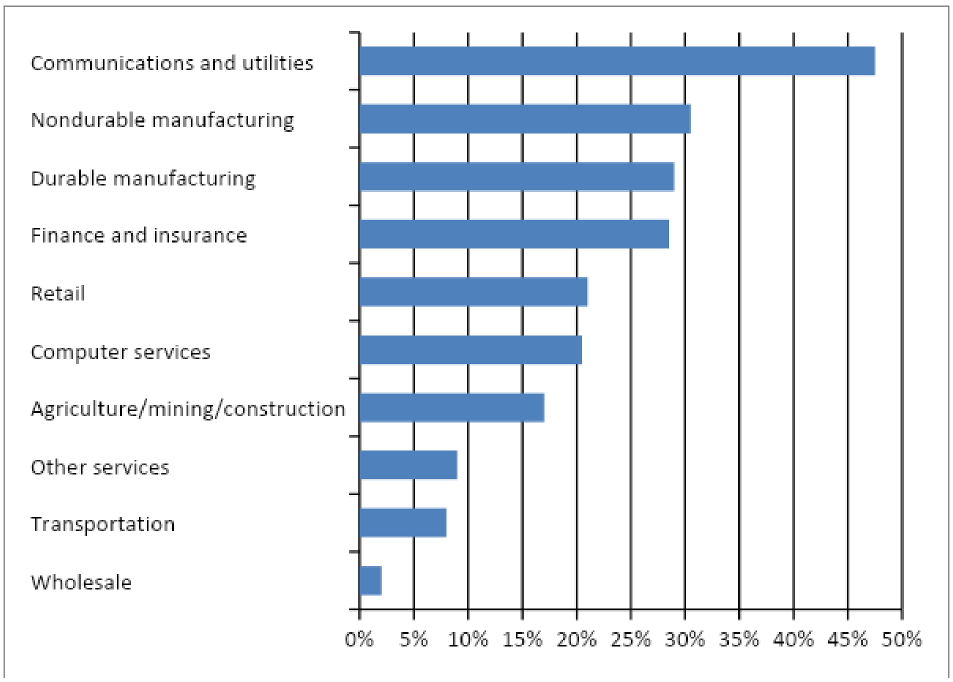
Summary Note: Shared Capitalism and Employee Ownership

1. Historical background of SC/EO in the U.S.
   a. Blasi, Freeman, & Kruse, 2013
      - William Findley, John Adams, Thomas Jefferson, James Madison, and in the Homestead Act
      - Washington gave tax incentives to New England cod fishers to rebuild their fleets after the Revolutionary War on the condition that the captains and the crew sign contracts ensuring broad-based profit sharing among all workers. He also favored grants of substantial land to veterans of the Revolutionary War to make them into self-sufficient property-owners.
      - Under President Abraham Lincoln, Congress enacted the Homestead Act of 1862, which gave 600,000 citizens access to about 100 million acres of land in 160-acre plots if they lived on the land and improved it. States such as Texas and Florida implemented generous state homestead acts.
      - The Republican Speaker of the House of Representatives, Pennsylvania Rep. Galusha Grow, who managed the Homestead Act through the Congress for Lincoln, believed that the future of the homestead idea was in workers owning shares of corporations.
      - In 1956, the Employee Stock Ownership Plan (ESOP) was invented by economist and corporate lawyer Louis O. Kelso as a way for the workers of a privately owned newspaper chain to buy out its owners. In 1974, as part of the Employee Retirement Savings Act (ERISA), Congress instituted tax incentives for corporations to grant workers shares of stock.
   b. Blasi, Kruse, & Freeman, 2017
      - Thomas Jefferson (Louisiana purchase), Abraham Lincoln (Homestead Act of 1862)
      - Penn rep. Galusha Grow saw that business and corporate assets, unlike land, were unlimited.
      - Pillsbury Flour Mill, Procter & Gamble, Standard Oil developed PS and share ownership. Carnegie pushed for the PS tax deduction.
      - R Sen. Arthur Vandenberg and the FDR administration: Tax incentives for deferred profit-sharing trusts in the 1940s.
      - Sen. Russell Long and Louis Kelso: ERISA 1974. Eliminated employee risk of buying ownership with wage deductions or retirement savings. ☾ Tax Reform Act of 1984 made investors' interest income half deductible.
      - IRS Section 1042: Private firm owners can defer capital gain taxed when selling more than 30% of C corps to ESOPs or eligible coops.
      - Weakening Federal support: Carter admin.'s 401 (k) defined contribution ☾ greater individual risks, weakened incentives for PS. Bush admin. Eliminated

tax incentives for ESOPs in public companies. Clinton admin.'s IRS Code 162 (m) made the deduction of PS and EO possible only for the top 5 exec.

2. Prevalence in the U.S. (Blasi, Freeman, & Kruse, 2013; Kruse, Blasi, & Park, 2010)
   a. Blasi, J. R., Freeman, R. B., & Kruse, D. L.
      - Total 47% workers with capital stake in firm: 12% all, 12% PS + Stock own, 4% PS + Stock opt, 5% Stock own + Stock opt, 14% only one.
      - PS median 2,000/mean 6,935. EO stake median 10,000/mean 32,692
      - EO in different parts of economy



3. Empirical Evidence: Performance (Arando, Gago, Jones, & Kato, 2015; Blasi, Freeman, & Kruse, 2016; Blasi, Freeman, Mackin, & Kruse, 2010; Bryson & Freeman, 2010; Freeman, 2007; Harden, Kruse, & Blasi, 2010; Kurtulus & Kruse, 2017; O'Boyle, Patel, & Gonzalez-Mule, 2016)
   a. O'Boyle, Patel, & Gonzalez-Mule (2016) meta analysis
      - Agency theory, HRM and OB (vertical and horizontal fit by Gerhart 2007, investment in firm specific HC, etc.), and property rights are often applied.
      - Analyzed 102 samples representing 56,984 firms, discovered variations in EO: Modes of acquiring stock, level of participation (from phantom stock to coop), and the breadth.
      - Difference between private vs. public: Weaknesses of private
      - Employee ownership has a small, but positive and statistically significant relation to firm performance (r = 0.04). Positive across different sampling

    (pre-post or not), performance operationalization, firm types (public vs. private), and sizes.
    - Performance effects increased over time, and stronger in the samples outside the U.S.

b. Blasi, Freeman, & Kruse (2016) BJIR
    - Firms that applied to the Great Place to Work Institute competition ‘100 Best Companies to Work For in America’ from 2005 to 2007, 780 firms (GPWI randomly surveys 200-300 employees each firm).
    - Standard and Poor’s Compustat file for firm performance.
    - 480 applied once, 168 twice, 182 three times □ random effects specification of the model to use within-firm and between-firm variation.
    - Great variation exists among the applicants to the ‘100 Best Companies to Work For’ list in their use of group incentive systems of pay, in workplace practices, and in worker assessment of workplace culture.
    - The firms that use SC have policies that allow greater employee participation in decisions, greater information sharing, and a more positive workplace culture than those in other firms (ESOP and deferred PS the strongest).
    - The combination of SC + empowering policies + positive workplace cultures □ Higher intent to stay, lower TO, higher return on equity.
    - With high SC and high empowerment, TO is lower.
    - SC has significant impact on ROE: Low empowerment (or trust) + SC = reduced ROE, High empowerment (or trust) + SC = raised ROE
    - SC has positive effect on firms but with varying degree □ context, support system matter.
    - Free-rider: Workers establish and enforce norms of high effort (Axelrod, 1984). Feelings of reciprocity (Akerlof, 1982) □ Greater effort and cooperation. Self-monitoring (Freeman et al., 2010).
    - Complementary policies necessary (Ben-Ner & Jones, 1995)
    - Self-selection of the firms: Sample from the upper tail can be a strength as an empirical study.
    - Self-selection of employees: Empirical evidence with the same workers but increased performance (Weiss 1987; Hansen, 1997). Experiments say random assignments to SC still improve performance (Peterson & Luthans, 2006).

c. Blasi, Freeman, Mackin, & Kruse (2010) chpt 4.
    - Shared capitalism is linked positively to greater loyalty, employee willingness to work hard and greater efforts.
    - SC negatively related to reduced turnover and absenteeism, two of often cited cost factors. Less supervision also can lead to reduced monitoring and supervision cost.

d. Institute for Public Policy Research (2014)

- Across almost 30 European countries, workplaces with inclusive profit-sharing schemes are 5.5% more likely to report having 'better' or 'much better' labor productivity.

e. Arando, Gago, Jones, & Kato (2015) on Mondragon
   - Econometric study of efficiency for Eroski, the largest member of the Mondragon group of worker cooperatives. Three types of stores are found within Eroski: 1) cooperatives with significant employee ownership and voice; 2) cooperatives with modest employee ownership and limited voice (known as GESPAs); and 3) conventional stores with no employee ownership.
   - Compare performance and if productivity differences occur, what accounts for these differences? What are the implications of these differences in organizational form for worker outcomes (satisfaction)?
   - 80 hypermarket and 542 supermarket stores (total 2,441 in all Europe) that have been part of the Eroski chain for at least six months and for which we have continuous and reliable data over the study period, February 2006 to May 2008.
     25 Coop hypermarkets 55 GESPA
     191 Coop super 26 GESPA 325 no EO
   - Satisfaction data of all hypermarket yees 4,328
   - Econometrics case study (Ichniowski & Shaw, 2003; Jones & Kato, 2011).
   - Hypermarket stores with cooperative ownership have significantly faster sales growth than do GESPA stores.
   - Net difference of sales growth is 2.4%p between Coop and GESPA.
   - For supermarkets overall, they find no significant differences in performance among the three types of stores.
   - For a subgroup of small supermarkets, cooperatives outperform conventional stores.

f. Freeman (2007)
   - On a firm level, increase firm productivity, profitability, and longevity.
   - EO on Firms: more productive and profitable, survive longer, and result in better shareholder returns. "In every category tracked (Merger or Acquisition, Bankruptcy, Liquidation,
   - Reverse Acquisition, Leveraged Buyout, Privatization, Other, and Missing) non-employee owned firms disappeared at a greater rate than employee-owned firms (Park, Kruse, & Sesil, 2004)." Benefits of longer survival for the firm discussed. Mechanisms—decision making (Kardas, 1994)? Commitment and identification? Motivation? Effort (no reduction in turnover or grievances in an ESOP that was sold without worker vote or input, Kruse, 1984)? L-M cooperation (Rosenstein, 1984)?

- Skepticism: Most economists predict either underinvestment and inefficient decision-making, inadequate supervision, or both (Bonin et al., 1993). Takeover defense, concentration of control, management entrenchment.
- Problems completely unaddressed in the literature, e.g., capital formation, maintaining liquidity, managing retirements and payouts.

4. Empirical evidence: Worker outcomes (Arando, Gago, Jones, & Kato, 2015; Buchele, Kruse, Rodgers, & Scharf, 2010; Freeman, 2007; Hallock, Salazr, & Vennenman, 2004; Kruse, Freeman, & Blasi, 2010)
   a. Arando, Gago, Jones, & Kato (2015) on Mondragon
      - More extensive opportunities for employee involvement, training, and stronger economic incentives in cooperatives.
      - Lower job satisfaction among coop workers—high stress system (autonomy, communication, training, selection, job security, promotion, pay, intrinsic reward)?
      - Employee involvement: the proportion of scheduled working hours spent on joint labor-management meetings at the store level per month (INVOLVE) was on average 0.24% for CO-OP hypermarket stores as opposed to only 0.02% for GESPA hypermarket stores
      - Incentives for workers to take advantage of employee involvement opportunities
      - Emphasis on training and skill formation in cooperatives
   b. Freeman (2007)
      - Individual employee-owners benefit from ESOPs, considerably greater employment stability, and when combined with worker participation, increase job satisfaction, organizational commitment, identification, motivation, and workplace participation.
      - EO on individuals: Gain substantial wealth, sizable ESOP benefits accrue, increased job security (Blair et al., 2000; Craig & Pencavel, 1992, 1993, 1995) and work satisfaction (not from the EO size, contingent on increased participation. Key studies reviewed), in general, no associated with increased risk (risks can arise from potential lack of diversification and increased management control).
      - No research on the impact on owners.

5. Empirical evidence: Society
   a. Freeman (2007)
      - Research very limited. Contribution to sales and employment growth (Kumbhakar & Dunbar, 1993; Rosen & Quarray, 1987).
      - Reducing inequality (Kardas et al., 1998; Onaran, 1992)?

- Spillover (No study. Schur et al., 2005 on HIWS found no change of political efficacy, but increased in one department where the HIWS was strongly supported and very successful, and decreased in another department characterized by bad labor-management relations and little management support).

6. Issues: Dilution
    a. Blasi, Freeman, Kruse (2017)
        - Manageable by keeping the size of the ESOP modest
        - Gift Exchange (Akerlof) – Workers respond by high effort, cooperation, and work standards
        - Overall economic impact is small due to the limited incidence of broad sharing

7. Issues: Financial risk
    a. Blasi, Freeman, Kruse (2017)
        - Manageable: ESOPs' net plan assets per participant 20% higher than the non-ESOPs. 57% of over 100 employee ESOPs (75% of employees) are diversified. 5/6 of the U.S. families owning stock fall below Harry Markowitz's 15% threshold (optimal 9%, 10 to 15% OK) of company stock in overall wealth portfolio.

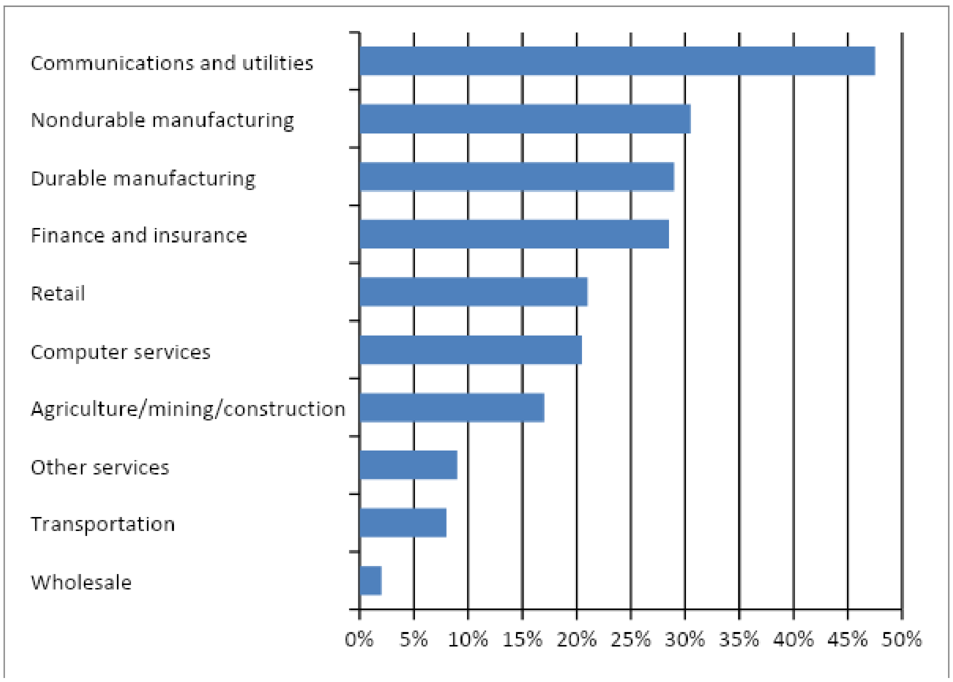
8. Issues: FRP

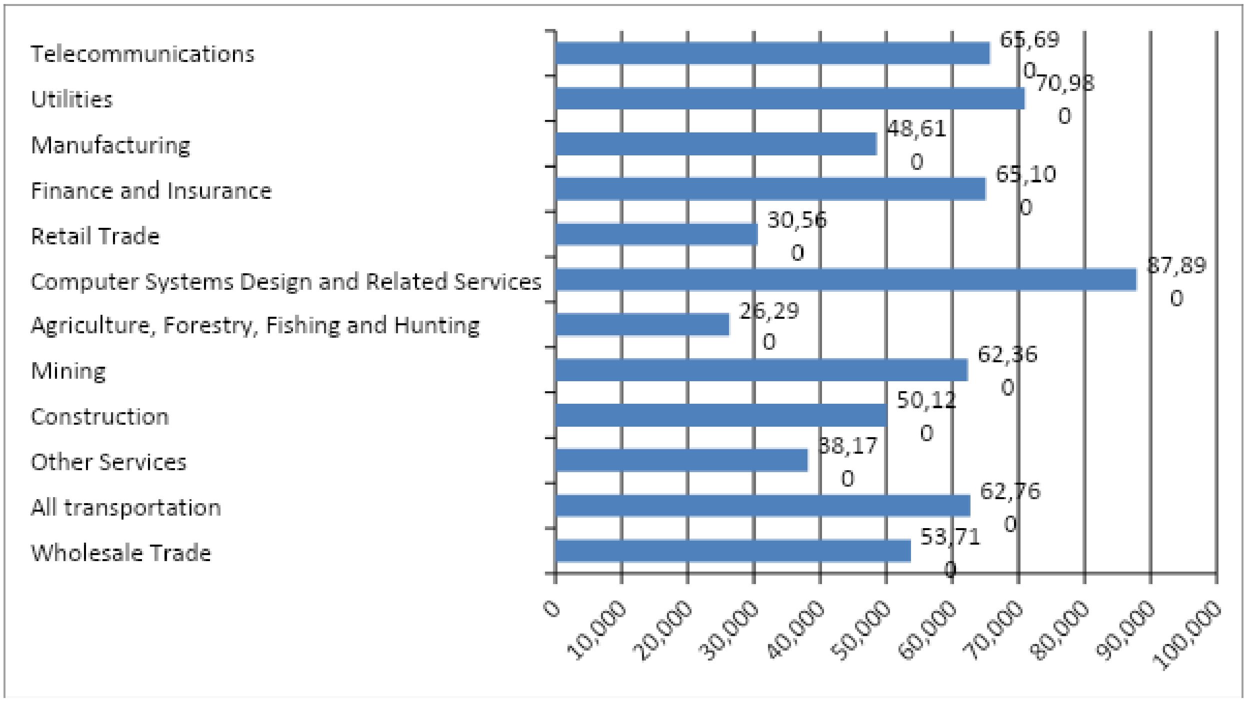
Questions:

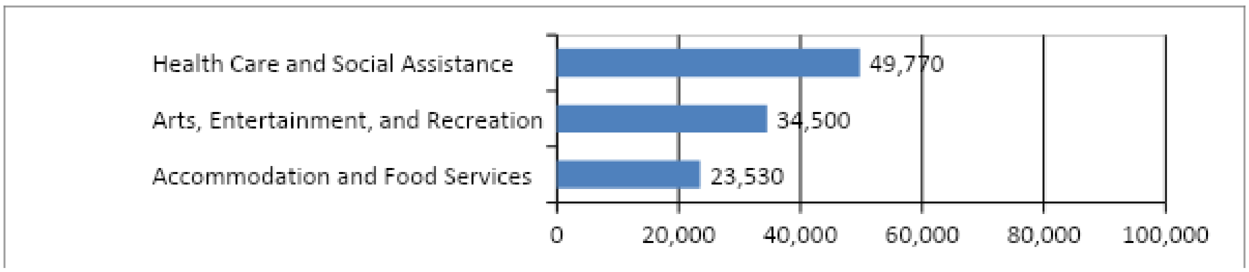
A. Regional differences in the prevalence of SC/EO in the U.S. and different countries?
B. Selectivity issue is common to all SC/EO. In case of Mondragon, local characteristics of the Basque country may be in play. How should the selectivity or broader context be dealt with?
C. More specific categorization and differentiation of SC/EO required?

Further Directions:

A. SC/EO and the spillover thesis
B. Differential effect of SC/EO with various structures and designs
C. Motivations of the owners and execs to introduce SC/EO and the impact of transition
D. Lower prevalence x Low wage industries
   High prevalence x Low wage industries







E. Suggestions by Freeman (2007)

- Identify and address real problems faced by employee owned firms
- Rigorous documentation of firm performance benefits
  - What part of, if any, this advantage is due to tax advantages?
  - How well do firms that adopt participation policies and voting rights do?
- Mechanisms by which employee ownership leads to better performance (e.g., the role of flexibility, resilience, commitment, identification, and motivation)
- Explanation of why new growth of employee ownership is stagnant
- Theoretical explanations for the desirability, benefits, and challenges of employee ownership

- Reconcile data and empirical findings on employee ownership with existing theory of the firm findings from distinct fields, and received wisdom
- Explicit acknowledgment of ESOP costs and quantification of benefits
- Documentation of social benefits
  - the role of ESOPs in enabling continuity & orderly transition
  - benefits of (employee) ownership stake and ownership society