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Analysis of Financial Performance under The Equity Incentive System of Real Estate Companies

——Vanke as an Example

Shengxiao Zhong

Liuzhou Institute of Technology, Liuzhou 545616 , China.

Astract: Equity incentive is produced to solve the separation of ownership and management right brings principal-agent problem to enterprises. The company distributes the shares to the employees through the means of equity incentive. Equity incentive makes the company and the employees establish the interest relationship in order to promote the development of the company, whether the enterprise implements the equity incentive and how to implement it is of great significance to the development of the enterprise. At present, most of the related research on equity incentive in China is based on the data of listed companies, but in the companies that implement equity incentive schemes, Many companies can not successfully implement the equity incentive schemes because they just copy the design schemes of other companies.Because the real estate industry plays an important role in the people's livelihood, the healthy development of the real estate industry deserves our attention. After comprehensive consideration, this thesis decided to select one of the leading real estate companies in China —— Shenzhen Vanke Real Estate enterprises as the research object, mainly using literature research and case analysis to study Vanke equity incentive scheme. This thesis analyzes its impact on financial performance and makes horizontal and vertical comparison. The results show that the equity incentive system implemented by Vanke has a great impact on the financial performance of the company. The profitability of the company has improved, but the company's solvency and development capacity has not changed significantly. At the same time, it also got the positive market reaction.This report compares and analyzes the financial performance impact of equity incentive in different housing enterprises, and mainly takes Vanke as an example to analyze the problems existing in the scheme, which can provide reference opinions for other enterprises in the same industry and solve common problems.

Keywords: Equity Incentive; Financial Performance; Real Estate

1. Issue Identification

The equity incentive addresses the principal-agent problem that results from the separation of ownership and management rights for businesses. Through equity incentives, the corporation gives the shares to the staff members. The establishment of an exciting relationship between the company and its employees thanks to equity incentives helps the business flourish; therefore, how and whether the enterprise chooses to apply equity incentives has a significant impact on how the business develops. Data from listed businesses provides the foundation for the majority of related research on equity incentives in China. Yet many companies that use equity incentive programs are unable to do so successfully because they mimic the design strategies of rival businesses.

The healthful growth of the real estate industry merits our attention because it is essential to people's livelihoods. After careful evaluation, the Shenzhen Vanke Real Estate Companies, one of the top real estate firms in China, was chosen as the research subject for this report. The Vanke equity incentive plan was primarily studied via case analysis. This report compares the horizontal and vertical effects on financial performance.

This report picks a sector of the real estate market with significant economic impact, outlines its history and the current condition of equity incentive programs for housing firms, and investigates the benefits and drawbacks of various equity incentive programs to give real estate businesses experience and lessons so they may create proper and sensible practices. This report compares and analyzes the financial performance impact of equity incentives in various housing enterprises and primarily uses Vanke as an example to diagnose the issues with the scheme. By doing so, it can serve as a benchmark for other businesses in the same industry and offer solutions to issues that are frequently encountered.

2. Situation analysis

2.1 Analyzing the Equity Incentives

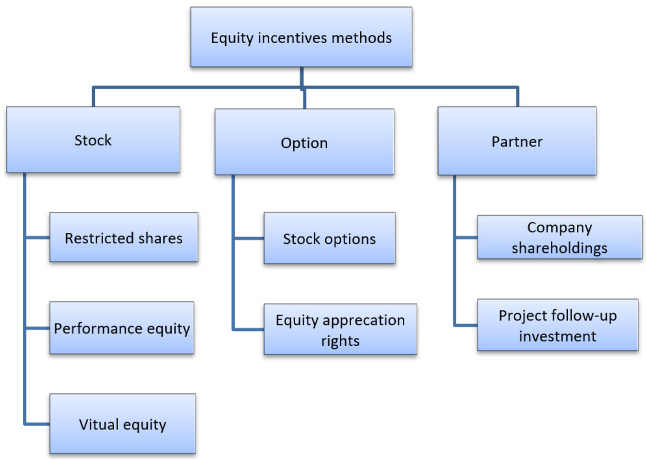
2.1.1 Definition

A system of incentive constraints is established between the employee, who is the target of the incentive, and the company, and this system is the equity incentive. Equity forms a bond of interest and risk between the employee and the company (Wu,2020). According to the classification method of the Management of Equity Incentives in Listed Companies, it is possible to classify the targets of equity incentives into several categories, which are members of the company's board of directors, senior management, middle management, and core technical staff (Zhu,2017).

2.1.2 Categories

The standard methods of equity incentives are a stock method, option method, and partner method, as shown in Figure 1. Restricted stock, stock options, and partner approach are more frequently used in real estate and are the main objects of this report. Most companies choose a single method, and a few use a combination of both methods. 2014 was an epoch-making year for real estate companies' equity incentives. Vanke, Country Garden, and Golden Land launched the innovative upgraded version of the equity incentive plan - the business partner and partner incentive method is a newly developed equity incentive method. As a newly developed equity incentive method, partner incentive is still being explored by each company.

Figure 1 Equity incentives methods.



Equity incentive is the core element of the partnership. Its idea comprises four cultures: "consensus, sharing, creating, and sharing." "Sharing" is related to equity incentives. To classify the partnership can be divided into platform type and equity type. The equity-based partnership is my primary research direction. To continue the breakdown, the equity type consists of company ownership and project follow-on investment. Project followers are those who invest in the company's projects together with the company, sharing the benefits and risks with the company, which is a short-term incentive; company shareholding refers to the use of employees' salary or own funds to buy shares of the company, which is a long-term incentive to bind the interests of employees and shareholders. The equity-based partnership is a broad equity incentive (Zheng,2014). It transforms the incentive method from encouragement with cash to equity incentive. It uses part of the profits of real estate projects to make shares to establish a close relationship with stakeholders and achieve profit maximization (Lu,2019).

3. Action planning and evaluation

3.1 Collecting information

3.1.1 Vanke Company Profile

Vanke was established in 1984, entered the real estate industry in 1988, and was listed on the Shenzhen Stock Exchange in 1991. It has been China's No.1 real estate company for six consecutive years (Wang,2019). Currently, the company is profoundly implementing the business partner mechanism. By the end of 2022, Vanke's primary business consists of real estate development, property services, and others , of which real estate development accounts for more than 93.37%, mainly residential development.

3.1.2 Content of Vanke's equity incentive program

Business partner equity incentive this stage of equity incentive assessment index requirements are: ROE reaches 12%, net profit growth rate exceeds 15% in meeting the standard. The benefits of this incentive method are huge, and Vanke's operating income has continued to grow steadily in the years after its implementation. 2016 Vanke's sales amount set a new record high, exceeding 300 billion yuan, up 39.5% year-on-year, and operating income increased 23% year-on-year. From 2014 until now, it is even more evident from Vanke's announcement that the company's business partners have continued purchasing it in A shares. This program has continued to this day.

3.2 Selecting and evaluating a course of action

3.2.1 Longitudinal analysis

After implementing the equity incentive, the operators own the company's equity, and their status is changed to shareholders. The operators who get equity start to pursue their interest maximization. In the long run, the intrinsic value of the stock, i.e., the discounted future net cash flow of the company, is also the share price, which depends on the future net earnings of the company and is ultimately reflected in the performance of the company (Zhao,2019). The dividends received by incentive recipients also depend on the future net earnings of the company.

From the announcement of the purchase of Vanke A shares by the business partners of Shenzhen Vanke in 2014, we know that this equity incentive program aims to enhance the company's value, strengthen the association between owners and operators, and motivate the employees. This report analyzes the changes in the company's performance through the financial indicator method. This report collects and compiles financial data from Vanke's annual reports from 2012 to 2018 and vertically compares and analyzes the changes in the company's operating capacity, profitability, solvency, and development capacity indicators before and after the implementation of equity incentives.

(a)Operational capability

The operational capacity of the enterprise reflects the management level of the operator and the efficiency of the use of assets and is closely related to operational performance. Due to the characteristics of real estate enterprises, inventory and accounts receivable account for a large proportion of the total assets (Zhu,2017).In this report, the following three indicators are selected to measure the level of the operating capacity of Vanke. The specific index data are shown in Table 1.

Table 1 Vanke's operating capacity indicators data..

	2012	2013	2014	2015	2016	2017	2018
turnover ratio of receivable	60.63	54.54	58.87	88.79	104.9	138.48	197.21
inventory turnover ratio	0.28	0.32	0.32	0.40	0.41	0.30	0.28
turnover of total capital	0.31	0.32	0.30	0.35	0.34	0.24	0.22

Data source： Vanke Annual Financial Statement Data.

Analysis of Table 1 shows that the accounts receivable turnover ratio increased significantly from 2015 onwards, indicating that the enterprise's capital realization ability improved after implementing the equity incentive. It can return money quickly, which is especially important for real estate enterprises. The inventory and total asset turnover ratios increased less in the two years after the implementation. Then it decreased subsequently, which indicates that the implementation of the equity incentive program can promote inventory management to a certain extent.In conclusion, this report concludes that the partner-based equity incentive program implemented by Vanke can improve the operating ability of the enterprise and promote asset management.

(b)Profitability

Vanke is also a profit-oriented company. As a real estate company in a highly indebted context, profitability is of particular concern. This is shown in the following table：

Table 2 Vanke's net profit from 2012 to 2018.

	2013	2014	2015	2016	2017	2018
Net profit	1,829,754	1,928,752	2,594,943	2,835,025	3,720,838	4,927,229
Growth rate (%)	16.82%	5.41%	34.54%	9.25%	31.25%	32.42%

Figure 2 Vanke's net profit growth trend from 2012 to 2018.

Data source: Vanke Annual Report Data.

Vanke's net profit was on an upward trend during the seven years, and in 2014, the industry's overall net profit growth rate was significantly lower due to the poor market of the whole real estate industry. However, Vanke's net profit in the same year remained high in the industry (Zhao,2019). From 2015 to 2018, the general economic environment improved, the market trend improved, the real estate industry sales situation improved, and Vanke's net profit increased significantly.

Table 3 Vanke Earnings Indicators:2012-2018.

	2012	2013	2014	2015	2016	2017	2018
Earnings per share (yuan)	1.14	1.37	1.43	1.64	1.90	2.54	3.06
Return on equity	19.66%	19.66%	17.86%	18.09%	18.53%	21.14%	21.68%
Weighted average return on equity	21.45%	21.54%	19.17%	19.14%	19.68%	22.80%	23.24%

Data source: Oriental wealth network.

Table 3 shows Vanke A's earnings per share was ¥1.43 in 2014. It continued to increase in the following years. It grew to ¥3.06 in 2018, indicating that Vanke maintained an upward trend in earnings per share and enhanced profitability per share after implementing the equity incentive plan. Although the return on net assets in 2014 decreased compared to the previous two years, it was still the best in the real estate industry. After implementing the equity incentive, Vanke's weighted average return on net assets showed an upward trend from 2014 to 2018. The overall profitability of the real estate industry declined from 2014 to 2016, so Vanke's data in these two years were affected by the macro environment and slightly decreased compared with the data in 2012 and 2013, but kept rebounding and was always higher than the industry average, showing a downward trend in the industry as a whole When the industry as a whole was on a downward trend, Vanke achieved profitability higher than the industry average. When the industry was on a downward trend, Vanke achieved counter-trend growth. From analyzing these three indicators, Vanke's implementation of this plan can promote profitability improvement.

(c)Debt-paying ability

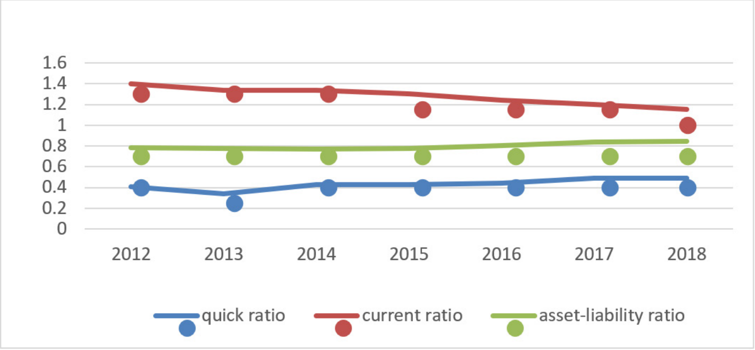
The real estate industry needs to recycle capital faster than other industries because of the long development cycle of real estate projects, the amount of capital invested, and the large inventory. Funds for development projects are first obtained from creditors and must be recovered through sales promptly after completion to have sufficient cash flow to repay debts. With timely repayment, the enterprise becomes financially more accessible and can continue to develop its business.

Table 4 Vanke Debt Service Capacity Indicators：2012-2018.

	2012	2013	2014	2015	2016	2017	2018
quick ratio	0.41	0.34	0.43	0.43	0.44	0.49	0.49
current ratio	1.40	1.34	1.34	1.30	1.24	1.20	1.15
asset-liability ratio	78.32%	77.99%	77.20%	77.70%	80.54%	83.98%	84.58%

Data source：Vanke Annual Report .

Figure 3 Vanke's Solvency Trend.



According to Table 4, the annual gearing ratio is around 77%, which gradually increased after 2014. Vanke has been acquiring other companies and expanding continuously for several years, so the gearing ratio is high. From the overall situation, the gearing ratio has slightly increased, but it does not fluctuate much, so the asset structure needs to be optimized. According to the trend Figure 3, Vanke's current ratio shows a steadily decreasing trend, while the quick ratio shows a steadily increasing trend. 2014 current ratio has no change compared with 2013, and from 2014 to 2018, the quick ratio increased from 0.43 to 0.49. The quick ratio is more sensitive than the change of the current ratio, and the quick ratio indicates more robust liquidity, which can more directly indicate the short-term solvency of the company compared with the current ratio. It is a more direct indicator of the short-term solvency of the company than the current ratio. The increase in the quick ratio is a practical meaning to the increase of Vanke's solvency as the accounts receivable turnover rate has increased significantly.The growth rate is significantly accelerated after the implementation of equity incentives, which indicates that the implementation of equity incentives has a boosting effect on the asset flow, and the short-term solvency is increased.

(d)Development capability

A sustained increase in primary business income indicates a better basis for the survival and development of the firm. An increase in the growth rate of net assets indicates a rapid expansion of the capital scale of the enterprise.

Table 5 Vanke Development Capacity Indicators:2012-2018.

Year	2012	2013	2014	2015	2016	2017	2018
Growth rate of main business revenue	43.65%	31.33%	8.10%	33.58%	22.98%	1.01%	22.55%
net profit growth rate	35.03%	16.82%	5.41%	34.54%	9.25%	31.25%	32.42%
Net asset growth rate	21.09%	28.37%	9.91%	17.62%	18.61%	15.46%	26.22%
Total asset growth rate	27.88%	26.51%	6.09%	20.24%	35.88%%	40.29%	31.17%

Data source：Vanke Annual Report Data.

From the data in Table 5, it can be seen that Vanke's primary business income has been increasing, and Vanke is motivated to survive and develop in the long term. After 2012, due to the influence of macro-control of national policies, the growth rate of primary business income of the real estate industry as a whole started to decline, but Vanke's primary business income still kept growing, which shows that the implementation of the equity incentive plan has promoted the financial performance of the company. Net profit also continued to grow for several years, especially in 2015, which shows that the company's development showed an excellent trend after implementing the equity incentive plan. The growth rate of net assets increased from 9.91% to 17.62% in 2015 compared with 2014 and maintained a stable growth level until 2018, which shows that the owner's equity has been accumulated to a greater extent. All the above figures improved significantly in 2015 compared to 2014, which shows that the company can grow continuously. However, the growth rate from 2015 to 2018 has not changed significantly from 2012-2013, which indicates that the company remains in its current state and maintains its current development.

3.2.2 Transverse analysis

However, this does not create a causal inference about the effect of the equity incentive plan because some other policy adjustments may also lead to changes in firm performance while the equity incentive plan is being implemented. The difference-in-differences approach is often used to study the effects of policies after their implementation, i.e., to compare ex-post differences between regions or individuals affected by the policies.To effectively address the limitations of the difference-in-differences approach, Ashenfelter and Card of Princeton University propose a double difference-in-differences (DID) model, which effectively controls for ex ante differences in the study population and strips away the true results of policy impacts.Zhou and Chen (2005) introduce a double difference-in-differences model for the first time for an empirical study, which, excluding the effects of other factors, effectively compared the contribution of tax reform areas to the growth of farmers' net income with that of areas without policies.Kato et al. (2005) proposed that the "double difference score" could be used to evaluate the financial performance of companies implementing equity incentives.First, the relevant financial indicators are selected as the comparison criteria. Then, the differences between the indicators of the target company and the average values of the comparable companies in the two stages before and after the implementation of the equity incentive are calculated. Finally, if the difference between the two stages is greater than zero, it means that the financial performance of the target company is better than the comparable companies and the equity incentive can improve the financial performance; otherwise, it cannot prove the promoting effect of the equity incentive on the financial performance.

(a)Comparable objects and comparable indicators

The comparable companies selected for this report are listed real estate companies in the same Shanghai and Shenzhen as Vanke. After reviewing the information,During the study period, they did not participate in the equity incentive plan：

Table 6 Basic information of Vanke and comparable companies.

Comparable company	scope of business	company qualification
Shenzhen vanke	Real estate development; industry (specific projects will be declared separately); domestic commerce, material supply and marketing; import and export business.	Real estate development level 1 qualification enterprises
China Fortune Land	Investment in industrial park and infrastructure construction; real estate; intermediary services; construction equipment services; enterprise management consulting, biomedical research and technology promotion services.	Real estate development level 1 qualification enterprises
Changchun Economic development District	Real estate development, public facilities investment, development, leasing, construction, operation and management; industry and science and technology investment.	——
Tianjin Realty Development	Real estate development; real estate information consulting services and intermediary services; agent sales of commercial housing; self-owned house leasing; house replacement.	Real estate development level 1 qualification enterprises

Data source： Oriental wealth network.

This report selects weighted return on net assets and net profit growth rate as comparable indicators. The return on net assets reflects the profitability of the owner's equity and serves as an assessment indicator for implementing equity incentives. The net profit growth rate is also a key indicator for evaluating profitability levels. The larger its value indicates the profitability of the enterprise and the stronger the ability for subsequent development.

The year of comparison was chosen with 2014 as the node, from the first two years to the last two years from the non-implementation of this equity incentive.

(b)Comparison process and results

First, the financial data for the indicators of weighted return on net assets and net profit growth rate were obtained from the annual reports, and the average values were calculated. The detailed indicators are shown in Table 7.

Then, the values of Vanke's financial indicators are compared with the average values of the three comparable companies, and the differences are first recorded as D1 and D2, where D1 = represents the difference between Vanke's financial indicators after the implementation of the equity incentive and the financial indicators before the implementation, and D2 = the difference between the financial indicators of the comparable company Vanke in the same period after the implementation and the financial indicators in the same period before the implementation. The impact on financial performance in D1 includes the impact of equity incentives and many other factors, while D2 only includes the impact of other factors. Detailed data are shown in Tables 8 and 9：

Table 7 Comparable company financial indicators.

	Weighted return on equity（%）			
year	China Fortune Land	Changchun Economic development District	Tianjin Realty Development	mean value
2012	51.42	0.42	6.51	19.45
2013	44.3	0.34	6.03	16.89
2015	42.07	0.19	0.1	14.12
2016	29.54	0.32	-8.66	7.067
	Net profit growth rate（%）			
year	China Fortune Land	Changchun Economic development District	Tianjin Realty Development	mean value
2012	45.91	248.93	42.05	112.30
2013	43.91	-18.34	-16.91	2.89
2015	31.19	-49.51	72.03	17.90
2016	23.68	64.86	-40.73	15.94

Data source：Comparable Company Annual Reports.

Table 8 Calculation of the difference in weighted return on equity.

Weighted return on equity（%）		
year	Vanke	Comparable Company Mean
2012	21.45	19.45
2013	21.54	16.89
Pre-implementation mean	21.50	18.17
2015	19.14	14.12
2016	19.68	7.07
Post-implementation mean	19.41	10.59

For the impact of the weighted return on equity,D1=19.41-21.50=-2.09；D2=10.59-18.17=-7.58.

Table 9 Calculation of net profit growth variance.

Net profit growth rate（%）		
year	Vanke	Comparable Company Mean
2012	35.02	112.30
2013	16.82	2.89
Pre-implementation mean	25.92	57.59
2015	34.54	17.90
2016	9.25	15.94
Post-implementation mean	21.90	16.92

For the net profit growth rate, D1=21.9-25.92=-4.02 and D2=16.92-57.59=-40.67.

Finally, the second difference is calculated. DD=D1-D2=effect of equity incentive + effect of other factors - effect of other factors. The value of the second weighted difference is more significant than zero indicating that the impact of Vanke's financial performance during the implementation of the plan is better than the three selected companies that did not implement the equity incentive program, proving that Vanke's implementation of the equity incentive program is effective and promotes the improvement of financial performance. The calculation results are shown in Table 10:

Table 10 Second difference calculation.

Comparable indicators	D1	D2	DD
Weighted return on equity（%）	-2.09	-7.58	5.49
Net profit growth rate（%）	-4.02	-40.67	36.65

As can be seen in Table 10, the mean of the variance of the weighted return on net assets and the mean of the variance of the net profit growth rate after the implementation of the equity incentive program are both higher than before the implementation, by 5.49% and 36.65%, respectively. It shows that for the selected comparable companies, Vanke's program of implementing equity incentive is effective and has contributed to the financial performance.

4. Recommendations

4.1 Conclusion

(a) Vanke's implementation of the equity incentive program positively impacts financial performance.

Through statistical analysis of Vanke's financial data from 2012-2018, it is found that the enterprise's profitability and operating capacity have significantly improved, and there is also a positive impact on short-term solvency, while the impact on development capacity is not significant. Vanke only started its new business partner program in May 2014, so the incentive effect was not apparent in 2014, and the net profit growth rate decreased. It was evident in 2015, when primary business revenue and net profit grew substantially, despite adverse factors such as economic downturn and policy regulation. In the same year, the return on net assets grew against the industry, and the incentive effect was noticeable. However, this equity incentive has no pronounced improvement effect on Vanke's long-term debt-servicing ability. Moreover, the growth rate indicators representing the development ability mostly stayed the same from before the implementation. The implementation of the equity incentive program enables Vanke to maintain a better profitability level and promote the long-term development of the company, which confirms the viewpoints of the three theories mentioned in Chapter 2; that is, the implementation of the equity incentive is conducive to closely combining the interests of operators and owners to achieve goal alignment, and operators will strive to improve the company's performance in order to enhance their interests.

(b) Comparing with the comparable companies in the same industry by excluding the influence of other factors with the double-difference method, the mean value of the final post-implementation difference is greater than the mean value of the pre-implementation difference, indicating that Vanke's implemented equity incentive program can indeed promote the company's financial performance compared with the companies that did not implement equity incentives.

In conclusion, the equity incentive program implemented by Vanke in 2014 generally had a positive impact on financial performance. It achieved the purpose of this Vanke's equity incentive program implementation, which can provide some reference value for companies in the same industry.

4.2 Proposing the specific solutions

For how to improve Vanke's financial performance, this report will make suggestions for Vanke's characteristics from the conclusions in the previous section, combined with the objectives of equity incentives and the equity incentive theory mentioned before.

(a)Enhancement of development capability

Vanke has developed into a mature real estate enterprise. In the increasingly competitive real estate industry, Vanke must seize the market and expand to occupy a place. In the financial index, the faster the enterprise expands the scale of asset operation in a certain period, the higher the growth rate of total assets will be. However, while continuously developing new markets, Vanke must ensure quality and expand slowly. In order to ensure the quality of the housing products sold by Vanke while increasing the quantity, gaining the trust of customers, and maintaining a high level of customer satisfaction, Vanke can ensure its continued development and rising performance.

(b) Pay attention to debt servicing ability

The real estate industry is under tremendous pressure of debt, so Vanke should broaden the channels of fundraising in order to face the competition directly and improve its performance. In addition to bank loans, it can do more external financing, such as issuing bonds. Also, pay attention to the asset-liability ratio, which must stay within the appropriate debt level of China's real estate enterprises.

(c) Diversification of assessment index

When evaluating the results of equity incentives and implementing rewards to employees, Vanke can adjust the assessment indexes. In finance, it should not only focus on profitability; otherwise, it may also only get a short-term incentive effect. Vanke should consider the four financial indicators comprehensively to reflect the information on the financial risk and operational risks of the enterprise at the same time, adding non-financial indicators, such as market share, customer satisfaction, etc., in order to make a judgment on whether the company's competitiveness in the industry is improved, which is beneficial to long-term development.

(d) Expand the scope of incentive targets

Human capital theory tells us that the development of an enterprise needs a continuous stream of talents to contribute to the enterprise. In the real estate industry, besides the contribution of top management, it also needs the efforts of sales elites, property managers, and designers. When implementing the equity incentive, the core talents should be covered as much as possible. For example, the coverage of these talents closely related to the enterprise's long-term development can be further expanded in the project follow-up and even give them preferential policies to retain talents and improve performance.

4.3 Reflection

The business partner system has gradually started to be applied in the real estate industry. Continuous improvement of the business partner system is a gradual process. Further research is needed in the future in the following areas.

(a) The conclusions from the study of Vanke itself alone are not sufficient to represent the entire industry. Therefore, when other companies implement equity incentive plans, they should make appropriate reference to the equity incentive plans of other companies according to their situation and improve the content of the plans. They can also study the suitability of different equity incentive plans for their companies, and the effect on financial performance may differ.

(b) For the factors that affect financial performance, a more robust data processing system and more scientific methods can be used to study in depth in the future to get more accurate conclusions with a reference value.

(c) How to deal with the conflict of interest if the management of the company disagrees with the investment staff due to the capital problem or when the employees cannot get the stock proceeds purchased by the corresponding bonus when they leave the company in the process of implementing the business partner project follow-on investment? The business partner system needs to develop corresponding measures to solve such problems.

Through specific case studies, this report can provide examples and references for more and more real estate companies in China that are implementing or want to implement equity incentive plans. We can only bring better development to implementing China's equity incentive system by combining theory and practice through case studies of enterprises developing in China's unique economic environment. At the same time, solving the principal-agent problem, retaining core talents, improving employees' motivation, and enhancing performance can only promote the sustainable development of the real estate industry and China's economy.

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About the author:

Shengxiao Zhong (1998-12), female, Han, Liuzhou, Guangxi, Liuzhou Institute of Technology, postgraduate, financial performance evaluation, tax system.