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# Long-term Performance of the Issuance of Employee Stock Options for Firms in Taiwan: Evidence from the Free Cash Flow Theory

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**Abstract:** This study focuses on the long-term investment performance of employee stock options (ESOs) issued by listed companies in Taiwan for their respective employee compensation packages. The results indicate that the detrimental effect on investment performance of the companies manifest three months after the issuance of the ESOs. In addition, companies that own low free cash flow (FCF) have better long-term performance after issuing ESOs. This result supports the FCF theory of Jensen (1986).

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## 1. Introduction

Employee stock ownership plans are the most common method to incentivize employees and maximize corporate performance (Kruse, 1993; Jones & Kato, 1995; Park & Song, 1995; Blasi, Conte, & Kruse, 1996; Ichniowski, Shaw, & Prennushi, 1997; Cui & Mak, 2002). While most of Taiwan's listed companies have earnings, they appropriate part of the yearly retained earnings to pay stock dividends to employees for employee compensation packages (i.e., employee stock bonus). However, shareholders' earnings per share have a dilution effect due to the stock bonus, thus jeopardizing shareholders' interests. Furthermore, incremental outstanding shares incurred from the stock bonus dilute stockholders' equities, and a result of the selling climax emerges in terms of capricious share prices and detrimental side effects for stockholders. Moreover, for Taiwan's listed