/investments, including personal housing.

The opportunity to gain from the employer subsidy, to share in share price growth and dividends and, in some jurisdictions, to benefit from tax relief can create a very effective vehicle for building capital. Unlike retirement-based plans that usually lock away savings for many years, equity plans can allow for the release of savings and share gains at key points in the employee’s life. They offer much greater flexibility. As GSK noted in its case study, share plans also can be an important vehicle to start employees saving. A small number of employers are providing education on not just the value of share plans, but also on other savings/investments, borrowing considerations, personal property aspects and the importance of diversification and risk management.
External financial providers may increasingly support this work under a “corporate employer” banner. There are many similarities in the United States relating to the role of financial providers relating to the management of 401(k) plans. As the responsibility for developing future income has shifted to the employee, so has the associated risk. The recent market volatility and the high-profile failure of certain previously well-respected companies underline this. Some employees who had built up substantial shareholdings in their employer through regular participation in equity plans saw these investments substantially diminished or even wiped out. Although large shareholdings may at first sight seem to be in the employer’s interests through the alignment effect, they also carry corporate reputational risks if employee savings are eliminated.

Financial awareness and education can help employees to understand risk and ways of mitigating it (e.g., through diversification). Additionally, as noted in Chapter 1, different types of share plan have different risk profiles and understanding the risk inherent in the plan on offer is important.

Companies may therefore increasingly believe that their staff need not only understand how the company’s equity plan works, but also how this particular savings choice compares and fits with other investment/savings choices available to them — whether provided by the company or by the financial market. As a result, employers may feel that relying on the phrase “please consult your financial adviser” is no longer sufficient. Although the responsibility for managing their financial future has shifted to employees, these companies may feel they retain some responsibility for ensuring that their staff members are properly equipped to carry this burden. As a result, employers may wish to provide an appropriate level of broader financial awareness and education. Such an approach may have additional payoffs. It may raise appreciation of the whole rewards package. It may fit better with the overall employment ethos, ensuring that people make the most of their engagement with the company through challenging roles, development opportunities, working conditions and personal improvement. If widely adopted, such an approach may also have societal benefits as a proportion of the workforce raises its financial understanding.

In some countries, for example the United States, a sophisticated approach to financial education may be more common. In other countries it is only just beginning. Given the varying circumstances across the globe, it is likely that most international companies have not yet developed their principles on this issue.

However, an employee who feels in better control of his/her personal financial situation (possibly recognizing the assistance provided by the employer in getting to that point) is likely to be a better employee. Provision of personal financial modeling tools can be a highly effective part of this process.

Raising the Appreciation Value of Shares and Options
Most employees will be aware of the share price (although care needs to be taken that overseas employees have ready access to this in their own currency), but how many know the personal tax aspects of dividends and sale proceeds? How many, including those overseas, have easy access to a share trading facility? And with options, how many employees understand what their value is, how it is determined, how to track it, how they are taxed and so on? Anecdotal evidence as well as exercise behavior strongly suggests that the understanding of value is low. Employees tend to discount its value. This perceived value often is lower than the fair value charge to the company.

Raising employee understanding and appreciation of shares and stock option plans might be achieved through more financial training and modeling tools. Additionally, ready access to share valuations, and perhaps stock option valuations through an option trading arrangement could be provided. (See Google case study.) Institutional shareholders generally take a negative view of repricing or cancelling and replacing underwater options. A trading plan that is based on real pricing for existing options does not involve these actions but is a way of helping employees understand and realize value from what is a generally poorly understood instrument. Figure 4-1 provides further explanation.

Communicating Plan Performance
There may be a tendency for companies to consider that the performance of their broad-based share plans is obvious to all given that the share price usually is well-publicized. It may be thought that everybody knows when the share price is doing well, so there is little need to publicize how the plan actually is performing. When the share price is performing badly and grants may be underwater or participants have
lost value, companies may feel reticent to publicize this, even if the plan is performing relatively well over the longer term.

Is this passive approach to plan performance the right way of promoting understanding and appreciation? Clearly there are issues. Companies would wish to avoid the appearance of giving financial advice. Handling negative valuations requires careful consideration. It may take time and experience to learn how to do this well.

However, regular feedback could help employees understand the benefits and risks of the plans. Employees who have many years’ participation may feel comfortable that they have lived through market adjustments and seen the share price recover as confidence in the economy or company was restored. But other employees may not have experienced this.

It may be helpful therefore to show how plans have performed over different periods. This may emphasize the longer term nature of equity holdings. For example:

- Showing the gain (loss) over recent vesting, anniversary or maturity dates could illustrate how plan outcomes can vary over time and put the plans in a long-term perspective.

**FIGURE 4-1: Enhancing Employee Appreciation of Options**

<table>
<thead>
<tr>
<th>Option Trading</th>
<th>Option Repricing</th>
<th>Option Replacing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employees generally have a poor appreciation of the value of their options. Also, they can only realize the value of their options by exercising them and subsequently selling the resulting shares either immediately or later.</td>
<td>Many companies have experienced employee option grants going underwater, and potentially losing any residual motivational power.</td>
<td>A more acceptable practice for handling underwater options is to replace the original options with a new grant.</td>
</tr>
<tr>
<td>Holders of options in financial markets are able to sell their options freely, enabling them to capture the intrinsic value (excess of market price over exercise price) and time value (remaining exercise period), as well as scope to take advantage of changing price expectations for the stock.</td>
<td>Historically, some organizations repriced such options with a new exercise price based around the prevailing lower share price.</td>
<td>The new grant has a lower exercise price, but the number of options is reduced (and the exercise period also may be reduced) such that the worth of the new grant is equivalent to that being replaced.</td>
</tr>
<tr>
<td>Arrangements can be made for employee options to be tradable and sold by participants to a third-party financial institution (or to the employer).</td>
<td>This involves the provision of additional value to the employee as the lower exercise price increases the worth of each option. Value also is raised if exercise periods are extended.</td>
<td>In this approach, no additional value is being assigned to plan participants but some motivational power might be restored.</td>
</tr>
<tr>
<td>There is no change to the original grant prices and exercise periods.</td>
<td>Shareholders dislike such arrangements, viewing them as providing an exit from poor share price performance and inconsistent with pay for performance. Repricing now rarely occurs.</td>
<td>However, the quantity of replacement options will only be small if the original options are significantly underwater and the remaining exercise period is short. Thus, this would only be worthwhile considering in particular circumstances.</td>
</tr>
</tbody>
</table>
Showing employees’ net contributions and the performance over time of monthly share savings plans may illustrate the cumulative power of dividends and how monthly contributions enable employees to buy more shares when the share price is low.

Such data would need to exhibit the appropriate risk language and steer clear of financial advice.

Persistent negative market sentiment or a floundering strategy usually requires companies to take action at some stage.

That employees are aware of these market and business pressures may well be helpful in facilitating the eventual change; employees usually perform better and with more commitment when they are provided with an understandable context for the actions they are being asked to undertake. That they will share in the success provides extra motivation.

Reviewing the Critical Mass of Employee Share Ownership

One survey finding revealed a low level of participation — less than 25% — in about half the employee stock purchase programs. This may not be a concern where the savings plan is supplemental to another broad-based plan (e.g., stock options or restricted/free shares). However, where an ESPP is the primary share ownership vehicle, a lower level of participation may mean that the number of employee shareholders is too small to provide the critical mass that promotes shareholder alignment and corporate identification.

Of course there may be various reasons for low participation rates, for example the nature of the workforce and the availability of tax relief. However a key reason could be the degree of employer subsidy (discounted share price/match ratio).

If an employer has concluded from its review that there is good return on investment in equity plans, and that greater return may be achieved by taking some of the previously mentions actions, it also may be appropriate to consider whether further investment can be made to gain additional access to these acceptable returns. For example:

- Re-communicate the merits and features of the existing plans with renewed energy (at a small cost).
- Set a more generous level of employer subsidy (at a greater cost and unlikely to be acceptable in the current climate unless the returns are seen as particularly high).

Consider supplementing the current plan with a one-off or regular award of free shares — in part substitution for a pay increase or cash bonus in order to avoid incremental cost. Although expensed, the cost of such share payments might achieve some tax mitigation in some jurisdictions and actually reduce or spread costs. This approach would rapidly expand the depth and reach of share plans, even without any lock-in or restriction on the shares awarded. Some additional financial flexibility would also be provided to the company as there would always be a choice as to whether to issue new shares or buy them in the market. At a time when cash is short and the share price considered low, such an approach could have its attractions.

In due course, there may even be scope to offer employees a degree of choice in how they wish to take their reward (i.e., between cash, shares and options). Choice in itself adds value.

Concluding Remarks

As we have seen, broad-based equity plans are currently something of a hybrid: part reward/part benefits. They have attributes that cash and other benefits do not possess. Different companies perceive their advantages in different ways as illustrated by our case studies. As evidenced by our survey, most companies are not currently considering changing their plans.

However these plans are now fully expensed and many have been in place for some time. It probably is appropriate, therefore, for companies to step back and actively consider how they wish to use them going forward.

We have discussed three potential outcomes of such a review:

- Withdrawing from broad-based plans
- Continuing “as is,” ensuring effectiveness and efficiency
- Enhancing value and reach.

Each approach may be an appropriate and legitimate response to a particular company’s circumstances, workforce, employment offer and priorities.

Our own view is that, for many companies, broad-based plans can be more than just competitive market positioning. They can help create an aligned and receptive climate in which the various tools for
motivating staff have stronger power. In economies in which the responsibility for planning longer term financial security rests with individuals, they represent a good way of helping employees to save or generate capital. However employees need to fully understand the benefits and risks of the savings vehicles in which they participate and be able to make appropriate investment choices. Given the market volatility of recent times, companies should consider afresh whether they are equipping their people to carry the financial responsibilities now passed over to them. Providing both the tools (a broad-based equity plan) and the know-how (financial education and communication) can benefit companies, economies and society.

A UK share plan contribution of £2,000 per annum over 40 years, growing at 5% per annum, would generate a savings of more than £250,000. This may well be as large as the defined contribution pension pot accrued and go a considerable way to bridging the gap left by the withdrawal of final-salary defined benefit plans. As these numbers illustrate, share-based rewards can play a significant role in long-term financial planning. In certain jurisdictions it is associated with tax advantages, sometimes being as tax efficient as retirement savings.
Appendix I

Case Studies

Google’s Innovation Extends Beyond Technology to Employee Equity

Google has created innovations during its first 10 years of existence that have left many competitors scrambling to catch up. But in 2006, the company marked itself as an innovator in a realm outside of technology and the Internet. In December 2006 Google introduced a transferable stock option, a so-called “TSO” program, for employees. Google’s TSO program is unique in a number of ways because it is predicated on several organizational and cultural principles that the company strives for in just about everything it does: innovation, “launch and iterate” (try something to see if it just might work), and auctions. Prior to the TSO program, Google offered its employees a nonqualified stock option plan (NQSO). The company launched its first employee equity plan very early, with the desire to instill an entrepreneurial culture — something that is still a core value for the company. Many of the early Google employees saw considerable financial benefit from the stock option program as the stock rose considerably. But within just a few years, those who were hired later didn’t seem to be getting a similarly large upside opportunity. One of the company’s founders noticed the situation and began a conversation with the compensation group about the psychological discount being applied to options by newly recruited and hired employees. He asked the group to begin looking for a way to clearly and easily communicate an honest economic value of the options to employees. Google shifted its option plan and implemented its now-famous TSO plan in the second quarter of 2007, complete with — not surprisingly — an extremely sophisticated online system.

Under the prior program, employees were permitted to do two things with their options upon vesting: hold the options or exercise them and then hold or sell the stock. With the introduction of the TSO program, however, employees were still able to exercise their options, but also had the ability to sell their options to financial institutions as an alternative. The company chose Morgan Stanley to manage the auction of the TSOs between employees and multiple bidders, and Google worked with multiple financial institutions to participate as bidders in the auction. These pre-approved financial institutions could now bid on vested options, a feature that was seen as a benefit for newer employees. The plan generally operates as follows:

- Participants may either exercise their vested options or sell their vested options to third-party financial institutions through an online auction.
- Google provides a Web tool for employees to view the highest price offered by participating financial institutions for the options. This is similar to the public market trading prices of listed stock options with similar maturities.
- Vested options granted on or after the date of Google’s IPO are eligible for sale.
Options have a 10-year term; however, once sold to a third party, the option expires two years from the date of transfer or on the original expiration date of the option, if earlier.

The tax consequences of the TSO program are essentially the same as with a traditional NQSO plan. There is no income to the employee (or deduction to the employer) at the time of grant or vesting. If the employee chooses to sell the option, he/she will have ordinary income on the sale proceeds. The employer must withhold income and payroll taxes and deliver the net proceeds to the employee, and the employer receives a compensation deduction at that time. If the employee exercises the option, he/she has compensation income equal to the excess of the fair market value of the stock over the strike price and, again, the employer must withhold and there is a compensation deduction available.

Google's TSO program did not result in a change to the accounting method used for valuing employee stock options. However, the amount of stock-based compensation expense was higher than it would have been if not for the program. One of the unexpected results of the Google TSO program is that it has proven the reliability of the Black-Scholes valuation methodology. According to compensation team leaders, what employees receive via the TSO is very close to the modeled Black-Scholes value, with a small discount.

Organizational leaders see the change brought by the TSO program in 2007 as a significant positive. Google co-founder Sergey Brin was an early proponent of the auction system, which he saw as a way to improve the fairness of the options system for new employees whose strike prices were much higher than people hired even shortly before them. Today, more than 90% of employees use the online TSO system.
Walk into any Starbucks location around the world and there’s a high likelihood of being greeted as a “regular.” It seems as though every barista — the front-line employee of this globally recognized chain of coffee shops — is cut from the same cloth: friendly and welcoming to any customer who stops in. This type of customer service didn’t happen by accident. CEO Howard Schultz has been quoted as saying: “We realize our people are the cornerstone of our success, and we know that their ideas, commitment and connection to our customers are truly the essential elements in the Starbucks Experience.”

This philosophy has paid off for the company, which had more than 176,000 employees worldwide in 2007. Starbucks’ total rewards philosophy has helped to produce an 82% employee job satisfaction rate, compared to a benchmark standard of 50% satisfaction for most employers. Stock in the company is among the benefits Starbucks has long offered to employees. For many years, the company has used a broad-based stock option plan with the clever name “Bean Stock.” Approved by the company’s board in 1991, the first employee Bean Stock grant was made in October of that year. Coinciding with the launch of the program was the company’s decision to internally change the term “employee” to “partner.” Initially, partners (including part-time employees working at least 20 hours per week) were eligible for stock options after six months. Each partner was granted stock options worth 12% of base pay, and the value of the first shares was $6 per share. In addition, under the Bean Stock plan, options were granted to employees annually and were granted to partners as a percentage of base salary.

In 2005, the original Bean Stock plan was replaced by a long-term equity incentive plan, which was approved by shareholders in February of that year. Today, to be eligible for the stock, partners must be:

- Employed by Starbucks as of April 1 of the fiscal year preceding the grant date
- Paid for at least 500 hours from either the beginning of the fiscal year (October 1) through March 31, or from April 1 through the end of the fiscal year.
- Partners in a director position or above are not eligible for Bean Stock, but are eligible for stock options under the key employee stock plan.

The number of stock options a partner may receive depends on three factors:

- Company success and profitability for the fiscal year
- A partner’s fiscal-year base wages
- The exercise price.

Bean Stock options vest at a rate of 25% per year over a period of four years. Once a portion of options vest, they become exercisable, allowing partners to purchase and hold, or purchase and sell the shares. Today, Starbucks has more than 16,000 locations in more than 35 countries. The company owns more than 9,000 of its shops, which are located in about 10 countries, while licensees and franchisees operate more than 7,400 units worldwide. The business has three types of management arrangements: wholly owned (United States and United Kingdom), joint venture markets, and licensed arrangements. While the corporate offices don’t technically control rewards for all employees around the world, management has strived to embed a philosophy that partners and their engagement are very important to the company’s success. Bean Stock is offered in wholly-owned...
markets, however it is not offered in licensed markets. The UK share incentive plan, which is approved by Her Majesty’s Revenue & Customs, allows eligible partners in the United Kingdom to purchase shares of common stock through payroll deductions during six-month offering periods at the lower of the market price at the beginning and the market price at the end of the offering period. One matching share is awarded for each six shares purchased under the plan.

The decision for Starbucks to offer a stock option plan to employees below the manager level has shown the company’s desire to move beyond the marketplace, and the decision has had good results. For a time during the last decade, while most U.S. retailers and fast-food chains had turnover rates between 150% and 400%, the turnover among baristas at Starbucks was about 65%.

While a strong contributor to attracting potential employees, the effect the plan has had on retention has been difficult to determine, particularly when stock prices are down. Regardless, the decision to offer stock options — even after stock option expensing came into play — was made to attach partners to the company in a way that cash compensation alone could not accomplish.

“I believe that one of the most defining moments for the company is when we introduced Bean Stock to all our partners,” said CEO Schultz. “Since its implementation, Bean Stock has served us very well in linking long-term value for our shareholders with creating long-term value for our people. As we rapidly accelerate our expansion worldwide, it is critical that we continue to nurture the passion and devotion of our partners, and do everything we can to include our people in the success of our company.”
At Standard Chartered Bank, employee share plans are seen as a critical component of the “One Bank” philosophy, helping to create a sense of belonging and keeping employees aware of how the bank is performing. The share plan is strongly positioned as an integrated part of the overall rewards package, not an “addition.” The Employee Sharesave Scheme provides the opportunity to put the equivalent of £250 per month toward the purchase of shares over a three- or five-year period. 65,000 employees are eligible, and participation globally has been as high as 40%, although this has recently dropped to the mid-30s and varies across countries. For example, in a recent Korean bank acquisition, there was 90% take-up by the new employees.

Standard Chartered runs both an equity-based “classic” scheme and a cash-equivalent “phantom” plan, although the aim is to use the equity model wherever possible and 80% of the plans are in equity. The bank partners with an external broker to provide dealing services and manages the delivery of all its share plans through its own global shared service team in India. It also partners with Computershare (as share registrars) on the administration.

The Sharesave Scheme has been in operation for a number of years, operating as an approved plan in the United Kingdom and unapproved internationally. When integrating newly acquired companies across the world, Standard Chartered offers Sharesave to make new employees feel like part of the organization. The aim is to link all 90 countries as closely as possible to the UK model and to “keep it simple.” The philosophy is to encourage employees to have a regular commitment to saving and to give the opportunity, wherever possible, for employees to become shareholders or share in the success of the bank. However the bank aims to be a responsible employer and is mindful of the need for appropriate modifications, for example relating to cultural variations in disposable income/affordability, share-ownership and securities laws, and perspectives on “long-term” in reward and taxation systems. For non-UK participants, international currency fluctuations also affect Sharesave, as employees save in local currency and the share price is fixed at purchase for the duration of the contract.

Communications relating to share plans are part of overall business performance and benefits communications and the company does not issue total reward statements. In the UK operation, a pilot communications exercise has been conducted, designed to develop greater employee financial awareness and understanding of the benefits package.

Recent external events, increasing performance pressures and share price changes are seen to provide a great opportunity to raise financial awareness generally and to re-highlight the relevant benefits at different stages of the employee lifecycle. However, in developing its communications strategy, the organization is seeking a balance between raising product awareness and individual responsibilities.
awareness while avoiding frenzy in reaction to short-term changes.

In Standard Chartered’s view, the current external changes provide an excellent opportunity for the company to appraise the impact of its offering, for example considering the effect on share plans of the developing frameworks for executive-level remuneration in the financial services industries. That said, given Standard Chartered’s core “One Bank” philosophy, and recent developments in remuneration in the financial services industry, share plans will continue to have a big role to play across the organization — as part of a group-wide deferral arrangement, a portion of everyone’s annual performance award above a certain level is delivered in shares. The bank sees it as the right instrument but the way the company plays the tunes may need to change.
Case Studies

Linking Employee Rewards to Business Success at GlaxoSmithKlein

GSK has established a strong reputation for highly innovative practices in the compensation and benefits arena. The share-based programs are based on a perceived need to maintain market competitiveness as well as being a retention tool. The exception is in many international markets where GSK is often notably above market in the LTI values granted.

A combination of factors have contributed to the effectiveness and changing shape of the company’s share-based plans in the United States and United Kingdom, including tax regulation changes, the broader financial and investment environment and both the real and anticipated success of the business.

That said, the programs have remained relatively static in recent years, save for a perceptible shift to restricted shares rather than options for broader-based grants and changes to performance-related criteria for executives. Putting a much greater percentage of pay at risk through LTI tools is not considered to be an appropriate approach for the company, given the relatively high proportion of the overall compensation package already delivered through LTIs.

While the GSK approach of linking employees’ success to the company’s success is still an important cultural concept, this is now managed carefully in light of the risk of over-leverage, particularly in the United States where there is significant legislation post-Enron. The general perspective for share-match and discounted-share purchase plans is now oriented towards “long-term savings,” which is felt to be a less aggressive statement than the notion of “employee wealth.” Internationally, various tax, funding and administrative complexities have limited the organization’s ability to deliver creative share-match/discount-share arrangements outside of the United States and United Kingdom, although on occasion countries in Europe and Asia have pursued opportunities. The United Kingdom and United States provide share match plans (via choices within the 401[k] in the United States) and these remain among the most popular benefits programs offered at GSK, with more than 80% participation. The United Kingdom provides an additional discounted-share purchase plan that is also very popular with employees while the United States provides a supplemental pension contribution that may be put into GSK shares (a majority of employees keep this portion in shares). The plan designs are standard and competitive, although the United Kingdom share match plan is relatively generous. Optional programs such as share-match and discount-share purchase have very high acceptance rates.

Long-term incentive plans (i.e., performance shares, restricted shares and share options) are delivered based on job grade eligibility and offered to employees in more than 90 countries (although delivery may be restricted to cash due to local exchange/tax issues). Although not part of share plan design in the United Kingdom, linking the share match plan with the opportunity to roll this into a Self-Invested Personal Pension was an innovative approach at the time it was first implemented. Furthermore, GSK has one of the most complex LTI plans to be globally outsourced to a single provider, which has provided significant operational innovation.

GSK incorporates LTIs and share plan programs into regular employee total reward statements, although there are varying opinions on the most appropriate methodology to value them for those statements.

The company believes that expected decreasing value from historic pension planning approaches may
make share-based plans/LTIs a more popular vehicle for long-term growth in the United Kingdom. In the United States, greater publicity about other companies that have limited 401(k) matches has reminded employees of the benefits of GSK’s programs. In both countries a more positive outlook on GSK’s success has led to more optimism on future share price growth and corresponding value in long-term incentives.

To appraise the effectiveness of the plans, surveys are conducted on an ad-hoc basis and consultants are employed to provide external perspectives. Employee actions also are seen as useful source of feedback on the effectiveness of the plans. For example, when U.S. legislation changed and a concerted effort was made to inform employees not to over-invest in company stock, many employees continued to elect for investments based on company stock.

Looking forward, GSK anticipates that share-match and discount-share purchase plans will remain active components of total rewards plans and, although design details may alter, the company does not anticipate notable changes. Furthermore, GSK expects to continue long-term incentive programs in the light of market competitiveness issues and the cultural value placed in the alignment between investors and employee rewards.
## Appendix II
Comparison of Principal Plan Types

<table>
<thead>
<tr>
<th>Risk for Employees</th>
<th>Share Options</th>
<th>Restricted/Free Shares</th>
<th>Employee Share Purchase Plans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shareholder Information Cost to Employer</td>
<td>Automatic</td>
<td>Automatic</td>
<td>Sharesave/S423</td>
</tr>
<tr>
<td>Enrollment</td>
<td>Automatic</td>
<td>Automatic</td>
<td>Self-selection</td>
</tr>
<tr>
<td>Employee coverage</td>
<td>Wider</td>
<td>Wider</td>
<td>Narrower (self-selection)</td>
</tr>
<tr>
<td>Risk for employees (of loss)</td>
<td>Lower (no contribution)</td>
<td>Lower (no contribution)</td>
<td>Lower*</td>
</tr>
<tr>
<td>Participation decision</td>
<td>Passive</td>
<td>Passive</td>
<td>Active (saving)</td>
</tr>
<tr>
<td>Shareholder information</td>
<td>No*</td>
<td>Yes</td>
<td>No*</td>
</tr>
<tr>
<td>Dividends</td>
<td>No*</td>
<td>Yes</td>
<td>No*</td>
</tr>
<tr>
<td>Shareholder experience</td>
<td>Partial/instrumental*</td>
<td>Regular</td>
<td>Partial/instrumental*</td>
</tr>
<tr>
<td>Cost to employer (simplified)</td>
<td>Modeled cost of possible share price gain over exercise period</td>
<td>Cost of shares awarded</td>
<td>Modeled cost of possible share price gain, including any discount, over exercise period</td>
</tr>
<tr>
<td>Conclusion</td>
<td>Wider coverage but partial shareholder experience</td>
<td>Wider coverage; more complete shareholder experience but without personal investment</td>
<td>Narrower coverage; alignment/commitment is partial (unless retain shares exercised)</td>
</tr>
<tr>
<td></td>
<td>Lower risk unless substitute for cash</td>
<td>Lower risk unless substitute for cash</td>
<td>Lower risk as need not exercise</td>
</tr>
</tbody>
</table>

* Until/unless shares retained.

In all cases, the primary relationship is that of employee rather than shareholder.
Appendix III
U.S. and UK Share Plan Histories

A Brief History of Employee Stock Rewards in the United States

Since the founding of the New York Stock Exchange in 1792, stocks have had a significant influence on American society. It wasn’t until the 20th century, however, that equity gained popularity as an employee reward device, when it was first deployed as an executive compensation vehicle.

It was in the 1920s that stock options began to be offered for the first time in many U.S. companies at the executive level. Within a decade, two new federal acts were signed into law that affected stock rewards: the Securities Act (1933) and the Securities Exchange Act (1934).

The Securities Act contained Rule 144, which required an executive to hold stock for two years before selling it on the open market. A year later, the Securities Exchange Act not only established the Securities and Exchange Commission (SEC) for the enforcement of rules regarding the reporting of financial and business results to shareholders of publicly owned companies, but also established new disclosures on executive compensation. In the mid-20th century, executives witnessed a shift from stock options to restricted shares.

Indeed, by the 1950s and 60s, restricted shares had become the most common form of long-term incentive-equity compensation for executives in the United States. However, tax law changes in 1969 dramatically changed the tax favorability of these plans. As a result, the popularity of restricted stock was diminished and stock option programs once again gained favor among executives.

The Ebbs and Flows of Restricted Shares and Stock Options

Meanwhile, more than a decade earlier, pharmaceutical company Pfizer had pioneered the practice of offering broad-based stock options to all employees in 1952. Prior to this event, stock had historically been granted almost exclusively to top management in companies for the stated purpose of firmly linking their interests with the interests of the company’s shareholders. The Pfizer program extended the notion of linking shareholder and employee interests to all employees, not just those in the executive suite.

In 1972, 20 years after Pfizer’s historic decision, the Accounting Principles Board (a pre-cursor to today’s Financial Accounting Standards Board, or FASB) published a landmark decision called Opinion 25, Accounting for Stock Compensation (APB 25). APB 25 introduced the measurement data principle, stating that compensation expense should be measured when the number of shares and the price per share are known.

The effect of APB 25 was that no expense was associated with fair market value (FMV) stock options. However, when the U.S. stock markets stalled in the late 1970s, restricted stock plans again made a short-lived resurgence as companies became concerned with the psychological effect of underwater options. The favorable accounting treatment afforded options under APB 25 and the bull markets of the 1980s swung companies back to use of options in the period that has become commonly considered the golden age of stock options, from the 1980s to the early 2000s.

In the 1980s, the practice of granting equity through stock options became more popular, most notably with the burgeoning high technology companies in California’s Silicon Valley. For these companies, stock options were not only a practical way to attract, motivate and retain employees, but they also served the highly-desired purpose of conserving cash in the startup phase of a young company. According to the National Center for Employee Ownership (NCEO), between 7 million and 10 million employees in the United States held stock options by 2001 — an indication that, “stock options were not just awarded to the upper echelon, but had been incorporated into the overall culture of many publicly traded companies across the United States, especially in the high-tech sector.”
Stock in 401(k) Retirement Plans

In 1978, the U.S. Congress passed the Revenue Act that included a provision to create Internal Revenue Code (IRC) Section 401(k). When the law became effective in the early 1980s, the 401(k) plan quickly became popular with employers. Within five years of the law’s passage, some of the largest U.S. companies had created 401(k) plans, including Johnson & Johnson, FMC, Pepsico, Honeywell and Hughes Aircraft Co. By 2007, there were more than 56,000 plans and 21.8 million participants in 401(k) plans in the United States. By definition, under section 401(k) of the U.S. IRC, employees are not taxed on the portion of income they choose to receive as deferred compensation rather than direct cash payments. Other features of the 401(k) retirement plan have made the plans popular with employees — including the fact that it is more flexible than the individual retirement account, or IRA (it allows for loans), and has higher annual contribution limits than the IRA. In addition, many employers have chosen to provide a matching contribution for employee contributions, often in the form of stock or cash. Employees may also have the choice to invest in their company’s stock through the 401(k) plan.

From the employer side, companies have generally preferred the 401(k) plan to the traditional defined benefit pension plan because it is less expensive. Instead of required pension contributions, the employer pays only for administration, support costs and any employee matching or profit sharing contributions it chooses to make in the 401(k) plan. As noted in the next section, the danger of the 401(k) plan is if the employee’s contributions are highly concentrated in company stock and not sufficiently diversified. In the case of Enron Corp., an accounting scandal caused the share price to collapse and a large portion of employees lost the money they had invested in Enron stock.

Enron and FAS 123

The explosion of broad-based stock option programs in the 1980s and 1990s did not occur without controversy. U.S. lawmakers and shareholder activists frequently criticized the appropriateness of no expense charge for fair market value (FMV) stock options. The criticism was largely ineffective, however, until the implosion of Enron Corp. in 2001. The Enron scandal led many to believe that the demise of the company was at least partially fueled by the huge stock option grants that were provided to the company’s employees. Critics alleged that employees were highly motivated to create small, short-term upward movements in stock price because it could mean huge gains. Many believed that Enron’s executives were improperly motivated to inflate earnings artificially in order to increase the value of the stock, and thus their own personal wealth. In 2004, within three years of Enron, the Financial Accounting Standards Board (FASB) published a draft rule (FAS 123) that for the first time applied an earnings charge to equity that does not have readily ascertainable value. FASB decided that publicly traded companies in the United States would be required to adopt the new standard using a “modified prospective” method, meaning all equity-based compensation costs would be recognized for all employee stock awards granted.

Almost immediately, nearly 500 U.S. public companies determined that FASB’s draft rule would probably eventually be adopted, and they decided to voluntarily elect FAS 123 and expense the value associated with stock options. From an accounting perspective, the LTI playing field had quickly evolved from three alternatives (no charge to earnings, fixed charge to earnings and variable charge to earnings) to just two (fixed charge to earnings or variable charge to earnings).

An issue that was perhaps not widely considered in the context of the accounting change was the impact of a volatile market on the associated earnings expense of stock options. Almost all methodologies that have been considered by FASB to determine the value of an FMV stock option use volatility as a variable in the calculation. For example, the Black-Scholes methodology currently used for reporting in company financial statements depends on volatility as the key variable for determining the value of an FMV stock option. Under Black-Scholes assumptions, the higher the volatility rate, the higher the stock option value. This has created a scenario in which the tremendous volatility realized by U.S. stock markets over the past several years (and potentially in years to come) punishes companies for awarding stock options because of what some believe to be an artificially-inflated expense. Consequently, in recent years, the accounting expense of stock options has made companies more reluctant to use FMV stock options as an award to employees.

Why Stock Has Been Used in the United States to Reward Employees

As noted, many U.S. organizations have used equity to reward employees for a number of different reasons. Most frequently, the reasons cited include:
Align management and employees with shareholders. Employee interest in the profitability and success of the company is often limited to the desire for job stability. Equity or stock awards help to create an “ownership culture” in which employees take a greater interest in factors driving business success. (It should be noted that many U.S. employees sell their ownership interest as soon as rules and regulations allow them to do so.)

Build motivation. Many components of the total rewards package can be used to motivate employees. Money is one of the most powerful motivators available, and equity reward programs offer employers effective methods to financially motivate employees.

Conserve cash and other resources. In many cases, stock or equity rewards allow companies to provide competitive compensation without depleting other assets, such as cash.

Wealth creation. The actual realized gain can create significant opportunity for employee wealth creation.

Tax advantages. Equity reward programs may offer tax advantages to the employee and/or the employer. In some cases, employers may significantly reduce their tax obligations through the use of various equity reward programs.

Attraction and retention. Creative use of stock rewards, coupled with the right mix of other total rewards components may provide the competitive edge to attract, motivate and retain key talent.

Capital accumulation. Positive cash flow from employee stock purchases provides a mechanism for the company to raise capital.

### A Brief History of Employee Share Plans in the United Kingdom

This brief history of share plans from a UK perspective looks first at the factors that have shaped that history before giving a brief chronology of how plans have evolved in the United Kingdom. The United Kingdom had, at least until relatively recently, largely developed its own range of share plans. It has been a leader in developing employee equity participation, particularly broader based arrangements. As in many areas, however, practice in the United States has had an increasingly significant effect as businesses have become more global.

### Timeline of Important Milestones in the History of Stock Rewards in the United States

- **1792**
  - New York Stock Exchange opens
- **1920s**
  - Executives at U.S. companies begin to receive stock options for the first time
- **1933**
  - Securities Act becomes law
- **1934**
  - Securities Exchange Act becomes law
- **1952**
  - Pfizer offers first broad-based stock option program
- **1959**
  - Accounting Principles Board, funded by private industry, is created to establish U.S. accounting standards
- **1964**
  - Revenue Act becomes law, leading to the creation of employee stock purchase plans (ESPPs) — benefits plans that allow employees to use payroll deductions to acquire company stock, usually at a discounted rate.
- **1950s and 60s**
  - Restricted stock programs are the most popular executive stock reward programs. A tax law change in 1969 shifts popularity back to options.
- **1972**
  - Accounting Principles Board publishes APB 25, Accounting for Stock Compensation, and establishes the measurement date principle, requiring measurement of the compensation expense at the point where the price/share and number of shares in an award are first known.
- **1973**
  - Fisher Black and Myron Scholes develop a methodology to value stock options for the purpose of comparison with other elements of compensation.
- **1980s-early 2000s**
  - An explosion in broad-based stock option plans occurs, particularly in high technology companies that leverage the ability to use stock options as a motivation tool, while preserving cash in startup phase.
- **1995**
  - FASB issues FAS 123, allowing the earnings impact of stock options to be reported in financial statements under a present value method, or with a footnote on present value.
- **2001**
  - Enron Corp. collapses; critics allege that large stock option grants caused employees to take excessive risk in the quest for short-term stock price fluctuations.
- **2004**
  - FASB publishes revised FAS 123 (FAS 123[R]), requiring the expensing of employee stock options and eliminating APB 25.
Why Companies Have Share Plans

Share plans were introduced in the United Kingdom for a variety of reasons. The reasons most commonly expressed for introducing them have been a desire to “recruit, retain and motivate” both senior management and employees more generally.

Since the middle of the last century there have been evangelists for equity participation by employees. Early arguments were expressed in terms of “breaking down barriers between capital and labor,” the more contemporary expression of which has been an expressed desire to “encourage employees to identify their interests with those of shareholders.”

The Wider Share Ownership Council was established in 1954 and promoted employee share plans until it was absorbed into Proshare (now ifsProshare) in 2003. IfsProshare continues to promote employee share plans. Against these common themes, three other factors have always influenced employee share plans: tax, accounting and issues of disclosure and shareholder approval. The latter gradually evolved into a broader concept of “corporate governance” as levels of participation increased and a more holistic evaluation of all the elements of executive remuneration developed.

Tax

Tax is relevant from two perspectives. Companies and their advisers have used shares as a way of delivering remuneration in a tax-free, or more recently with the advent of capital gains tax, a more tax efficient manner.

The story of share plan taxation has been one of cat and mouse with the Inland Revenue (and more recently Her Majesty’s Revenue and Customs). This began with early steps by the Inland Revenue to fix the tax point for share options at their exercise, followed by piecemeal blocking of plans that tried to fall outside the income tax net.

Today’s tax regime aims to provide a level playing field for a wide range of nontax-relieved share benefits and to prevent abuse. The other side of the coin has been the introduction by successive governments of so-called “approved plans” that provide tax advantages to participants and their employers. These have been stated to be designed to encourage employees to identify their interests with those of shareholders through having a financial interest in their company’s shares. There has been, and continues to be, almost universal acceptance among the United Kingdom’s major political parties that share plans are a good idea and their efforts in the past 30 years to translate that ideal into reality has spawned a number of tax-advantaged share plans that have largely managed to coexist.

Accounting

There has never been any doubt that share plans that involved companies spending money had an accounting cost. But for many years share option plans using new issue shares had the almost magical property of delivering a benefit with no profit and loss or cash cost. In the early days of share plans, this was not seen as an issue — the overall level of benefits (particularly under executive plans) was relatively modest and there were perceived difficulties in attributing an accounting cost to benefits that did not involve a cash cost and where the grant and vesting dates for an award might fall in different accounting periods. But, as the extent of equity participation increased, there were inevitable concerns that the high levels of awards to senior executives could not be ignored from an accounting perspective. They could have a material effect on shareholders and, for this to be largely reflected only through dilution of shareholders interests without any stated effect on profits, did not provide the necessary transparency. That this state of affairs continued for so long was to a significant extent due to the increasing internationalization of business — if one country acted in isolation, its companies would be at a disadvantage. This, combined with strong lobbying against any change (particularly because of the implications for all-employee option plans), meant that it was not until 2005 that International Financial Reporting Standard 2 (IFRS 2) applied an accounting charge to all “share-based payments.”

Corporate Governance, Disclosure and Shareholder Approval

In the United Kingdom, there have been three strands to this: company law, the “listing rules” relating to shares traded on the main list of the London Stock Exchange (now joined by “disclosure and transparency rules” implementing EU legislation) and guidelines produced by institutional shareholders.

In the early days little disclosure was required and what was required did not provide much transparency. Shareholders also had less ability than they do now to influence share plans. Only plans involving the issue of new shares required shareholder approval and there was no formal way of influencing executive remuneration more generally. Institutional shareholders did however take a keen interest in share
plans. Guidelines were first published by their representative bodies in the 1960s and these have been regularly updated ever since. In recent years there also has been a growing role for institutional shareholders' own corporate governance departments.

Over the years there also have been a number of high profile reports on corporate governance. The key outcomes for companies have been the creation of, and a developing role for, remuneration committees of nonexecutive directors and pressure for more disclosure. Government has picked up on these themes, enshrining in company law detailed disclosure requirements and a published annual remuneration committee report which is subject to a nonbinding shareholder vote.

**Performance Conditions**

Any plan that gives employees an interest in their employer's shares in a sense has a performance condition because the value of the company's shares will affect the value of the benefit. This is most clearly the case with share options with a market value exercise price — without an increase in share price over the period to exercise, the option will not deliver a gain to the employee.

In the early 1980s this was as far as thinking went. But with bull markets and substantial option grants being made immediately before companies' initial public offerings (IPO) and pressure from companies to allow exercised options to be replaced (guidelines at the time limited option grants over ten years to a market value of four times earnings over 10 years), institutional shareholders shifted their ground and started to require an increase in "underlying performance." Early performance conditions were relatively "soft."

Two trends created pressure for more demanding targets. One was the escalation in the size of awards made to executive directors, the other was the move away from market value options toward awards that delivered free shares. These awards, usually in the form of nil exercise price options or conditional awards, became popular after a period in the early 1990s when bear markets left many options underwater. The consequences of are that awards today almost invariably have sliding-scale performance targets and a wider range of performance measures. The requirement for performance conditions to be attached to awards for executives has been a feature of UK share plans that has set them apart from those in most other countries. The starkest divide has been with the United States where, until recently, performance conditions have been rare.

**A Brief Chronology of Share Plans in the UK**

**1961 | Abbot v. Philbin**

In 1961 the Inland Revenue suffered a significant setback in the case of *Abbot v. Philbin* where it was decided that the grant of the option was the taxable benefit rather than the Inland Revenue's contention that it was the exercise of the option. Gains not taxed as income would at the time have been tax free (capital gains tax was not introduced until 1965).

**1966 | The Tax Challenge Begins**

The inevitable spread of share options following the *Abbot v. Philbin* decision could not be ignored for long. The 1966 Finance Act saw the first UK tax legalization aimed specifically at share incentives. *Abbot v. Philbin* was reversed as the first shot in a battle that was to continue for over half a century. The popularity of share incentives was, however, established and increasing. The income tax benefits of share options had been reduced but their perceived commercial attractions remained undiminished. Benefits were only delivered if a company's share price rose, significant rewards could be delivered without any cash or accounting cost; the actual benefits realized by senior executives were far from transparent and there were social security (National Insurance contributions) savings for both employer and employees.

**1978 | Approved Profit-Sharing Plan: The First All-Employee Plan to Have a Major Effect**

In 1978, the Labor government introduced the approved profit sharing scheme (APSS), which allowed companies to provide annual gifts of up to £500 worth of shares to each employee on the basis that the shares could not normally be sold for five years and were free of income tax after 10 years. The APSS was introduced at a time of high taxation and general income restraint. Its significant tax benefits were sufficiently attractive to a large number of companies that had not previously operated broad-based share plans, and, in at least some cases, this was as an alternative to increasing cash remuneration.

The original intention was that the APSS would be used to deliver only gifts of shares. But two important
variants soon appeared after some fairly determined lobbying from companies. Employees were soon able to choose whether to receive either taxable cash or shares that were potentially tax free. The other variant was the so called “matching plan” or “buy one get one free plan.” This addressed a concern that employees should not be able to benefit from free-share awards without making some personal commitment, particularly since awards could not be forfeited on cessation of employment. The idea was that employees who were prepared to invest their own money in shares and agree to hold them for a period would receive a free award.

1980 | A Second Tax-Favored All-Employee Share Plan
After coming to power in 1979, the Conservative Government wasted no time in proving that it was also committed to the employee share ownership ideal. Sharesave, the savings-related share-option plan introduced in 1980, provided tax reliefs for share options where employees saved by pay deduction into a tax-free savings account. Options could run over five or seven years, the exercise price could be set at 10% below the market value of the shares at grant and savings were limited to £50 per month.

This rapidly became the most widespread all-employee share plan. It was popular with both employees and employers. In the early days at least, savings rates were very favorable, and in rising markets there were soon anecdotes of junior employees realizing significant gains. There was also always the fallback that options did not have to be exercised if share prices fell. For employers, benefits could be offered to all employees but costs would only be incurred for those who chose to participate, benefits could generally be clawed back from leavers, there was no cash or accounting cost (until IFRS2) and administration costs would generally be met from the profits that plan administrators made from the employees’ savings. These plans remain the most popular of the UK all-employee arrangements.

1984 | Tax Relief for Executive Plans
Although there was consensus among the political parties in favor of broad-based employee share ownership, the same could not be said about executive plans. It was therefore a controversial move by the Conservative government in 1984 to introduce tax relief for discretionary share options with a market value exercise price that could be up to the greater of £100,000 and four times earnings (cut back to £30,000 in 1995). The tax relief applied to the gain made by an optionholder on exercise of his/her option.

2000 | Introduction of the Share Incentive Plan
With the new millennium a new Labor government introduced a comprehensive vision of employee share ownership in the form of the “All Employee Share Ownership Plan,” since rebranded as the Share Incentive Plan or “SIP.” The government described the new plan as “the most generous all-employee shares incentive a British Government has ever introduced.” The SIP built on the previous APSS, but as well as providing free shares, the SIP can also be used for awarding shares purchased out of pre-tax income with the flexibility for additional free matching shares and for providing dividends paid in the form of tax free shares. Details of the plan are summarized elsewhere in this appendix.

International Perspective
There have been two important changes to share plans resulting from globalization in the past 25 years or so. Firstly, UK companies are increasingly extending equity participation to their non-UK employees. One of the earliest, largest and highest profile international employee offers was made on the IPO of the pharmaceutical company, Wellcome plc (now part of GlaxoSmithKline), in the mid-1980s. Nearly all of the larger companies (and many smaller ones) with shares traded on the London Stock Exchange now offer at least some of their share plans on an international basis. Secondly, the increasing numbers of foreign companies with UK operations has resulted in an increase in non-UK companies operating plans in the United Kingdom.

The prevalence and development of share plans in mainland Europe has been significantly less than the United Kingdom and United States. This partly reflects the fact that share ownership by the public in those countries is a less popular form of investment than in the United Kingdom and the United States. However, a number of governments in mainland Europe have promoted employee share plans by providing local tax incentives. The most generous of these until recently were offered by France and Italy. However, Italy has recently abolished its tax breaks for share options while France has recently introduced social security charges on grant for its main tax-advantaged plans. Both of these moves appeared to reflect a backlash against high levels of executive share incentives.
However, France still continues to offer a generous range of tax advantaged plans, which are summarized in Appendix IV.

The Republic of Ireland has promoted employee share plans significantly, mainly by adopting the UK tax-advantaged share-plan models. These include tax advantaged profit sharing plans, share option plans and sharesave plans. (See Appendix IV for details.)

Support for share plans often is shown in the security regimes adopted both by single states and by supra-national bodies such as the EU. Generally, these regimes prohibit the offering of shares not listed on local stock exchanges unless the offer is accompanied by detailed information on the company concerned. However, almost invariably these regimes have exemptions for shares offered to employees of the company concerned which therefore enables international companies to provide shares to its overseas employees without fulfilling onerous information requirements.


2 According to the WorldatWork Glossary (2008), “restricted stock” in the United States is defined as “stock that is given or sold at a discount to an employee who is restricted from selling or transferring it for a specified time period — usually three to five years. The employee must forfeit the stock if he/she terminates employment before the restriction period ends. If the employee remains in the employ of the company through the restricted period, the shares vest, irrespective of employee or company performance.”


4 Longnecker and Crawford, p. 21.

5 Cadbury Report and Code of Best Practice (1992) – recommended Remuneration Committees, “comply or explain” approach
Hampel Report (1998) – principles to be followed by companies and investors, Combined Code (appended to the Listing Rules — comply or explain)
Myners Review of Institutional Investment (2001) – role of investors
Appendix IV
Tax Efficient Share Arrangements

The table below sets out an overview of the main tax efficient employee share incentive arrangements currently available around the world. All information is correct as of Jan. 10, 2009.

<table>
<thead>
<tr>
<th>Country</th>
<th>Type of Tax-Favored Arrangements Available</th>
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<tr>
<td>Australia</td>
<td>Australia has been omitted from the schedule since, at the time of compilation, the tax arrangements for equity plans are the subject of consultation and government review.</td>
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<tr>
<td>Austria</td>
<td><strong>Share Options</strong></td>
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<td>Belgium</td>
<td><strong>Share Options</strong></td>
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<td>China</td>
<td><strong>Share Options and Restricted/Free Share Awards</strong></td>
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<td>Denmark</td>
<td><strong>Share Options, Free and Discounted Share Awards</strong></td>
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<td>Country</td>
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Spain

**Share Acquisitions** Shares must be offered by to all employees or all employees of a certain category. Tax relief on €12,000 of shares per employee per year. Tax relief on acquisition of shares and shares must then be held for three years from acquisition. Additional tax relief may be available whereby the taxable amount (up to certain limits) may be reduced by 40% if the award is deemed an irregular grant with a vesting period of at least two years.

South Africa

**Share Acquisitions** Tax-advantaged all-employee arrangement allowing free shares up to ZAR 50,000 per employee in any given three year period.

Onerous qualification criteria, including participants must not participate in any other equity ownership scheme of the company. Participants must be entitled to all dividends and full voting rights and shares may not be subject to any restrictions, other than restrictions on sale for a period up to five years. If the relevant criteria are met, gains made on the sale of shares will be subject to capital gains tax (rather than income tax).

United Kingdom

**Share Options** Tax-favored market value options may be granted on a discretionary basis under a HM Revenue and Customs (HMRC) approved company share option plan. An employee may hold up to £30,000 worth of shares (measured at time of grant) under approved options at any one time. If the options are exercised at least three years following grant, the gain on the exercise of the option will not be subject to income tax or social security.

Smaller companies (less than 200 employees and assets of less than £30 million) may be able to grant tax-favorable Enterprise Management Incentive Scheme options under which awards worth up to £120,000 may be granted on a discretionary basis. The gain on the exercise of an option will not be subject to income tax or social security.

Discounted share options (up to 20% discount to market value at grant) may be granted under an HMRC approved savings related share option scheme (also known as “sharesave” or “SAYE”). Under this arrangement, which must be operated on an all-employee basis, participants save up to £250 per month over a three- or five-year savings term. On the maturity of the contracts, participants can elect to use their savings (and interest) to exercise their option. The gain on the exercise of the options will not be subject to income tax or social security.

**Share Acquisitions and Restricted/Free Shares** An HMRC tax-favored Share Incentive Plan allows the offer of restricted/free shares and/or tax-advantaged share purchase.

Employees can save up to £1,500 each year (up to a maximum of 10% of taxable salary) out of pre-tax income to purchase “partnership shares” at the prevailing market value. If there is a savings period (which can be up to 12 months), the partnership shares can be purchased at the lower of the share price at the beginning and end of that savings period. If partnership shares are left in trust for five or more years, no income tax or social security is payable either on the income used to buy shares or the shares themselves.

No capital gains tax will apply if shares are sold as soon as they leave the trust. Since employees save out of pre-tax income, the company can also save social security, although this can be clawed back if partnership shares are removed from the plan within three years.

In addition, the company may choose to offer “matching shares,” up to a maximum of two restricted/free matching shares for every partnership share purchased by employees. The matching shares are tax free if left in the trust for five years.

Up to £3,000 p.a. of “free shares” can be awarded to employees. These shares are tax free if left in the trust for five years.

Dividend share awards may be awarded based on the value of the dividends paid on other shares in the plan. These shares are tax free if left in the trust for three years. In all cases, participation in the Share Incentive Plan must be offered to all UK employees on “similar terms.”

United States

**Share Options** Tax-advantaged incentive stock options may be granted to an employee over shares worth up to US$100,000 in any tax year based on the fair market value of the shares at the time of grant. There is no tax charge on exercise. Gains arising on the sale of shares will be subject to the long-term capital gains tax regime (provided that they are sold one year or more after acquisition and two years or more after the grant of the option). There is no corporation tax deduction for the employer company where options are exercised within the relevant periods and the shares are held for the specific holding periods. Shareholder approval of the plan is required.

**Share Option/Share Purchase** An employee share purchase plan (ESPP) under which shares may be purchased on tax-advantaged terms. Awards may be granted to an employee over up to US$25,000 worth of shares in any tax year (based on share price at grant). If the exercise price is determined by reference to the time of grant there is usually an offering period of up to twenty seven months, during which payroll deductions are taken for the exercise price. The exercise price may be set at a discount of a minimum of 85% of fair market value (FMV) at the time of grant or at the time of exercise, if lower. If shares are sold more than one year after the vesting date and two years after the offering commencement date, income tax may be paid on the lesser of (i) the gain or (ii) the purchase price discount. The plan must be approved by shareholders and offered to all employees on the same terms.
Appendix V
Literature Review

The following synopses cover a sample of 15 papers from the large body of research published in the past decade that review the reasons for the growth of employee share ownership (in particular through workplace schemes), and test our understanding of the benefits derived from these schemes. Three of the papers (Landau et. al. [2007], Blasi et. al. [2003], Poutsma et. al. [2005]) look more specifically at the differences between countries in the use of employee share schemes and in some cases proffer a view on the socio-economic factors which might explain why these differences arise.

The key benefits of employee share ownership are generally assumed to include:

- A positive effect on the attitude and behavior of employees as a consequence of the interests of employees being directly aligned to the success of the business, which generates a sense of ownership
- An improvement in the performance of the company resulting from better employee performance

This review aims to establish whether the most recent research undertaken supports this assumption. The measurement of a subjective quality such as the attitude of an individual, is particularly difficult and attributing the result to one specific cause (i.e., the fact of share ownership, is similarly problematic).

Effects on the productivity of the employing company have been even more difficult to prove given the great number of factors which converge to determine company performance. These problems are reflected in the qualifications and caveats included in the conclusions to these research papers. Eleven of the 15 papers reviewed look specifically at the effect of employee share plans on the attitude and behavior of employees and the productivity of the company. Despite the difficulties already mentioned, a number of interesting findings can be drawn from the evidence.

Overall the research supports the view that employee share plans are beneficial to both the individual and the company. A positive effect on attitude and behavior was identified in three papers. Another four papers concluded that there was likely to be a beneficial effect in this area but that it was difficult to prove. Freeman (2007) found the link unproven and Ning and Zhou (2006) concluded that there was no incentive effect at all on employees.

The link with productivity seems to be even more difficult to prove. Pendleton et. al. (2009) found the level of improvement to be insignificant unless it was accompanied by a majority employee shareholding, in which case it is perhaps more likely to be a reflection of the employees’ involvement in decision making.

Two papers (Kruse [2002] and Sesil et. al. [2001]) both found a positive impact on performance in the region of 4%-5%, but other researchers concluded that although a positive result was probable, it was unproven.

On balance, the assumption is probably fair for most situations, but the evidence is not sufficiently conclusive to pronounce a definitive correlation.

Some of the papers reviewed touched on other benefits, such as the finding that companies with employee share ownership plans tend to have greater stability of employment. This is because they tend to be more successful companies and therefore have better chances of survival. As we see from Pendleton’s finding, the role of employee participation in decision making also is relevant to the motivation of employees and may therefore affect productivity. We include in this review a paper which looks at the incidence of various forms of participation and the relationship between them. Oyer and Schaefer (2004) comment on the use of employee stock option plans as a retention tool, observing that when stock prices track labor market conditions, stock options work well to discourage employees from moving on. At the time of greatest employment opportunities, the stock price is strong and the loss to the employee on leaving early, is at it greatest. These research papers reaffirm the qualitative benefits which we know accompany employee share ownership. They are widely used throughout the United Kingdom and the United States to good effect and are used increasingly across the world and routinely in overseas subsidiaries of multinational companies.
Review of Existing Research


This paper is a preliminary discussion paper reviewing past research on employee share ownership. It looks at different types of share plans, highlighting the main findings so far and identifying those areas in which there has been little research to date. The authors note the variation that occurs between countries in the type and use of share plans, revealed by past research. The various studies also show a range of views about the significance of employee share ownership and its value as an incentive leading to greater employee motivation and performance. The findings of past research on levels of employee participation, the impact of participation on employee attitudes and behavior and company performance are all commented upon and limitations in the past research projects are identified.

Conclusions
Generally speaking, employee share ownership is proportionally small and employees do not expect to influence management decisions. These factors tend to limit any fundamental effect on the employment relationship. Exceptions do occur and evidence does suggest an impact upon attitudes and behavior and favorable effects on company performance. More than 70 studies since the 1970s have looked at the relationship between share ownership plans and performance, using different measures — some financial, others more subjective. Although overall the consensus seems to be that employee share ownership has a positive effect on performance (both through share plan participation and majority employee share ownership), the effect is often small. The biggest effect seems to be where there is majority share ownership by employees rather than ownership through a “mainstream” employee share plan and where it is accompanied by participation in decision making. The paper concludes that there is room for future research on the effect of different levels or types of ownership and the different reasons and factors behind employee participation.


This paper reports on the research findings on the effects of employee ownership on:
- Individuals — personal wealth and on attitude and behavior in the workplace
- Firms — productivity, profitability, economic strength
- Shareholder returns
- Society.

The paper looks at how past research studies have sought to establish a credible link between positive benefits and employee ownership and considers dissenting views. Freeman also addresses the perceived shortcomings in past research. His assessment is that researchers often fail to disclose the full data on which the research reports are based and overall there is a lack of peer review. His interviews with officers of companies with ESOPs (tax advantaged plans through which employees invest in employer stock and distributions are paid in stock) revealed problems which past research has failed to address: capital formation; maintaining liquidity; managing retirements and payouts. Problems arise between those who reap the rewards of ownership and those who do not, with the resulting perceived inequality of treatment. He laments the failure of proponents of employee ownership to engage with academics and critics at the highest level, with heavy reliance on empirical evidence of questionable rigor and too little economic theory to back up their claims.

Conclusions: The mass of research around the issue of employee ownership generally supports the view that ESOPs offer positive benefits to both the individuals and the company. The bulk of the research Freeman has reviewed suggests that individuals are the primary beneficiaries as the rewards can be significant and tend to be in addition to the main remuneration package, rather than in place of part of it. The research suggests ESOPs give rise to greater employment stability, greater satisfaction with work with little personal risk (in most cases). Freeman states that the benefits to the company of having an ESOP include better performance (thought by one study to be an average annual increase of 4% compared with no ESOP), reduced risk of bankruptcy and better shareholder return. The links between share ownership and motivation are insufficiently proven although there is some evidence that ownership seemed to produce a higher quality of work among employees, reflected in lower numbers of customer complaints. Freeman lists the gaps in the research and calls for future research to address some of the unanswered questions, such as why there appears to be no new growth in employee ownership, and fill in the gaps in our knowledge and understanding. He also advocates the use of other methods to complement the written survey approach. Looking forward, he encourages researchers to use the knowledge gleaned to predict the conditions which would encourage the use of employee ownership schemes.


This research paper pulls together the findings of a number of surveys carried out during the preceding decade, to present a picture of the current use of broad-based employee share ownership (ESO) plans in Australia. The study looks at:
Incidence of all and particular types of ESO
- Trends
- Awareness of ESO among businesses
- Characteristics of companies which have ESO
- Characteristics of employees who participate
- Attitudes of businesses to ESO
- Comparative data from North America, Europe and Asia.

Conclusions
- The incidence of ESO in Australia is on the increase, although still behind the United States and United Kingdom.
- Australian companies tend to view ESO as beneficial to the organizational culture and workplace relations.
- ESOPs are more likely to be found in larger publicly listed companies, companies with overseas offices and in particular sectors of industry.
- Full-time and higher earning employees are more likely to participate and higher levels of participation are found in certain occupations.

The conclusion recognizes the limitation of this study and the relative lack of detailed data needed to get a fuller understanding of how individual companies structure their ESO and how it fits into broader HR strategy in Australia.


This paper looks at the historical development of employee share ownership in the United States and reviews past research undertaken in the late 1990s.

Employee ownership is far more prevalent in the United States, and the paper comments upon the apparent gap between employee ownership in the United States compared with the European Union, examining some of the factors which may have contributed to the variations found.

Conclusions: The slow development of employee ownership in the European Union is thought by some to haveimpeded economic growth, but in looking to expand European employee ownership, the European Union should understand the factors which have influenced the U.S. growth in employee ownership, learning from its experience. There seem to be socio-economic differences between the United States and European Unions that may account for the significant differences in the development of employee ownership: one is the relatively low involvement of regular citizens in the European Union in public stock markets; another is the lack of legislative encouragement for small businesses to provide ownership involvement to employees.

The authors recognize the significance of the collapse of the fixed wage structure on the development of employee ownership. The fixed wage structure provided a simple remuneration package of a fixed wage plus a pension, which offered little incentive to employees particularly as average real annual wage increases have, over the past 20 years, been particularly low. The desire of companies to have low fixed salaries and the much higher returns available from stock have, to a large degree, fuelled the growth of employee ownership in the United States. Another important factor has been the need to provide performance-related pay in high performing companies.

The problem encountered by U.S. employees investing their savings in the employer, thereby exposing the employee to unacceptable levels of risk, needs to be addressed. The authors call for further discussion on this issue, and the investigation of methods which will give employees greater protection from undue risk.


This paper was presented as testimony before the Subcommittee on Employer-Employee Relations Committee on Education and the Workforce, U.S. House of Representatives.

It gives an overview of the prevalence of employee ownership in the United States and identifies the lessons to be learned from the 70 or so empirical studies that have looked at various aspects of employee ownership over the preceding 25 years. These studies are grouped into the following category headings and the author draws out broad conclusions from 31 of these studies, under these categories:
- Employee attitudes and behavior
- Firm performance
- Employment stability, growth and firm survival
- Employee wealth and wages.

Conclusions
- The results of the studies are generally split between favorable and neutral findings on the effect of employee ownership on employee attitudes and firm performance, with very few negative findings.
- On average, employee ownership is linked to 4% to 5% higher productivity, and greater employment stability, growth and firm survival.
- Employee ownership cannot be assumed to automatically improve employees’ attitude or performance.
- Employee-owners generally do not sacrifice other benefits for employee ownership — they are, in fact, more likely to have diversified retirement plans.
The broad conclusions suggest that generally, employee ownership is beneficial to both employees and employers. The paper concludes with a look at the implications for public policy, noting that the potential economic and social benefits of employee ownership mean that public policy should ensure that employees have good access to the information they need to make the right financial and other workplace decisions and not attempt to restrict employee ownership.


This study reviews more than 50 large empirical studies undertaken over the preceding 25 years. Although recognizing that the expansion in stock ownership is a worldwide phenomenon, this research particularly focuses on the United States to avoid the difficulties arising from variations in the purpose and manner of use of employee ownership in different countries.

This worldwide growth has taken place against the following background:
- General business expansion and the rise in capital markets
- Use of equity by employers to give employees a real prospect of increasing their wealth beyond inflation-linked salary increases
- Transitional economies have used privatization of state assets as a means of jump-starting the private equity markets, in most cases including some form of worker-owned equity
- The expanded use of equity incentives in the high technology companies, where skilled labor is in high demand.

The study reviews the relevant economic theory and the findings of these 50 studies on the:
- Incidence of employee ownership characteristics of companies using employee ownership and determinants for it
- Evidence on firm performance (including profitability, productivity, firm survival and employment stability)
- Evidence on employee attitudes and behavior.

Conclusions
- No assumption may be made that the implementation of employee equity ownership will automatically improve employee attitudes, behavior or performance.
- It is rare to find examples of deterioration in attitudes or performance under employee ownership — it is therefore unlikely to be detrimental and may produce positive financial results for employees.
- Employee ownership is linked to 4% to 5% higher productivity on average, although the dispersion of performance outcomes is just as great among other firms.
- Employment stability and firm survival may be enhanced by employee ownership, but further research is needed.
- Pay seems to be higher among employee-owners — again further research is needed to investigate why this might be so, in particular, whether there is any trade-off between higher pay and job security or other outcomes.

With a view to having a greater confidence in research findings, the authors identify the need for more research to be done based on panel data with truly representative samples and some in depth case studies, relying less on cross-sectional studies (which concentrate on comparing those with and those without).

Original Survey-Based Research


This study was commissioned by UK HM Revenue and Customs to assess how Save as You Earn (SAYE) and Share Incentive Plan (SIP) all-employee share schemes are working in practice and the perceived effects.

Sample: 984 organizations participated in the study. Of these, 27% provided a SIP, 26% provided an SAYE scheme and 10% provided both a SIP and an SAYE scheme. 37% provided neither. 2,253 employees from organizations providing one or both of these types of share scheme were also interviewed of which 31% participated in a SIP, 25% in an SAYE scheme and 7% in both.

Method
Questionnaires were sent out to all the participating organizations including questions about the reasons for setting up the scheme(s), details about how the scheme(s) are run, the overall effect of the scheme(s) and, where no scheme(s) had been set up, the reasons for this. Employees were questioned about their reasons for participating or not participating.

Conclusions
- Organizations with larger numbers of employees, public limited companies or those offering other award schemes and employee benefits, are more likely to provide an SAYE plan or a SIP and an SAYE plan.
Employers reported that the main reason for setting up a share plan was to enable employees to participate in the ownership of the organization with a view to encouraging greater commitment and motivation.

Overall, the schemes had a positive effect on relationships with employees, half reported a positive effect on productivity. Other benefits included perceived improvement in staff turnover and recruitment.

Organizations which ceased to offer a SIP or an SAYE scheme did so because they already offered other incentive schemes and the cost of a SIP or an SAYE scheme was too much. Dilution of share ownership was also a reason.

Employees who participated were likely to be aged 25 or older with a salary of at least £26,000.

Employee participants treated it as an easy way to save, make money or buy shares. Most said that participation in the plan had increased their overall level of saving and it encouraged them to stay in their job.

Employees and employers were generally positive about the impact of the plans.

2 | Employee Share Ownership and attitudes in the context of the large multinational: some new evidence (2006) Marco Caramelli, GSCM, Montpelier Business School

The purpose of this research was to test the established models (intrinsic, extrinsic and instrumental) explaining the effects of stock ownership on employee attitudes, in large French multinationals. The intention was to find out whether previous research findings, often derived from small companies, translate to multinationals where the individual's stock-holding represents only a small proportion of the entire company stock. Sample: A Web-based survey was used to approach the employees of four French multinationals. The response rate was about 25%, with 1,517 questionnaires collected. The majority of participants were French, aged 40 or older, with high average levels of education. The response was reasonably representative of functions across the organization.

Method

45 items were hypothesized to measure seven cultural sub-dimensions and two cultural dimensions, and 68 items measuring scales related to employee stock ownership and employee attitudes. The survey also collected personal and demographic information.

Conclusions

The results suggested that the effect of stock ownership on employees in French multinationals is very similar to the effect in smaller companies:

- Employee ownership is more likely to affect employee attitudes when managers and employees see employee ownership as a means of empowering employees rather than a purely financial tool, and management are philosophically committed to the process.

- Employee ownership is more likely to affect employee work attitudes when it reaches the level at which that particular employee attaches an importance to the ownership.

The results suggest that this is more commonly reached in France than in countries which adopt the typical “Anglo-Saxon” type of employee ownership due to the differences in the ownership structures.

The author considers the “Anglo-Saxon” model to be collective ownership through a trust compared with a typical arrangement in France, in which the individual employee chooses whether to invest in the employing company or in diversified funds.


The purpose of this study is to compare the incidence, structure and form of share plans throughout Europe. Sample: The data was derived from CRANET 2000 (the Cranfield Network on European Human Resource). This describes company HR practices and policies in private-sector organizations of at least 200 employees, 2,506 organizations across 14 EU member states completed a mail survey. The results were weighted prior to the analysis to try to take account of uneven sampling between countries, but even having done this, there is no claim that the data is a fully reliable, representative picture of the European Union.

The hypotheses forming the basis of this study were:

- Being a subsidiary of a U.S. multinational is a good predictor of the use of narrow (typically executive schemes) and broad-based plans.

- The incidence of narrow and broad-based plans is higher in the United Kingdom than in other European countries.

- The incidence of narrow and broad-based plans tends to be lower in Germany than other selected countries.

- Being a subsidiary of a U.S. multinational, which is of strategic global importance, has a positive effect on the incidence of narrow-based plans (when compared with subsidiaries which operate at a more local level).

Conclusions

- National institutional arrangements and the presence of U.S. multinationals both play an important role in affecting the prevalence and type of share plans.

- U.S. multinationals are more likely to introduce narrow-based plans in Europe than broad-based, suggesting that narrow-based plans are the primary choice for multinationals accommodating the needs of a global business while also reflecting some of the characteristics of the “home” practice.

- The variation in capitalism across Europe is reflected in the diversity of national arrangements for financial participation. These national institutional arrangements tend to determine the nature and incidence of broad-based plans, although they seem to have less influence on narrow-based plans. Further research is needed to analyze the following more closely:
The effect of the “agency” factor. In this study, the relationship of interest is that between the parent company and the subsidiary (in particular how the parent can influence the subsidiary to act in a certain way) and how that affects the incidence of global equity plans. In particular whether they are more common among subsidiaries which themselves operate at a global level, in comparison with subsidiaries which operate in the local market.

The human resource related determinants for share plans (to understand the factors which affect the use of certain HR practices, some transported from the foreign parent company and others reflecting local domestic HR practices).

The contribution employee share plans make to employee retention.

Acknowledged weaknesses in this study:

“Anglo-Saxonization” (a term which is used in this study to describe the attempts by U.S.- and UK-based parents to achieve conformity across multinationals) is far broader than just the influence of U.S. multinationals. Other factors may provoke local companies to adopt the practices of internationalized companies, other than the influence of a U.S. parent.

No distinction was made between different types of plans; therefore the relevance of some theoretical statements for some plans is questionable.


This paper reports on the findings of research into the following questions:

- What is the incidence of financial participation (share in profits or rewards for increased productivity)?
- To what extent do the various forms of participation coexist, and do the various forms of decision-making participation predict the use of financial participation?
- Does the presence of direct and/or indirect participation influence the level of employee participation in profit sharing and equity-based plans?

Sample
869 listed firms across Finland, The Netherlands, United Kingdom, Germany, France and Spain.

Method
A structured questionnaire was sent to selected companies. It was designed to capture information about financial participation plans and other forms of employee participation. It covered consultative and delegative forms of participation as well as indirect participation and employee involvement in governance.

Conclusions
Although the expectation was that the study would find complementary relationships between the different forms of participation and the different types of financial participation, in fact the study found that some forms of financial participation were more likely to coexist with other forms of participation. Profit sharing arrangements tend to be accompanied by other forms of participation, whereas equity-sharing (particularly stock option) plans are much less likely to be accompanied by any other form of participation. The conclusion comments upon the possible reasons for this result which tends to contradict the findings of previous studies. The expectation of these researchers, having reviewed previous literature, was that equity plans should be more common and levels of participation higher, where there are other forms of employee involvement. The results of this study suggest that the rationale behind participation in equity plans may be different from that governing other forms of employee involvement. For instance, the offer of tax breaks for equity plans may influence the level of employee participation. The conclusion calls for more research to understand fully the relationship between financial participation and other forms of employee participation.


This U.S. research looks at the potential benefits for the employer arising from the use of broad-based stock options, which may explain the increase in use of stock option based compensation, despite the considerable risk borne by the employee. The research tests three possible theories about the benefits to employers of using broad-based stock option plans:

- A stake in the firm will motivate the employee to act in the firm’s best interests, by overcoming agency problems. Agency problems arise when the interests of the employee (the agent) are not aligned with the employer (the principal) thus making it difficult to motivate the employee to act in the employer’s interests;
- Sorting, or offering options to attract employees who are optimistic about the future performance of the firm. The more optimistic they are, the greater the scope for the employer to reduce compensation costs;
- By increasing the cost to the employee of leaving the firm (by the loss of options yet to vest), options operate as a retention tool. The effect is most pronounced when stock prices track labor market conditions as the loss is then greatest when outside opportunities are at their highest.

Samples and Method — data was gathered from:

- A survey by the National Centre for Employee Ownership (NCEO) in 2000, giving salary and option information about middle-level executives. The NCEO only surveyed firms it believed to have broad-based plans;
A random selection of 1,000 publicly traded firms with information taken from the Report and Accounts and SEC proxy statements filed in 1999; a Bureau of Labor Statistics (BLS) survey of option grants made in 1999. Limitations on the information disclosed meant this data was useful only in describing the broad patterns of stock option usage in the United States.

Conclusions

- Stock options are a very inefficient incentive mechanism for middle-level employees, because of the amount of compensation required to offset the risk associated with stock options, before they can have a motivational effect on personal effort.
- If employees are sufficiently optimistic about the firm’s performance, offering stock options in place of cash compensation may prove an efficient way of reducing the wage bill.
- Stock options may be beneficial as a retention tool. Employers may issue stock options as an efficient way of adjusting worker compensation to market conditions.

Although the evidence from this research suggests that sorting and retention are the most likely determinants for offering stock options, neither on its own is particularly efficient in achieving its aim. The report concludes that those firms where the cost benefits of attracting and retaining the right staff are particularly high, are most likely to offer broad-based option plans. However, the type of pay arrangement actually chosen is probably determined by accounting treatment or a need for simplicity in the compensation structure.


This study conducts a review of the growth in shared modes of compensation during the 1990s. During this period, there was a move away from the old wage/employment relationship toward sharing the financial rewards of the business and involving employees in the decision making. It was widely believed that this was the right progression for a modern competitive economy, and that such a transition would lead to a better work culture and improved productivity and commitment on the part of the employee. Tax incentives encouraged the transition. Previous studies tended to support this view, although these studies also show significant variations in the effect of these practices on a firm’s performance.

Against this background, this study asks two questions:

- How far has the United Kingdom moved from standard wage-employment contracts towards a shared mode of compensation?
- What effect has shared compensation had on economic outcomes?

Sample — Workplace Employment Relations Survey (WERS)

- 1998 cross-section survey covering 2,191 workplaces across Britain with 10 or more employees (80% response rate)
- 1990-1998 WERS panel survey — information on 882 surviving workplaces from the 1990 survey (86% response rate) — information obtained through interviews with management and 950 worker representatives. Completed questionnaires were obtained from 28,323 employees
- Conyon-Read 1999 survey of London Stock Exchange listed firms — 299 completed responses (20% response rate).

Findings

- In the United Kingdom, the use of shared compensation arrangements is substantial and growing (2002), partly due to tax incentives
- Firms which have shared modes of compensation, particularly deferred profit sharing or employee share ownership, are more likely to have formal channels for consultation and communication with employees;
- Firms with shared modes of compensation tend to have better productivity and financial performance figures and the stock price is better than firms without. Combining shared compensation with information and communication systems does not add further to productivity.

Conclusions

There has been a considerable increase in the use of shared compensation during the 1990s, with the biggest growth among employee ownership plans. There was an increase in the proportion of establishments with profit sharing and with nonexecutive ownership plans. The UK government has encouraged the growth of individual ownership through tax incentives in the belief that it will improve productivity. The UK approach is quite different from that adopted in the United States, where although collective ownership has been encouraged through ESOPs, it is the market rather than the state which has encouraged the growth of options and individual ownership. Shared capitalist modes of compensation should improve the economy in two ways:

- Increased communication and consultation with workers improving economic democracy
- Encouraging employees to make the right corporate financial decisions as they begin to think like owners. Although the evidence in this study suggests that shared compensation in the United Kingdom is positively linked with productivity, the results also show that the actual effect varies depending on which data is used and how outcomes are measured.

Research Based on Existing Databases


This research seeks to test two hypotheses:

- Company-level productivity is expected to be higher in companies which offer options than other companies
The effect of options on company productivity is expected to be dependent upon whether the plan is broad-based or selective.

The research distinguishes itself from other investigations into the economic impact of different types of stock options plans. The authors comment that previous research tends to rely on data which may not be representative, tends to be taken over a short time period and focuses on U.S. and UK experience. The existing data may also not enable a careful investigation of the productivity effects of different types of plan. This research uses panel data from Finnish companies listed on the Helsinki Stock Exchange and covers a period from 1992-2002. The methods used allow distinctions to be made between different types of plan. The paper discusses previous research findings and notes that the empirical evidence from these suggests a positive link between stock option plans and productivity. Highlighting the limitations of the past research the authors acknowledge that there are some areas of weakness which this research cannot address, such as the effect of HR practices and participation in decision making.

**Conclusions**
The most important finding is that there seems to be no significant link between broad-based option schemes and firm productivity and limited evidence that there is any more substantial link in selective schemes.

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**2 | The Illusive Performance Effect of ESOPs: Evidence from China’s Reform Experiment (2006)**

Xiangdong Ning (Tsinghua University Beijing), Xianming Zhou (University of Hong Kong)

This study investigates the motivational effect of an ESOP on employees and whether there is any link with the company’s performance. The circumstances surrounding the introduction of ESOPs in China are unusual. As part of the Chinese program of economic reform in 1992, the government allowed companies to be privatized through share ownership schemes. ESOPs were often adopted as part of the same exercise. This study looks at companies which adopted an ESOP as part of this process. The government stopped approving new ESOPs after two years.

This study is of particular interest because the Chinese ESOPs were introduced in an environment free of any developed incentive arrangements and did not therefore compete with other types of arrangement. Accordingly, free of other competing factors, including favorable tax treatment, one would expect any effect on motivation to be most obvious in this Chinese sample.

**Sample**
The sample contained all 750 companies listed on the Shanghai Stock Exchange and Shenzhen Stock Exchange between 1996 and 2000. Of these, 250 adopted ESOPs. Data was obtained from the financial information database published by Genius Information Technology Co. and the Chinese Stock Market and Accounting Research Database.

**Method**
The study undertook a cross-sectional comparison of those companies with and those without ESOPs looking at various performance measures including return on total assets (ROA), return on equity (ROE), stock return, Tobin’s Q (a ratio comparing the market value of a company’s stock with the value of a company’s equity book value), and productivity. The researchers also checked the IPO pricing to see if stock market values differed on going public as between companies with and without ESOPs.

Measures were taken to control the effect of factors which might influence the performance outcomes, such as size and industry.

**Conclusions**
The study concluded that ESOPs have no incentive effect on employees. This was particularly evident with low-level employees whose perception is likely to be that their contribution will make little difference to the overall performance of the firm. The high level diffusion of ownership encourages the “free rider" effect which negates any incentive value. The study concluded that the same would be true of all types of employee-ownership-based incentive arrangements.

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**3 Effects of Employee Stock Bonuses on Productive Efficiency: Evidence from Taiwan’s Electronic Industry (2002)**

Yuanchen Chang and Vivian Jeng (National Chengchi University, Taiwan), Robert C.W. Fok (Shippensburg University, United States)

This is a study of the effect of stock bonuses on productive efficiency and seeks to address the shortcomings of previous studies. The research looks specifically at the highly successful Taiwanese electronic industry, analyzing the relationship between employee stock bonuses and productivity. Other studies have analyzed the link between profit-sharing arrangements and performance measures such as return on equity or assets. This study adopts a different way of measuring productivity by using data envelopment analysis to produce an efficiency “score.” The authors state that government regulations do not allow companies to issue stock options in Taiwan and so paying bonuses in stock rather than cash is the way in which the electronic industry tries to attract, incentivize and retain high quality staff. It has been credited with being the reason for the success of one of the most competitive industries in the world.

**Sample**
89 electronic companies, traded on the Taiwan Stock Exchange and the over-the-counter exchange, each year from 1998 to 2001. Balance sheet and Income Statement data are obtained from the Taiwan Economic Journal (TEJ) database.

**Conclusions:**
The researchers found a positive relationship between higher levels of employee stock bonuses and the efficiency scores, suggesting that employee stock bonuses could improve productive efficiency. However, the effect on efficiency was found to be short-lived and companies therefore would need to regularly award stock bonuses to maintain the effect. However, the dilution caused by awarding stock bonuses makes them unpopular with shareholders. By making regular awards, the dilution effect would be accelerated over a period of time thus making them even more unpopular. The researchers identify other factors which may have a bearing on efficiency such as leverages, diversification and corporate governance which are intended to be the subject of future research.