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The Effect of Employee Ownership on Employment Stability and Firm Survival During the Past Two Recessions

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The Effect of Employee Ownership on Employment Stability and Firm Survival During the Past Two Recessions

HIGHLIGHTS:

- *Employee ownership could be used as a policy tool to curb unemployment during recessions.*
- *Employee ownership is linked to higher productivity.*

Broad-based employee share ownership allows employees at all levels of the firm's hierarchy to have an ownership stake in the company where they work. It is a channel through which employees share in the profits of the firm, can vote on important firm decisions, and otherwise have increased participation in workplace decisions.

What are the benefits of broad-based employee share ownership? First, because employee ownership shares profits among employees, it can motivate employees to work harder and increase productivity. Second, it can broaden access to capital income and expand the distribution of income and wealth. Finally, employee ownership can enhance firm survival and employment stability through greater compensation flexibility and higher productivity, which in turn can help decrease unemployment and increase macroeconomic stability in the overall economy, creating positive externalities that can justify supportive public policy.

This article is based on our new book, *How Did Employee Ownership Firms Weather the Last Two Recessions? Employee Ownership, Employment Stability, and Firm Survival: 1999–2011*, which was recently published by the Upjohn Institute. (See p. 6 for information on how to order the book.)

Our analysis presents large-scale empirical evidence on the role of employee ownership in employment stability during recessions, and underscores the importance of government policy that encourages employee ownership as a policy tool to curb unemployment during recessions. Our findings show strong evidence that employee ownership firms are less likely to reduce employment in the face of economy-wide and firm-specific negative shocks.

The prevalence of employee ownership has been growing over the past several decades in the United States and other advanced economies. According to the 2014 wave of the General Social Survey, 19.5 percent of U.S. workers own stock in the company where they work, and 7.2 percent own company stock options. According to data from the U.S. Department of Labor's Form 5500 firm pension records, between 1999 and 2010 the share of publicly traded U.S. firms with employee ownership plans grew from 16.8 percent to 17.5 percent, and the share of workers participating in employee ownership at a typical firm rose on average from 11.0 percent to 12.6 percent.

In our new book, we use longitudinal data on all publicly traded U.S. firms during 1999–2011 to empirically show that firms with larger amounts of broad-based employee ownership provide greater employment stability to their workers and are more likely to survive in the face of economy-wide and firm-specific shocks. Given the increasing prevalence of employee ownership, along with the high economic and social costs that can accompany job loss, understanding the connection between employee ownership and employment stability and firm survival carries great policy significance.

We conduct an in-depth empirical analysis of how firms with employee share ownership programs (ESOPs) weathered the recessions of 2001–2003 and 2008–2010 in terms of employment stability relative to firms without ESOPs. In the econometric analyses, we use a rich array of measures of employee ownership at firms, including the presence of employee ownership stock in pension plans, the presence of ESOPs, the value of employee ownership stock per employee, the share of the firm owned by employees, the share of workers at the firm participating in employee ownership, and the share of workers at the firm participating in ESOPs. We examine firm employment responses to both economy-wide negative shock measures (increases in the unemployment rate, declines in the employment-to-population ratio) and firm-specific negative shock measures (declines in firm sales, declines in firm stock price).

Our findings show strong evidence that employee ownership firms are less likely to reduce employment in the face of economy-wide and firm-specific negative shocks.

The firm data that we use to examine the relationship between employee ownership and employment stability come from Standard and Poor's Industrial Compustat database on publicly traded companies, matched to the Department of Labor's Form 5500 pension files, which contain detailed information on employee ownership in ESOPs and other defined contribution pension plans. These are administrative data for the population of publicly traded companies. This represents an improvement over data sets based on samples that are generally drawn from special surveys, which suffer from small sample sizes and bias from self-selection of respondents. Another

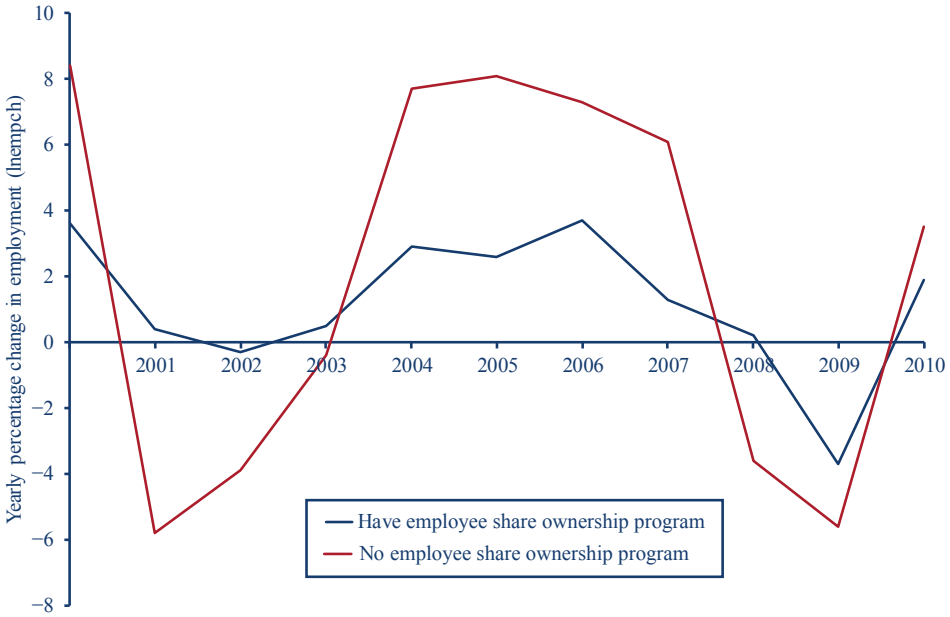
advantage is that we are able to follow firms over time, which allows us to use panel methods in our econometric analyses to help control for unobserved firm-specific effects.

Figure 1 plots the average yearly percentage change in employment over 2000–2010 at firms with and without any ESOPs in their defined contribution plans, and illustrates the basic story: employment was more stable at firms with than at firms without it. Our regression results show that this holds even when we control for an array of firm characteristics and firm fixed effects.

For example, when the unemployment rate increases by 1 percent, firms without any employee ownership in any of their defined contribution plans decrease employment by 3 percent, whereas firms with any employee ownership in their defined contribution plans decrease employment by 2.8 percent, and firms with any ESOPs decrease employment by 1.7 percent. Firms where the value of employee ownership stock per worker is low (25th percentile) decrease employment by 2.9 percent, whereas firms that have a median, high (75th percentile), or very high (95th percentile) value of employee ownership stock per worker, decrease employment by only 2.7 percent, 2 percent, and 0.6 percent, respectively. We find robust evidence of greater employment declines at firms with greater prevalence of employee ownership with our other employee ownership measures as well, and with our other negative shock measures (see Table 3.3 in the book for full results).

The book examines the relationship between employee ownership and firm survival, using the merged Form 5500-Compustat data on the entire universe of publicly traded U.S. companies. We use proportional hazards regression to predict the likelihood of firm disappearance, treating any disappearance of a firm from the data as a firm failure, as well as treating firm failure strictly as bankruptcy or liquidation. We find strong evidence that employee ownership firms were less likely to disappear than non–employee ownership firms. For example, firms with any employee ownership in their defined contribution plans were only 78.6 percent as likely as those with no employee ownership in their defined contribution plans to disappear for any reason in any year over the 1999–2011 period. The share of the firm owned by employees had a big impact on firm survival: firms where the share of the firm owned by employees was 5 percent or more were only 77.2 percent as likely to disappear as firms with less than a 5 percent share of employee ownership (see Table 4.2 in book for the full set of results).

Figure 1 Average Yearly Percentage Change in Employment by Employee Ownership Status, 2000–2010



SOURCE: Based on authors' calculations from the USDOL Form 5500 pension database.

We also explore the reasons behind the higher survival and stability of employee ownership firms found in earlier chapters, focusing on the potential roles of pay flexibility and productivity. Pay is found to be more flexible in employee ownership firms only when total shareholder return is counted as part of compensation, but this is not a plausible mechanism for greater stability or survival, given that the employee ownership comes on top of standard pay and benefits. Any increased flexibility comes in above-market compensation, and the firm would not experience labor cost savings when bad times occur.

The relationship between productivity and employee ownership is more promising for providing lessons about stability and survival. Consistent with prior evidence, we find that employee ownership is linked to higher productivity on average when making comparisons both among and within firms. The effect of employee ownership on survival and stability, however, is maintained when controlling for productivity levels. The lesson comes from examining the contingent nature of the relationship between productivity and employee ownership: consistent with the lower layoffs in employee ownership firms, these firms have lower short-term productivity from retaining more workers as the economy worsens. Retaining more workers may help their long-term productivity by helping maintain an employee ownership culture through retaining firm-specific skills and relationships that support such a culture. If this interpretation is correct, it suggests that there are strong positive externalities from employee ownership because of fewer layoffs, which helps decrease unemployment levels in the economy and maintain purchasing power for greater macroeconomic stability under recessionary pressures.

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