Research on the Causes and Countermeasures of the Termination of Equity Incentive - Take G Company of Electronics Industry as an Example

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Abstract

Appropriate equity incentive scheme is conducive to the healthy and sustainable development of enterprises. This paper takes G Company in the electronic industry as the research object, and makes an in-depth analysis of the reasons for the termination of the two equity incentive schemes. By referring to the successful enterprises which implement equity incentive, this paper makes a detailed analysis from the four dimensions of incentive mode, incentive object, incentive quantity and exercise price, and finds that the implementation of equity incentive will have a positive impact on the business performance, market value and technology research and development of enterprises. By studying the equity incentive model, this paper finds that the application of stock option has stronger incentive effect than that of restricted stock. Finally, according to the problems existing in the implementation of incentive scheme of G company, the paper puts forward optimization suggestions and safeguard measures.

Keywords

Electronics industry, Equity incentive, Countermeasure research

1. Introduction

As a mechanism to reduce agency costs, equity incentive has become a common way for shareholders to motivate executives of Listed Companies in China [1-2]. By the end of 2018, 405 listed companies in China have terminated the equity incentive plan (data from CSMAR database). The implementation of termination of equity incentive needs to announce and explain the reasons for termination, most of which are due to the fact that the stock price of the company is lower than the grant price[3-4]. The electronic industry is one of the important pillars of the national economy, and there are few studies on it[5-6]. The author believes that, based on the motivation of management to seek benefits and avoid disadvantages, the content of the announcement may emphasize the impact of the external market, thereby weakening shareholders'over-optimism about the market and management's inadequate ability to operate when formulating incentive plans. In order to explore the real reasons for the termination of the equity incentive plan, this paper takes G Company in the electronic industry as the research object, makes a thorough analysis of the reasons for the termination of the equity incentive plan in 2017, finds out the existing problems and puts forward countermeasures.

2. General Situation of Cases

G Company was listed on the Shenzhen Stock Exchange in March 2015. It is mainly engaged in the production of touch protection glass panels, which are used in a series of electronic products such as mobile phones, tablets, cars and watches. In order to retain, attract and agglomerate talents, the company introduced the draft stock option incentive in September 2017. After the filing of the SFC and the deliberation of the shareholders'meeting, the equity

incentive plan was officially launched in December 2017 (see Table 1). The company adopts a four-year equity incentive scheme, granting a total of 630 senior managers, core technicians and business personnel 30 million cents of stock options and restricted stocks. The exercise price of stock options is 30.84 yuan/share, and the grant price of restricted stocks is 15.42 yuan/share. The net profit growth rate in 2015 is taken as the exercise condition index.

Table 1. Main contents of stock option incentive scheme of G company in 2017

		2016	2017	2018
Awarding mode		stock option +restricted shares		
Grant date		18 December 2017		
Exercise price		Conditions of exercise and its reality (The base year is 2015)		
Conditions of exercise and its reality (Conditions of exercise and its reality)	Net profit growth rate	40%	75%	100%
	Net profit growth rate	-21%	33%	-54%
Feasible period		2018.12~ 2019.12	2019.12~ 2020.12	2020.12~ 2021.12
Exercise proportion		30%	30%	40%

In less than a year, however, the board of directors issued an announcement in November 2018 to terminate the incentive plan. The company's employees and investors were in uproar. The announcement shows that the reason for termination of equity incentive is that the internal securities market has changed a lot, and the stock price of the company is continuously lower than the grant price of the granted rights and interests. It is difficult to achieve incentive effect in the long run.

3. Case Study

The termination of the incentive plan is not accidental. G company proposed an equity incentive plan in September 2015, which was terminated in 2016. However, the equity incentive plan in 2017 was terminated again in 2018. The specific reasons are inseparable from the unreasonable design of the incentive plan. This paper will make a thorough analysis from four aspects: equity incentive mode, incentive object, incentive quantity and exercise price.

3.1. Improper Selection of Incentive Modes

The stock option is adopted in 2015, and the restricted stock of stock option is adopted in 2017. Stock option and restricted stock are the two most widely used and mature models in Chinese enterprises at present. The characteristics and nature of the two models are different, they are also suitable for different stages of enterprises, and some enterprises choose the combination of the two models to carry out equity incentive.

Table 2. Comparison between stock options and restricted stocks

	the stock option	restricted shares
Different rights and obligations	No equivalence	Have equivalence
Different time	Wait for more than 1 year to enter exercise period	The locking period is generally more than 3 years.
Different limitation link	Restrictions on the granting and exercise of authority	Restrictions on sales link
Different exercise price	The higher of the average price on the last trading day and 30 days before the benchmark date	Not less than 50% of the 20 trading days prior to the benchmark date or gifts from the company

As can be seen from Table 2, the risk coefficient of equity options is larger than that of restricted stocks and the return rate is higher, which is more suitable for knowledge-intensive enterprises with large development potential and strong scientific research ability. However, restricted stocks are more suitable for enterprises with stable development and balanced economic growth. For example, clothing, food and this kind of production and management are relatively stable enterprises. Stock options have no equivalence of rights and obligations. Employees can choose to exercise or choose options during the exercise period, which has no effect on the employee's economy. But the choice of restricted stock employees has the potential to lose, that is, the equality of rights and obligations. Although the benefits of restricted stocks are clearer and more effective, employees need to raise their own funds to buy shares when implementing the incentive program. Through the analysis, it is found that the economic returns and market capitalization of G Company are unstable in recent years, and at the same time, the employees need to raise funds by themselves, which causes the employees to think twice about it. In 2017, 630 people were motivated by the equity incentive scheme, and 60 people abstained when subscribing for restricted stocks, with the abstention rate of nearly 10%.This from the side of the return volatility of the enterprise is not suitable for the use of restricted stocks.I mproper choice of incentive model will also have a negative impact on the enthusiasm of employees. Through the current operating environment and income of company G and the incentive scheme of the company in the early stage, restricted stock is not suitable for the current situation of the company, and the incentive of restricted stock should be carried out under the condition of stable operation of the company. Instead of using better in other companies, follow blindly, and choose the model according to their own situation.

3.2. Incomplete Setting of Incentive Objects

For the emerging electronics industry, technical talent is an important resource for the development of the company, but also a driving force for the development of the company. The brain drain is a fatal blow to the enterprise, especially some professional scientific research personnel. When the company withdrew the equity incentive program, it said it had introduced a new high-end talent to expand its R & D team, but it did not include it in the list of listed equity incentives. It can be seen that the company does not have a plan to implement equity incentive to the new personnel, which also reflects the unreasonable setting of the object of equity incentive from the side.

The equity incentive object of G company is directly selected by the senior management of the company, and there is no explanation of any situation, which also leads to the non-transparency of the object selection. The company only distinguishes the position of the director, the secretary of the board of directors and the chief financial officer, the core backbone of the company does not distinguish, especially the technical research and development personnel and the sales personnel, their incentive standard and the check-up condition should be different. The purpose of implementing equity incentive is to make employees work together to manage the company well, so equity incentive should also be fair and public. The company's core backbone does not have clear standards, and there is a high likelihood of a position in which a large number of people are working hard, but those who receive equity incentives may be just one, which leads to a sense of injustice on the part of other paid employees. In the long run, it has also had a negative impact on the unity of the company, as well as the existence of some moral hazard. There is also a clear standard for employees who do not have a shortlisted equity incentive to know why they are not being encouraged by equity, and where they should work to get a chance to get the equity incentive next time. The lack of qualitative and quantitative indicators in the evaluation of incentive objects leads to a lack of transparency in subjectivity and the lack of clarity in the company's promotion path and equity incentive system will have a negative impact on employees' enthusiasm.

3.3. Unreasonable Number of Incentives

The number of equity incentives determines the extent to which the company gives employees equity incentives. In the announcement, employees who own more than 5% of the shares of the company are not within the scope of incentives. In 2015, among the 368 incentive objects, Only six of the company's management are included in the equity incentive list. With the exception of the secretary of the board, each manager has the same share of 20000 shares. As an important manager of the company, the director is the trustee of the company's wind direction. He is obviously different from the other managers in their contribution to the company, but the earnings are the same as the other managers. Such a distribution of shares is clearly unreasonable. After the company found that its unreasonable place made the corresponding adjustment as shown in the figure:

Table 3. Quantity distribution table of restricted stock incentive scheme

Name	Post	Quantity of restricted shares granted (10,000 shares)	Percentage of total restricted shares awarded	Percentage of total share capital as at the date of announcement of this incentive scheme
Zhou xx	Director	12.50	0.83%	0.0048%
Liu x	Vice president	12.50	0.83%	0.0048%
Liu xx	Deputy General Manager, Chief Financial Officer	10.00	0.67%	0.0038%
Peng xx	Vice president	10.00	0.67%	0.0038%
Rao xx	Secretary of the Board of Directors	12.50	0.83%	0.0048%
Li xx	Vice president	7.50	0.50%	0.0029%
624 technical operations staff		1135.00	75.67%	0.4335%
Obligate		300.00	20.00%	0.1146%
Total		1500.00	100%	0.5730%

Table 4. Quantity distribution table of stock option incentive scheme

Name	Post	Quantity of restricted shares granted (10,000 shares)	Percentage of total restricted shares awarded	Percentage of total share capital as at the date of announcement of this incentive scheme
Zhou xx	Director	12.50	0.83%	0.0048%
Liu x	Vice president	12.50	0.83%	0.0048%
Liu xx	Deputy General Manager, Chief Financial Officer	10.00	0.67%	0.0038%
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Data source: G listed company equity incentive draft

As you can see from tables 3 and 4, incentive plan companies changed the number of options between executives in 2017, and depending on what managers pay, they can motivate senior managers. However, there is still an equitable distribution of business technicians, and there is no distinction between R & D personnel, middle managers and grass-roots managers and core sales staff, with 18100 units allocated per person. The number of such options is low, especially for R & D personnel, the duration of R & D is long, and the market effect of R & D is lagging, so the motivation of employees is not fully stimulated. The number of such options is low, especially for R & D personnel, the duration of R & D is long, and the market effect of R & D is lagging, so the motivation of employees is not fully stimulated. Is that the reserved share and proportion are too large, resulting in injustice to the nominated motivators and insufficient number of incentives. Although the number of options is not as good as the number of options, but less equity will cause employees to lose confidence and motivation, so the number and distribution of equity incentives should have a better ratio, The motivation of the employees will not affect the ownership of shareholders, so there is still room for adjustment and improvement in the allocation of the quantity of the equity incentive.

3.4. Exercise Price Is Unreasonable

G Company 2015 stock option grant price of 105 yuan/share. The price is determined mainly through the closing price of the stock and the 30-day average price of the high price. The prices of stock options and restricted shares in 2017 are 30.84 yuan per share and 15.42 yuan per share respectively.

According to the "Memorandum on Equity Incentive Matters No. 1", if the source of the underlying stock is directional issuance, the issuance price shall not be lower than 50% of the average stock price of the company 20 trading days before the pricing benchmark date. There is only 10 trading days between 30 trading days and 20 trading days, but the average price of shares in the first 20 trading days of the company is 87 yuan per share, but it is 20 percent higher. From this we know that the recent volatility of the stock price of the company is very large, it is somewhat arbitrary to judge the adoption of the highest standard, and it does not

reflect the true intrinsic value of the company, and the stock market of our country is not mature. The effectiveness of corporate value is not fully reflected, these are inevitable non-systematic risks. At the same time, because the company does not go public for a long time, investors from all walks of life are more optimistic about the development of the company, resulting in a high stock price. So we can't just use the stock price as a measure of price, you should combine some other ways to make pricing more realistic and fair, but also to adapt to changes in the market. We should carry on the different choice according to the different market, the excessive stock price will also affect the enterprise employee's confidence. If the pricing is too low, the welfare will be formed, thus the incentive effect will not be achieved, and the interests of the shareholders of the company will not be guaranteed.

4. Equity Incentive Scheme Countermeasure

4.1. The Choice of Stock Incentive Mode

Since its listing in 2015, G company has only four years. It has been developing rapidly. Its scale is expanding, its development and innovation ability are strengthened. The company is in the growth stage. Along with the increasing sales of electronic products and the leading enterprises of electronic products manufacturing enterprises, the enterprises also have a lot of room for growth. Although the stock price of the company is greatly fluctuated by the influence of market environment factors, the overall intrinsic value of the company is showing an upward trend. Therefore, the mode of equity incentive can be adjusted according to different stages of enterprise development. G company should choose stock option as a long-term incentive mode at this stage.

Restrictive stocks are suitable for large-scale enterprises with mature development. The main reason is that companies usually use discount incentives and restrictive stocks have the equivalence of rights and obligations. Employees of enterprises need to pay a corresponding price for poor operation, which leads to employees'fear of risk and give up buying stocks. However, stock options do not have reciprocity. Employees have only rights and no obligations. Employees need not worry about bringing direct economic losses to themselves. Therefore, stock options are suitable for high-tech and talent-intensive enterprises with great potential for development, especially those in the transition period. G Company's total turnover reached 17.227 billion in 2015, and its profit increased by 31% compared with the previous year. This is not only due to the economic benefits of the company's listing, but also due to the economic benefits of stock options. According to the company's annual report disclosure, the company's customers mainly come from the United States, Apple's sales in China declined rapidly in 2018 due to the impact of Sino-US economic and trade frictions, so the company's business income was significantly hit by a 60% decline. As a result, G company has to turn its main customers into domestic mobile phone brands, because each customer has different requirements on product quality and process, and the company needs to change the process of different products, so the company is also in the transition period of products.

The mixed mode of equity incentive has been implemented by companies since 2015. According to statistics, 10 of 557 listed companies have adopted the mixed mode of incentive. In 2016, 18 of 415 listed companies have implemented the mixed mode. Although the number is not high, the number of companies willing to try increased, which means that the original equity incentive mode did not meet the expectations of the owners. Although G company is in the growth stage, it can adopt the mixed incentive mode after the company enters the stable stage. As a result of the implementation of two incentive schemes, we can see that the incentive effect of using stock option incentive is more significant. Considering the transformation of enterprise development, we should choose to continue using stock option incentive schemes.

4.2. Reasonable Determination of Incentive Object

Whether the incentive target is determined reasonably, whether the allocation ratio is appropriate and whether the scope is comprehensive, these factors directly affect the effect of equity incentive. Employees in emerging technology industries are the core of the survival and development of enterprises. Employees'technology and R&D ability are the main factors of the competitiveness of Companies in the market. Employees who are motivated by equity should be closely related to the importance of their jobs. Relevant to each other, employees can be divided into three categories: senior managers who make decisions on the overall operation of enterprises, core technology R&D personnel and strategic management personnel.

G company should pay attention to four principles when deciding on the target of incentive: first, pay attention to the incentive of the company's top managers. Senior managers are the leaders of the general direction of the company. Their decision-making is related to the survival and development of the company. Our country's "Management Measures" may contain such managers, so they should be excluded when choosing incentive targets. Secondly, to strengthen the incentives of middle-level managers, middle-level managers in the company is a connecting link between the pivotal role, the implementers of the work are often managed by them, they play a very important role in the development of the company. Third, expand the scope of incentives for technical and business personnel in the company. The incentive scope of G company's technical personnel increased from 362 in 2015 to 624, an increase of 72%, but it accounted for 0.15% of the total number of employees. From the analysis of the total number of employees, the company's incentive target can be further expanded. Fourthly, we should increase the number of new excellent employees as incentives. The company can increase the new employees who have outstanding performance as the incentive object. On the one hand, it strengthens the loyalty of the new employees, on the other hand, it is more conducive to attracting outstanding employees from outside, and can bring good work atmosphere to the company. Employees who are not motivated by equity incentives believe that as long as they continue to work hard, they can become the incentive targets of the company, so that the company's equity incentive scheme can make employees feel more fair.

Employee incentives can also refer to the experience of Western countries, the number of incentives will be increased to 5% of the total number, increase the scope of equity incentives, improve the enthusiasm of employees as a whole. G company can increase the incentive target to 5% of the total number, that is, the total number of 3000 people, so that the scope and management level can be more extensive, the incentive effect will run through the whole company, and play a full incentive effect.

4.3. Reasonably Set Grant Quantity

According to Memorandum No. 1 issued by the SFC, it is stated that the amount of equity incentives implemented by the company is legalized as long as the cumulative amount of equity incentives does not exceed 10% of the total equity. The number of equity incentives of G Company in 2015 is 0.03% of total equity, and the number of equity incentives in 2017 is 1.15% of total equity. It is feasible to understand that the number of incentives for company employees has not been fully covered, the number of incentives for company has room to increase, and the number of reserved parts is too high, while the number of nominated employees'incentives is too low, and equity is reasonably set up. The number of incentives granted can also make equity incentives work twice as well with half the effort. So how to determine the number of incentives is particularly important. Neither blindly pursuing equal treatment nor damaging the enthusiasm of employees, this requires quantifying the work and contribution of employees, combining personal development of employees with company performance, and determining the number of incentives has a basis. Quantitative work can be carried out by the compensation committee, but on the basis of the results, the process should be controlled, so that the number

of awards can be determined by the mode of "base + evaluation + other". Firstly, the model determines the base number of different positions, secondly, evaluates the comprehensive value of employees, and lastly, other contributions of employees to the company (e.g. overtime, training, promotion of the company's reputation, etc.). By adjusting the number of grants through the scoring of the model, more transparency helps to regulate the company.

If the number of incentive stocks is too high, the disputes within the company will arise, which will lead to internal contradictions. If the number of incentives is too low, the employees will not attach importance to it and it will be difficult to achieve the incentive effect. In terms of the number of incentives, enterprises should decide the number of incentives according to the comprehensive factors of employees. The creative value of employees can be quantified, and then the number of stocks can be matched. The number of equity incentives can be increased to 6% of the company's total equity. According to the total equity in 2017, the number of incentives should be increased to 15 million. By increasing the number of incentives and determining the total number of incentives, such a ratio can promote the better implementation of incentive plans.

4.4. Scientific Design Exercise Price

Whether the equity incentive scheme can achieve the desired effect, the exercise price and exercise right are also important factors. Stock options are used in both incentive schemes of G company. Stock options are greatly influenced by market environment, such as economic cycle, macro-policy, market speculation and public psychology. When the market environment is good, company employees can get high returns with little effort. If the market environment is not good, no matter how hard they try, they can also get high returns. It is difficult to achieve the conditions of exercise, so it is particularly important to design a scientific exercise price.

In 2017, the average trading price of stock was 29.32 yuan per share on the day before the announcement of the draft stock option incentive plan, and 30.84 yuan per share on the 60 trading days before the announcement. The exercising price of company stock option can not be lower than the higher price between the two. It is not scientific to use this as the criterion only. Our stock market is vulnerable to many factors. It is worth discussing the criterion of this orientation. This paper introduces the change rate of stock price and industry classification index as the design index to calculate the ideal exercise price so as to maximize the effect of equity incentive. Referring to these two indicators, consulting the relevant literature, the formula for calculating the exercise price is set as follows.

Exercise price=(Market price of current stock*Change rate of industry classification index)/[EVA growth rate*(1+Stock price in the industry.)]

Among them, the change rate of the industry sub-index is the change of the industry sub-index of the company to the base period; the formula of the intra-industry stock price is as follows

Stock price in the industry. =[(Pt-Po)/Po]-[(Qt-Qo)/Qo]

Pt: The closing price of the exercise company's shares; Po: Average closing price of G company 5 days before award; Qt: Average closing price of comparable companies in the industry on exercise date. ; Q0: The average closing price of comparable shares in the industry 5 days before the award date.

By calculating the EVA growth rate first by using the formula above, the EVA= after-tax operating profit-total capital * average capital expense ratio can be calculated to be 1.271 billion in 2017, with a growth rate of 0.147. In combination with the formula, the exercise price of the stock option should be 22.67 yuan, which is 8.17 yuan different from that of the company.The exercise price calculated through the above-mentioned way is no longer a single level of company performance, but is more scientific in combination with the industry level and the company's own situation.The growth of EVA will make the stock price and the exercise price have a certain price difference, make the income of the incentive object more correlated with

their own efforts and efforts, increase the effectiveness of the company equity incentive, and also make the incentive scheme maintain a long-term nature.To sum up, the exercise price of the company is 22.67 yuan, which is more fair and effective and motivates employees.

5. Conclusion

Based on the typical cases of G company's two incentive plans and the development process of the company, this paper puts forward some suggestions for improvement of G company's incentive plans, and then rises to the problems that need to be considered when China's listed companies implement the equity incentive plans. Finally, the following conclusions are drawn: Firstly, the appropriate equity incentive should be selected according to the industry characteristics and development progress of the company. Incentive mode. Second, the company should expand the scope of incentives and management levels, in order to implement the whole company and achieve a comprehensive incentive effect. Thirdly, we should combine short-term and long-term assessment indicators, introduce non-financial indicators, and establish a perfect evaluation index system of equity incentive plan. Fourthly, because too low or too high exercise price will have a negative impact on equity incentive scheme, we should take full account of internal and external factors and formulate reasonable exercise price.

To sum up, enterprises should choose and create equity incentive plans suitable for their own development according to their industry characteristics and company development stage. It is hoped that this case study can help listed companies to systematically understand the implementation rules of equity incentive, and bring some suggestions for other listed companies to implement equity incentive plans.

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