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## Introduction: Trends and Prior Evidence

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**How Did Employee Ownership Firms Weather the Last Two Recessions? : Employee Ownership, Employment Stability, and Firm Survival: 1999-2011**

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# 1

## Introduction

### Trends and Prior Evidence

Employee ownership is a situation in which employees have an ownership stake in the firm where they work, through holdings of firm stock. It is a channel through which employees share in the profits of the firm and can vote on important firm decisions and otherwise have increased participation in workplace decisions. The focus of this book is on broad-based employee ownership—that is, ownership of stock not just by top-level managers but by workers at all levels of a firm’s hierarchy. The past several decades have witnessed growth in broad-based employee participation in the financial performance of firms, both in the United States and in other advanced countries.

#### WHY DO WE CARE?

There are four broad sources of interest in employee ownership:

- 1) **Increased economic performance.** Since employee ownership shares the overall pie with employees of the firm, participation in employee ownership can motivate employees to work harder to increase the size of the pie, primarily through increased productivity. Employee ownership can thus alleviate principal-agent problems in the workplace. By tying worker pay to profits, the incentives of workers and owners can become aligned so that productivity-reducing conflict is minimized and productivity-enhancing cooperation and innovation are encouraged. Better outcomes can occur through higher worker effort, lower absenteeism and turnover, and greater worker commitment and willingness to share information and cooperate with management. There should be especially strong effects if employee ownership is combined

with employee participation in decisions (combining “residual control” with “residual returns”) (Holmstrom and Milgrom 1994; Jensen and Meckling 1992; Milgrom and Roberts 1990; Prendergast 2002).

- 2) **Greater job security and firm survival.** Employee ownership may enhance firm survival and employment stability, through greater compensation flexibility and higher productivity. If so, this can help decrease unemployment and increase macroeconomic stability in the overall economy, creating positive externalities that can justify supportive public policy.
- 3) **More-broadly shared prosperity.** Employee ownership can broaden access to capital income and broaden the distribution of income and wealth. The notion of workers sharing in firm profits has historical roots in the infancy of U.S. capitalism. The founders of the United States believed that broad sharing in ownership and economic rewards was vital to a thriving democracy (Blasi, Freeman, and Kruse 2013). Albert Gallatin, before becoming U.S. Treasury secretary under Thomas Jefferson, instituted a profit-sharing plan in 1795 at his Pennsylvania Glass Works, with the belief that such a system was important for the newly developing U.S. democracy. Broadening the distribution of wealth was a key reason for the creation of employee stock ownership plans (ESOPs) by Louis Kelso and their institutionalization in the Employee Retirement Income Security Act of 1974 (ERISA), spearheaded by Sen. Russell Long of Louisiana.
- 4) **Lower labor-management conflict and higher quality of work life.** Employee ownership may help to create a more harmonious work site, with less labor-management conflict because of increased alignment of incentives. Employees may also benefit from increased job security and control of their work lives. To the extent that employee ownership increases employee participation in workplace decisions, this may also help to strengthen democracy by increasing employees’ civic skills and interest in participating in politics, as argued by the political scientist Carole Pateman (1970).

Because of the above sources of interest, a number of countries give tax incentives to promote employee ownership. The European Union (EU) highlighted employee ownership and profit sharing in its four reports from 1991 to 2008 known as the PEPPER (Promotion of Employee Participation in Profits and Enterprise Results) Reports. It called on member states to promote participation by employed persons in profits and enterprise performance. Employee ownership can improve individual firm performance, which provides a rationale for firms to adopt these performance-enhancing practices, and public policy can play a valuable role in spreading this information. Furthermore, there is a very strong case to be made for supportive public policy of employee ownership if employee ownership firms lay off fewer workers and are more likely to survive, since the economic and social costs of layoffs and firm failures are borne by workers, families, communities, and the larger economy and society. In economic terms, the layoffs and firm failures create negative externalities that can justify the use of supportive public policies. In addition, a policy case can be built on the third source of interest listed above—increasing broad-based prosperity, which can reduce inequality and strengthen democracy. We discuss the policy implications further in the concluding chapter, taking all of these arguments into account.

There are nonetheless concerns about employee ownership that may limit the interest of companies and policymakers. The two principal concerns are these:

- 1) **The free rider problem.** The individual incentive to be a “free rider” in group incentives grows with the size of the group. This is also often called the “ $1/N$  problem,” since in a group incentive plan with  $N$  workers the average worker will receive only  $1/N$  of the extra rewards generated by his or her individual effort. This may be counteracted by workplace norms and company policies to encourage cooperation, higher effort, and monitoring of fellow workers, as will be discussed.
- 2) **Financial risk.** Stock values can obviously go up and down, and having a large share of one’s wealth in any one asset—including the stock of one’s employer—means that one may face financial risk by not being appropriately diversified. The financial risk may be increased under employee ownership, since if the firm fails the employee can lose both his or her job

and the company stock value. While this is an important concern and deserves attention in policy, we will review theoretical and empirical evidence that it does not appear to be a major problem in practice.

## **PLAN OF THE BOOK**

This book presents new evidence focused on the second major source of interest listed above: the stability and survival of employee-ownership firms. These topics are the most relevant to discussions of public policy support for employee ownership, given the potential broader benefits for the economy and society. In the remainder of this chapter, we provide an overview of the major types of employee ownership and prior evidence relevant to each of the four sources of interest and the two main objections. Following a brief history and overview of the prevalence of employee ownership in Chapter 2, we present new data on the relationship of employee ownership to employment stability in Chapter 3, and of employee ownership to firm survival in Chapter 4. We further probe these results in Chapter 5 in order to understand the role of compensation flexibility and higher productivity as potential explanations for the greater stability and survival of employee ownership firms. Apart from helping us interpret the stability and survival results, the evidence in Chapter 5 also sheds light on the first source of interest identified above—improving economic performance—by analyzing the relationship of employee ownership to productivity, and it sheds light on the financial risk objection by assessing pay levels and flexibility in employee ownership companies. Chapter 6 concludes with a summary of our key results and their implications for public policy.

## **WHAT IS MEANT BY “EMPLOYEE OWNERSHIP”?**

There is great variety in the types and extent of employee ownership. The extent of employee ownership within a firm can vary along

three dimensions: 1) the percentage of the company owned by employees (from a minority stake to 100 percent ownership), 2) the percentage of employees who participate in ownership (from a minority to 100 percent), and 3) the distribution of shares among employee owners (from perfect equality to a very unequal distribution where one manager owns the majority of stock and each of the other employees owns only a small amount). Regarding Dimension 1, in this study we measure the percentage of publicly held companies owned by broad-based plans, so that we can examine the effects of the percentage of company owned. Because they are publicly held companies, none are 100 percent employee owned, and most have only a small percentage owned by employees. Regarding Dimensions 2 and 3, we include only broad-based employee ownership as defined by pension rules governing coverage, so that all or most employees will be included and the distribution of ownership will generally be proportional to pay and tenure.

Overall, an estimated 22.9 million employees, or almost one-fifth of U.S. private sector employees, own stock in the companies they work for (the prevalence will be explored more fully in Chapter 2). Employee ownership programs can take several different forms, summarized in Table 1.1.

- One of the most prevalent forms of employee ownership in the United States is the ESOP. In an ESOP, ERISA allows companies to contribute company stock, or money to buy stock, to an

**Table 1.1 Population Covered by Various Employee Ownership Plans**

Types of employee ownership	Number of employees covered in U.S.
ESOPs	10.6 million
401(k) plans	5.7 million
Other pension plans	184,000
Employee stock purchase plans	Unknown
Worker cooperatives	About 7,500
Individual purchases on open market	Unknown
Stock held after exercising stock options	8.5 million stock option holders, though the number holding stock after exercising their option is unknown
Any employee ownership	22.9 million

SOURCE: Authors' compilation.

employee pension trust, or to borrow money to fund employee ownership and then repay it in installments from company revenues. Under this approach, workers generally gain an ownership stake without investing their own money to buy the stock (although in a small minority of cases they have taken wage or benefit concessions to fund the stock purchase) (Blasi and Kruse 1991). As of 2012, there were 10.6 million employee participants in ESOPs (USDOL 2015).

Apart from ESOPs, employee ownership may occur through the following ways:

- In 401(k) retirement pension plans, companies may match pre-tax employee contributions with company stock, and employees may choose to invest some of their own contributions in company stock. As of 2012, there were 5.7 million employee participants in non-ESOP 401(k) plans with employer stock (Table 2.2 in Chapter 2).
- In other pension plans, such as deferred profit-sharing plans without a 401(k) option, the company invests a portion of the profit-sharing contribution into company stock. These are rare: in 2012, there were only 184,000 participants in non-ESOP, non-401(k) pension plans with employer stock (Table 2.2 in Chapter 2).
- Employee stock purchase plans (ESPPs) typically offer stock at a 10 to 15 percent discount to the stock market price so that employees can acquire ownership through individual decisions to purchase company stock. About half of all large companies in the United States offer ESPPs, and an average of 30 percent of employees in these companies participate in the ESPP (Babenko and Sen 2014).
- Worker cooperatives are 100 percent—or nearly 100 percent—worker-owned companies in which workers invest in ownership stakes and typically make decisions based on one-person/one-vote, rather than having voting rights based on number of shares of stock. These are much less common than other forms of employee ownership; an attempted census of U.S. cooperatives found that they had a total of only about 7,500 employees in 2009 (Deller et al. 2009), although they are more common in several other countries.

- Employees can make individual purchases of company stock on the open market.
- Employees can exercise their stock options. Stock options give them the right to buy company stock at a preset strike price after a specific vesting period. Once the vesting period is over, the worker has the choice to exercise the stock option—i.e., to exercise his or her right to buy the stock at the preset strike price and sell at the going market stock price. The worker will have an incentive to exercise the stock option when the market price is above the strike price and thereby obtain a positive payoff. In this way, the employee gets the upside gain of a rise in share price without the downside risk of losing part of his or her investment. An important point is that stock-option holdings only constitute employee ownership if and when they are exercised, which would only occur when the stock price goes above the strike price and the exerciser exercises the option but continues to hold the stock. Thus, stock options could lead to employee ownership, but they do not strictly constitute employee ownership in and of themselves. Therefore, when we present descriptive statistics or figures on stock options in this book, we will always treat stock options separately rather than including them in our statistics or figures on employee ownership. Unlike direct purchases of company stock, stock options are not purchased with employee savings unless they are used for wage substitution. While stock options are most common in executive compensation, a number of companies—particularly high-tech companies—have implemented broad-based plans that distribute stock options to all or most employees. As of 2014, there were about 8.5 million employees holding stock options (Table 2.1 in Chapter 2).

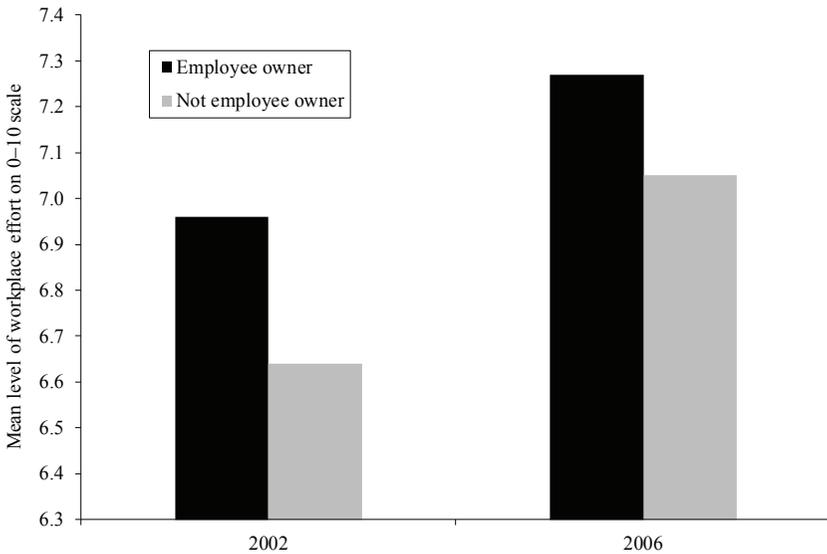
## **WHAT DOES THE EVIDENCE SHOW?**

Previous empirical research has shown employee ownership to be linked to a multitude of improved outcomes. There are several alternative methods that have been used in this research:

- Compare employee owners to individuals who are not employee owners.
- Compare outcomes at firms that have employee ownership to otherwise comparable firms that do not have such programs.
- Follow firms longitudinally and compare them before and after adoption of employee ownership relative to firms that did not adopt employee ownership.
- Employ laboratory or field experiments to examine the link between financial participation and performance outcomes.

On the following pages is an overview of prior evidence for each of the four major sources of interest—1) increased economic performance, 2) greater job security and firm survival, 3) shared prosperity, and 4) lower labor-management conflict and higher quality of work life—and for the two major objections (free riding and financial risk). We start each section with some results from the General Social Survey (GSS), which illustrate the basic relationship between employee ownership and outcomes of interest, and then provide more detail on the in-depth scholarly research. The GSS is a nationally representative survey conducted by the National Opinion Research Center at the University of Chicago. The GSS is conducted every two years on approximately 1,500 adults and includes questions on a wide variety of topics on social, demographic, and economic factors, such as political and civic participation, life satisfaction, and work habits. The GSS included several questions on employee ownership, stock options, and profit sharing in 2002, 2006, 2010, and 2014, which are useful in illustrating the trends and potential effects of these pay systems.<sup>1</sup>

**Economic performance.** The GSS results in Figure 1.1 are consistent with the popular view that employees tend to work harder and raise productivity under employee ownership. Survey respondents were asked how hard they thought their coworkers worked. Respondents who were employee owners reported that their coworkers had higher average effort (on a 0–10 scale) than was reported by employee non-owners. It is important to note that this question does not reveal whether the other workers at the respondent’s workplace also participate in employee ownership; however, employee ownership programs tend to

**Figure 1.1 Workplace Effort and Employee Ownership**

NOTE: Data are based on responses to the General Social Survey (GSS) variable *cowrkhrd*, which asks, “At your workplace, how hard would you say that people work, with 0 meaning not at all hard and 10 meaning very hard?” (The GSS asked this question only in 2002 and 2006.) This figure illustrates mean response by employee ownership.

SOURCE: Data are from the GSS on employees at private firms.

be implemented at the workplace level, so it is likely that most of an employee-owner respondent’s coworkers are also employee owners.

The results of this simple comparison are consistent with prior studies that demonstrate a positive association between employee ownership and company performance. Two reviews of the employee ownership literature have concluded that “two-thirds of 129 studies (including both performance and attitude studies) on employee ownership and its consequences found favorable effects relating to employee ownership, while one-tenth found negative effects” (Kaarsemaker 2006) and “research on ESOPs and employee ownership is overwhelmingly positive and largely credible” (Freeman 2007). Formal meta-analyses that statistically test the combined results of studies have found strong evidence of a positive association between employee ownership and per-

formance (Doucouliagos 1995; Kruse and Blasi 1997; O'Boyle, Patel, and Gonzalez-Mulé, forthcoming).

Examples of individual studies include one sponsored by the United Kingdom Treasury (Oxera Consulting 2007a,b,c) that aimed to understand whether government policies that encouraged firms to introduce employee ownership improved firm performance. The study obtained data from confidential tax records, and its examination of tax-advantaged share schemes at more than 16,000 UK firms reveals that broad-based employee ownership improves firm performance measures such as value-added and turnover. A parallel study using publicly available data on British corporations with broad-based employee ownership finds similar results. It also finds that the effects were greatly influenced by the delegation of decision-making autonomy from management to employees (Bryson and Freeman 2010). Also, Jones and Kato (1995) examine the effect of broad-based employee stock ownership plans by estimating production functions using a panel of Japanese firms; they find that the introduction of an ESOP resulted in a 4–5 percent increase in productivity and that this productivity payoff took from three to four years to actualize. In the United States, a study by Blasi, Freeman, and Kruse (2013) examined 300 privately held firms that set up ESOPs between 1988 and 1994, comparing each ESOP firm to a similar company of the same size and in the same industry without an ESOP. This study finds that ESOP firms have significantly higher sales growth and higher sales per worker than matching firms without ESOPs.

Of course, correlation does not imply causation. For example, companies may have good performance even before adopting employee ownership, so that good performance is a cause rather than consequence of employee ownership. To address this possibility, many studies have used longitudinal data that compare performance before and after the adoption of a plan, or that examine other variation in employee ownership over time (e.g., in percentage covered or size of stakes), and have found that performance improves after employee ownership is adopted or expanded. While these studies control for anything special about the firm that does not change over time, there may be other factors that affect the firm's choice of *when* to adopt a participatory pay plan, and that may be responsible for any performance changes. To address this possibility, many of the studies on this topic have used special methods

to adjust for any statistical bias, and these studies have continued to find generally positive results.<sup>2</sup>

Another potentially confounding factor is that higher-quality workers may be more likely to join participatory pay firms, and the higher firm performance may be due to the presence of better workers rather than the direct effect of employee ownership. If employee ownership does attract better workers, this could be a good reason for an individual firm to adopt employee ownership, but it does not provide a strong case for policy support, since any expansion of employee ownership may be essentially reshuffling workers among firms and not raising overall performance of the economy. While this issue of worker self-selection has not been examined in the context of employee ownership, there have been two studies of other group incentives that have found that average worker quality does not change as compensation is changed from individual to group incentives, whereas average worker performance improves under the group incentives (Hansen 1997; Weiss 1987).

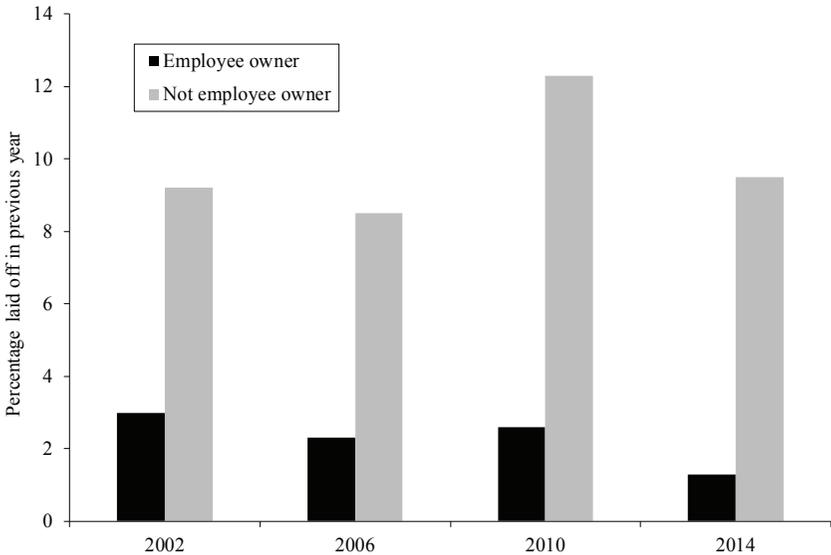
The interpretation that employee ownership increases productivity on average is supported by findings on employees' performance-related behaviors. A study of over 40,000 workers finds that those who owned company stock are more likely to say they would take action if they saw a fellow worker not working well, by talking to the worker, a supervisor, or members of the work team (Freeman, Kruse, and Blasi 2010). This result occurred both before and after controlling for a wide variety of job and personal characteristics. The idea that shared rewards is a causal factor was strongly supported in employee reports of why they would take such actions (e.g., "Poor performance will cost me and other employees in bonus or stock value"). Employee owners also reported lower levels of turnover, more pride and loyalty to the company, greater willingness to work hard to help the company, and more suggestions to improve performance (Blasi et al. 2010). While this study does not find lower absenteeism among employee owners, a French study finds that employee ownership plans were linked to reductions in employee absenteeism (Brown, Fakhfakh, and Sessions 1999).

All the studies described above are based on field research on actual firms and workers participating in employee ownership. While these studies control for many observable factors, it is always possible that there are some unobserved factors affecting the results. These unobserved factors can be fully ruled out only in a true experiment with

random assignment. While random assignment of employee ownership in actual work settings would be extremely difficult to implement, laboratory experiments have found higher productivity among subjects randomly assigned to be in employee-owned “firms” (Frohlich et al. 1998; Mellizo 2013), suggesting that there can be true causal effects of employee ownership on performance.

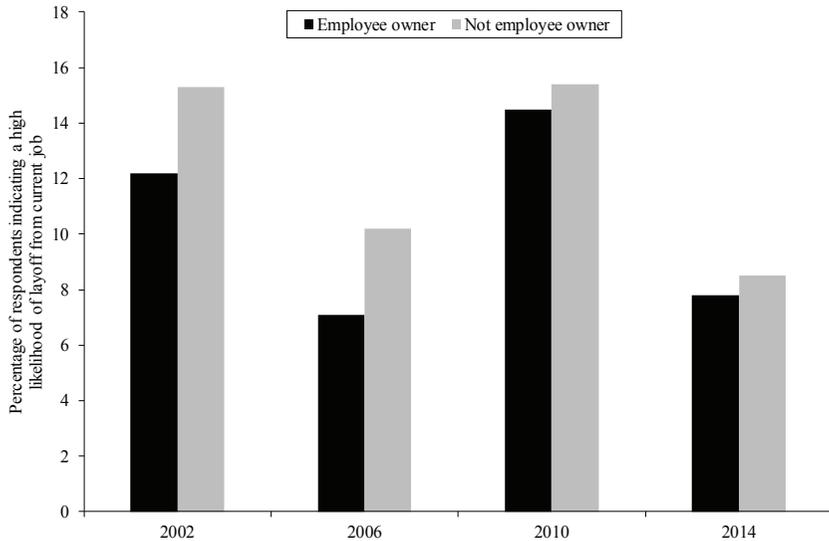
**Job Security and Firm Survival.** The GSS results show that both actual layoffs (Figure 1.2) and the perceived likelihood of layoff (Figure 1.3) are lower for employee-owners than for nonowners. As we can see in Figure 1.2, in each year, workers who participated in employee ownership programs indicated a lower incidence of losing their jobs than workers who were not employee owners. For example, in 2002, 3.0 percent of employee owners reported being laid off from their jobs in the past year compared to 9.2 percent of non–employee owners. In each

**Figure 1.2 Layoffs and Employee Ownership**



NOTE: Layoff information based on the GSS variable *laidoff*, which indicates whether the employee was laid off from his or her main job at any time in the past year. Figure illustrates mean response by employee ownership.

SOURCE: Data are from the GSS on employees at private firms.

**Figure 1.3 Perceived Likelihood of Layoff and Employee Ownership**

NOTE: Layoff information based on the GSS variable *joblose*, which asks the respondent how likely he/she is to lose his/her job in the coming year. Responses “very likely” and “fairly likely” were coded as high layoff likelihood, while responses “not too likely” and “not at all likely” were coded as low layoff likelihood. Figure illustrates mean response by employee ownership.

SOURCE: Data are from the GSS on employees at private firms.

year, employee ownership participants also reported a lower likelihood of losing their jobs than workers who were not employee owners, as seen in Figure 1.3. For example, in 2002, 12.2 percent of GSS respondents who were employee owners indicated a high layoff likelihood in the coming year (either “very likely” or “fairly likely”), while 15.3 percent of non–employee owners reported a high layoff likelihood. The difference in actual layoffs is particularly strong in the Great Recession year of 2010, when 12.3 percent of nonowners reported being laid off in the past year compared to only 2.6 percent of employee owners. One potential criticism of the layoff comparisons is that this difference may reflect the greater average job tenure of employee owners, since the nonowners may be new employees who are more likely to be laid off in recessions. The results are maintained, however, when restricted to

employees with more than one year of tenure, and when controlling for tenure, occupation, gender, race, age, and education.

Employee ownership may be linked to lower layoffs because of enhanced company employment stability and survival. Employee ownership may lead to this in at least four related ways, including 1) increasing productivity through greater cooperation, information sharing, and commitment (Pierce, Rubinfeld, and Morgan 1991); 2) reducing dysfunctional workplace conflict that can contribute to firm failure; 3) increasing employee investments in valuable firm-specific skills; and 4) creating a workplace culture that instills a sense of psychological ownership, with a corresponding commitment to preserve employee jobs whenever possible.

Prior evidence from U.S. studies shows that firms with employee ownership have higher survival rates: public companies with substantial employee ownership stakes in 1983 were 20 percent more likely than closely matched industry pairs to survive through 1995 (Blair, Kruse, and Blasi 2002), and those with substantial employee ownership stakes in 1988 were 21 percent more likely to survive through 2001 (Park, Kruse, and Sesil 2004). A study that focused on closely held firms used a similar methodology of matching ESOP and non-ESOP companies in the same industry and found that ESOP companies in 1988 were only half as likely as non-ESOP firms to go bankrupt or close over the 1988–1999 period, and only three-fifths as likely to disappear for any reason (Blasi, Freeman, and Kruse 2013). These three studies also found greater employment stability among the employee ownership firms compared to their same-industry pairs, as measured by the standard deviation of the logarithm of employment. Also, Welbourne and Cyr (1999) found that among companies with initial public offerings in 1988, those with broad-based employee ownership had higher survival rates. A study of S corporations with ESOPs over the 2006–2011 period found that they had higher average employment growth in the 2006–2008 prerecession period than did the economy as a whole, and they also had faster growth following the recession from 2009 to 2011 (Brill 2012, p. 6).

The greater stability of employee ownership firms is linked to substantially lower government costs for unemployment compensation and forgone tax revenues. An analysis based on the GSS results in combination with government data on unemployment compensation and tax

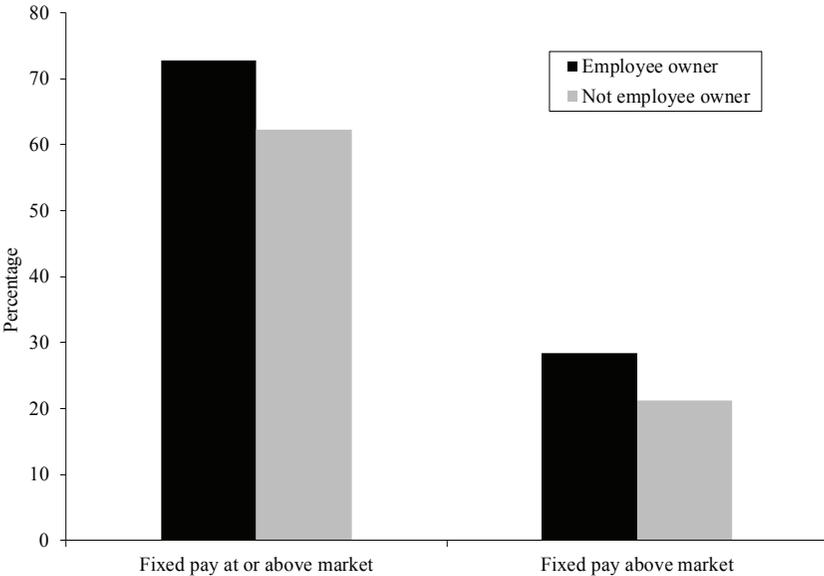
rates concludes that “based on the estimated cost of each unemployed worker, the implied federal savings from the lower layoff rates for employee owners is \$23.3 billion for the recession year 2010 and \$13.7 billion per year for the longer 2002–2010 period” (Employee Ownership Foundation 2013; Rosen 2013).

Apart from these U.S. results on stability and survival, there have been four studies of worker cooperatives outside the United States that have found high survival rates compared to conventional firms. These were studies of worker cooperatives in several countries by Ben-Ner (1988), in the United Kingdom by Thomas and Cornforth (1989), in France by Pérotin (2004), and in Uruguay by Burdín (2014). The last of these studies analyzed a long panel of administrative firm-level data maintained by the government and found that worker cooperatives had a 29 percent lower rate of dissolution than did conventional firms, and that the higher survival rate is associated with greater employment stability.

**More-broadly shared prosperity.** Employee ownership will not enhance worker incomes if it substitutes for standard worker pay or benefits. In this case it presents serious issues of financial risk, since variable pay is being substituted for fixed pay (although financial risk may nonetheless be reduced by greater job security, as will be discussed). While a common perception is that employee ownership will substitute for other forms of compensation, the evidence indicates that employee ownership tends to come on top of market levels of pay. The GSS data in Figure 1.4 provide a simple comparison to illustrate this point. Employee-owners are slightly more likely than non–employee owners to report that their fixed pay levels are at or above market levels, meaning that the employee ownership comes on top of market levels of fixed pay for most workers.

There are some cases in which employee ownership is used as part of wage or benefit concessions, but these are rare (despite the media attention paid to several cases).<sup>3</sup> A comprehensive longitudinal study of all ESOP adoptions over the period 1980–2001 finds that employee wages (excluding ESOP contributions) either increased (for small ESOPs) or stayed constant (for large ESOPs) after adoption, controlling for state-level and industry-level wage changes and other company characteristics (Kim and Ouimet 2014). Consistent with this, cross-

**Figure 1.4 Employee Ownership and Fixed Pay Relative to Market**



NOTE: Data are based on the GSS variable *compwage*, which asks “Do you believe your fixed annual wages last year were higher or lower than those of employees with similar experience and job descriptions in other companies in your region? Please answer on a 1-to-5 scale.” Responses of “4” or “5” were classified as “fixed pay above market,” and answers of “3” or more were classified as “fixed pay at or above market.” Figure illustrates mean response by employee ownership.

SOURCE: Data are from the 2014 wave of the GSS on employees at private firms.

sectional comparisons of matched ESOP and non-ESOP firms have found similar levels of pay and other benefits in the two types of firms, so that ESOPs appear to come on top of other worker pay and benefits (Kardas, Scharf, and Keogh 1998; Scharf and Mackin 2000).

Apart from ESOPs, employee ownership in general is linked to higher overall pay. More detailed analysis of the GSS data, with controls for job and demographic characteristics, finds that employee owners have higher levels of yearly earnings and are more likely to say they are “paid what they deserve” and that their fringe benefits are good (Kruse, Freeman, and Blasi 2010, p. 266). Other cross-sectional studies find that employee ownership is associated with higher aver-

age compensation levels (Blasi, Conte, and Kruse 1996), pension assets (Kroumova 2000), and overall worker wealth (Buchele et al. 2010).

For example, a study of more than 40,000 workers finds that an extra dollar of employee ownership value is associated with an extra 94 cents of wealth, indicating that there is very little substitution between employee ownership and other forms of wealth; thus, employee-owned stock appears to add to wealth in general (Buchele et al. 2010). While some of these forms of employee ownership involve workers directly purchasing stock (such as in Employee Stock Purchase Plans), such purchases are generally done on favorable terms for the employees (e.g., with discounts). The clear evidence that ESOP participants receive stock on top of regular compensation, and that employee owners in general receive higher pay, indicates that employee ownership generally does not substitute for regular fixed pay.

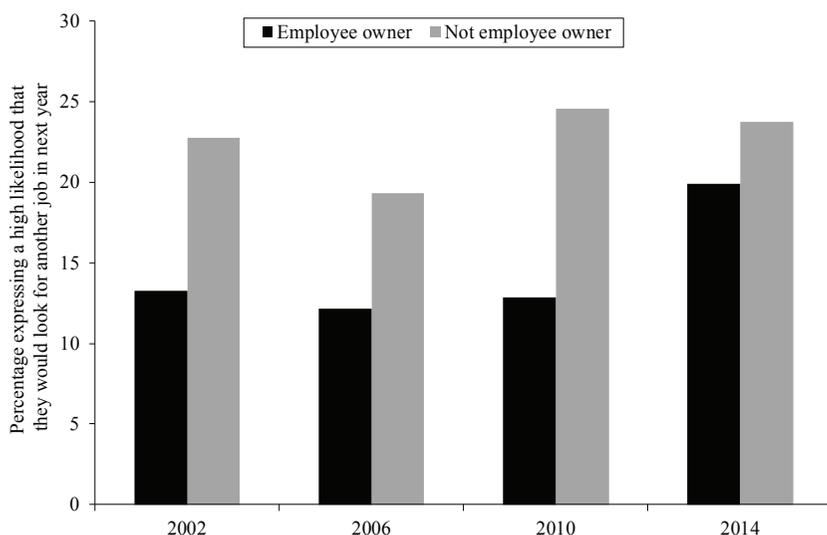
How can this be? How is it possible that employee ownership can simply add to, rather than substitute for, other forms of pay or wealth? One interpretation that integrates the accumulated evidence about worker behavior, productivity, and pay levels is based on theories of reciprocity and gift exchange. The idea that reciprocity is important in economic and social relationships receives strong support from laboratory and field studies (Axelrod 1984; Fehr and Gächter 2000; Gintis et al. 2005). This idea has been formalized in the efficiency wage model of “gift exchange,” in which workers respond to the “gift” of above-market compensation with a reciprocal “gift” of high effort and cooperation to benefit the firm and fellow workers (Akerlof 1982). There has been substantial empirical evidence in support of efficiency wage models of the labor market (as shown by the meta-analysis in Peach and Stanley [2009]). Giving employees the opportunity to own stock on top of regular compensation may be an especially effective “gift” for creating and reinforcing a sense of common purpose and encouraging higher commitment and productivity (Blasi et al. 2010). This is consistent with the studies finding higher average productivity under employee ownership, summarized above. Recent evidence lends further support to this interpretation, finding that positive effects of employee ownership on attitudes and behaviors are much more likely to occur when employee ownership comes on top of market-level wages and benefits (Weltmann, Blasi, and Kruse 2015).

The consistent finding that employee ownership tends to be “gravy” on top of other pay and wealth means that it may be a promising means for increasing worker incomes and wealth in general, which may help to reduce inequality. A 1986 General Accounting Office (GAO) report concludes that “the distribution of stock ownership within ESOPs appears to be broader than is the case in the population at large,” but that there were too few ESOP participants for this to make a noticeable difference in the overall distribution of stock ownership or wealth in general during this time—a time when ESOPs had just begun (USGAO 1986, p. 43). The first GAO conclusion is supported by more recent data, which finds that the distribution of wealth among employees in employee ownership companies is more equal than among all employees or households in general (Buchele et al. 2010). These results suggest that expansion of employee ownership has potential for enhancing the broad-based sharing of economic prosperity.

**Lower labor-management conflict and higher quality of work life.** Employee ownership may help to create a harmonious workplace, with workers having a greater say in decisions and other improvements in their workplace experiences.

Does employee ownership in fact create more harmonious workplaces? One study found that strikes were less common in unionized companies that adopted ESOPs (Cramton, Mehran, and Tracy 2008), which may reflect the greater financial transparency of unionized ESOP companies (Bova, Dou, and Hope 2015). Employees tend to give companies higher ratings on management-employee relations and other aspects of company treatment of employees (e.g., handling of promotions, worker safety, and trustworthiness) when they are employee owners or otherwise participate in shared rewards (Kruse, Freeman, and Blasi 2010).

Two basic measures of the quality of work life are workers’ turnover intentions and workers’ job satisfaction. The GSS data in Figure 1.5 show the relationship between workers’ turnover intentions and ownership. In each year, workers with employee ownership indicated a lower level of intention to find a new job than workers who did not participate in employee ownership; for example, in 2002, nearly 23 percent of nonemployee owners indicated a high likelihood of turnover intention, compared to 13 percent of employee owners. This difference

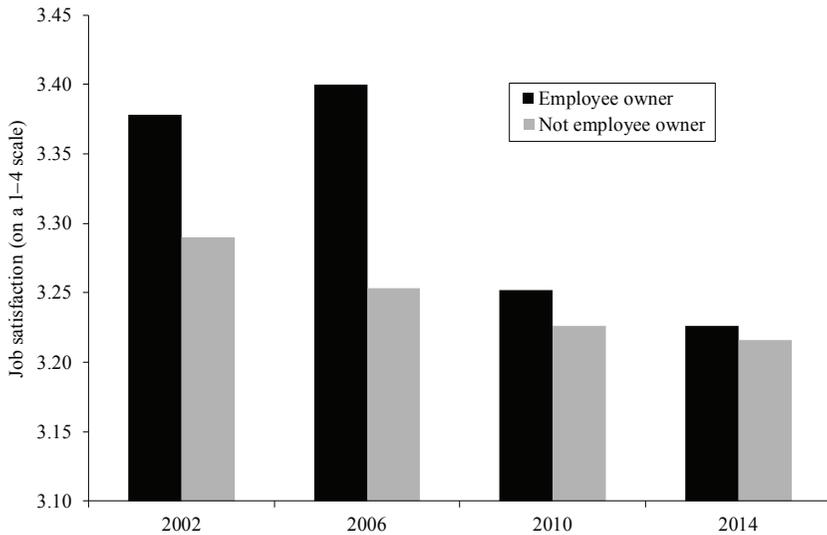
**Figure 1.5 Turnover Intention and Employee Ownership**

NOTE: Turnover intention information is based on the GSS variable *trynewjb*, which asks the respondent how likely he or she is to make a genuine effort to find a new job with another employer within the coming year. The response “very likely” was coded as high turnover intention, while responses “somewhat likely” and “not at all likely” were coded as low turnover intention. Figure illustrates mean response by employee ownership.

SOURCE: Data are from the GSS on employees at private firms.

is maintained over time, although the gap narrows in 2014. A more detailed analysis of the turnover data shows that employees who are owners are less likely than other employees to say they will look for a new job, after controlling for detailed job and personal characteristics (Blasi et al. 2010). In addition, a recent analysis of the “Great Place to Work” data set—which includes more than 700 firms and 230,000 workers—shows that worker intent to stay with the company is significantly higher in ESOP companies than in non-ESOP companies (Blasi, Freeman, and Kruse 2016).

The relation of employee ownership to the other basic measure of the quality of work life—job satisfaction—is illustrated in Figure 1.6. This shows that employee ownership and job satisfaction are positively

**Figure 1.6 Job Satisfaction and Employee Ownership**

NOTE: Data are based on the GSS variable *satjob1*, which asks how satisfied employees are with their jobs on a scale of 1 (“not at all”) to 4 (“very”). The figure illustrates mean job satisfaction by year.

SOURCE: Data are from the GSS on employees at private firms.

related in the 2002, 2006, 2010, and 2014 waves of the GSS. The difference between employee owners and non–employee owners is very small, however, in 2010 and 2014, which could reflect low stock values and uncertainty following the Great Recession.

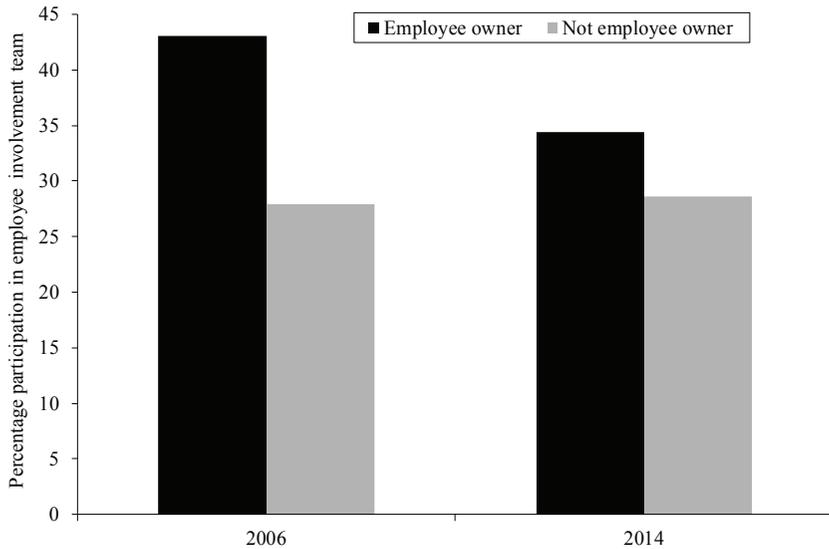
Further probing of the job satisfaction and turnover intention results shows that any favorable effects of employee ownership appear to be very dependent on the presence of other supportive workplace policies. An index combining employee ownership and stock options with other shared rewards (profit sharing and gainsharing) was found to predict higher job satisfaction and lower turnover intentions only when combined with high-performance work policies (employee involvement, training, and job security) and low levels of supervision; without such policies, the effect on job satisfaction was in fact negative (Blasi et al. 2010; Kruse, Freeman, and Blasi 2010).

This latter result may reflect mixed messages to employees when they are given employee ownership or stock options without supportive workplace policies: “We want you to be more productive as employee-owners, but we’re not going to give you the tools to be more productive, and we’re going to keep a close eye on you” (Kruse, Freeman, and Blasi 2010, pp. 274–275). In such cases, employee ownership may be seen primarily as an attempt to shift financial risk onto workers, rather than to empower workers.

Therefore, an important question is whether employee ownership is generally accompanied by supportive workplace policies. The GSS data show that employee financial participation goes hand in hand with workplace practices that empower workers with the ability to improve workplace performance (and thereby increase their payoff from having a share in company ownership), particularly employee involvement in decision making and firm-sponsored employee training. One of the 2006 GSS survey questions asks the following: “Some companies have organized workplace decision-making in ways to get more employee input and involvement. Are you personally involved in any group, team, committee, or task force that addresses issues such as product quality, cost cutting, productivity, health and safety, or another workplace issue?” Forty-three percent of employee owners responded affirmatively to this question in 2006, and 34 percent did so in 2014, compared to only 28 percent and 29 percent in those two years among nonowners, as seen in Figure 1.7. A similar relationship exists with respect to firm-sponsored employee training. As seen in Figure 1.8, nearly 65 percent of employee owners in 2006 reported that they had received formal training from their current employers in the past year, and 69 percent did so in 2014, compared to only 44 percent and 42 percent of nonowners in those two years. These relationships are strongly maintained when controlling for other job and personal characteristics (Bryson and Freeman 2010; Dube and Freeman 2010; Kruse, Freeman, and Blasi 2010).

The higher prevalence of participation in decision making and training among employee owners suggests that there are complementarities of these policies with financial participation. Most basically, this points to the importance of providing employee owners with the *means* to improve performance—through increased skills and opportunities for input—so that they can effectively take action in response to the financial incentives. In the language of economics, “residual control”

**Figure 1.7 Employee Involvement in Decision Making and Employee Ownership**



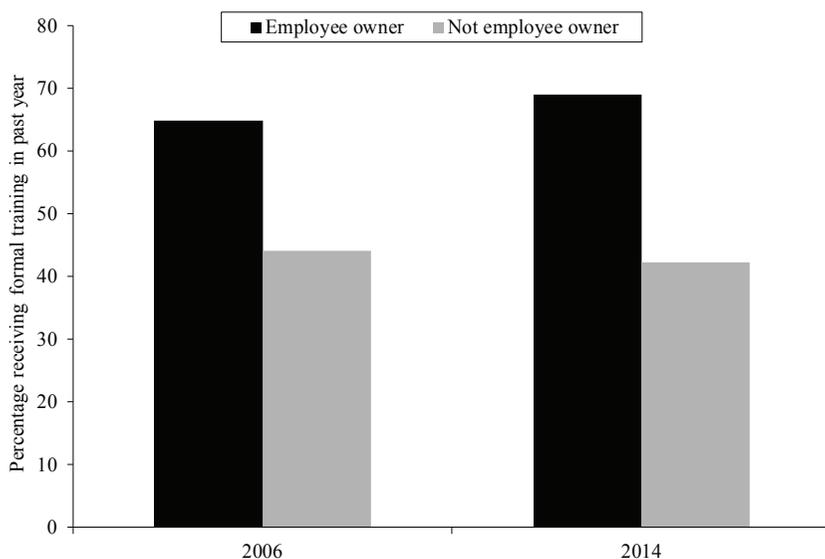
NOTE: Data are based on the GSS variable *empinput*, which asks, “Some companies have organized workplace decision-making in ways to get more employee input and involvement. Are you personally involved in any group, team, committee, or task force that addresses issues such as product quality, cost cutting, productivity, health and safety, or another workplace issue?” The figure illustrates the share of employees who responded affirmatively to this question.

SOURCE: Data are from the GSS on employees at private firms.

should be combined with “residual returns” in order to provide proper incentives. As noted earlier, prior evidence has supported the idea that employee involvement, training, and job security combine with shared rewards in improving performance-related attitudes and behaviors.

In summary of the literature on labor-management conflict and quality of work life, the above results—plus other studies reviewed in Kruse, Freeman, and Blasi (2010)—indicate that employee ownership is linked to the following results:

- fewer strikes and better evaluations of workplace relations
- lower turnover and higher job satisfaction, but only when shared rewards are combined with high-performance policies

**Figure 1.8 Employer-Sponsored Training and Employee Ownership**

NOTE: Data are based on the GSS variable *emptrain*, which asks, “In the last 12 months, have you received any formal training from your current employer, such as in classes or seminars sponsored by the employer?” The figure illustrates the share of employees who responded affirmatively to this question.

SOURCE: Data are from the GSS on employees at private firms.

- greater employee participation in decisions
- higher likelihood of company-sponsored training
- higher levels of pay
- higher job security

**Free rider problem.** Group incentives can clearly dilute the individual incentive to work hard, and thereby they can hamper productivity gains from share plans. However, as discussed above in the review of evidence on economic performance, it does not appear to prevent employee ownership firms from having higher productivity on average. Game theory shows that the free rider problem (an example of the “prisoner’s dilemma”) can be overcome in a cooperative equilibrium in

which everyone can agree on and enforce high work norms (Axelrod 1984; Fudenberg and Maskin 1986). Such cooperation may be created and maintained by policies that build team spirit, loyalty, and peer pressure to perform well. This idea is supported by the finding that positive effects of group incentives on attitudes and behaviors are more likely to occur when employees are covered by high-performance work policies (employee involvement, training, and job security) and are given freedom to work without close supervision (Blasi et al. 2010). In addition, the finding that employee owners are more likely than nonowners to take action against shirking coworkers indicates that the free rider problem is often overcome by worker comonitoring and enforcement of higher norms.

**Financial risk.** The financial risk that can result from tying worker pay and wealth to firm performance is an important concern. A fundamental premise of portfolio theory is that portfolios should be structured to balance risk and reward, and that diversification is important to mitigate risk. Having a large portion of one's wealth portfolio in any one asset means that the portfolio may not be properly diversified, and a plunge in the value of that asset can cause a significant decline in the portfolio's overall value. The financial risk may be greater with employer stock than with other assets, since if the company does poorly the worker could lose his or her job along with a decline in wealth, possibly endangering his or her retirement security.

It is undoubtedly true that some workers have too much of their wealth tied up in a single asset and thus are not properly diversified. For example, each year many people use some or all of their life savings to start their own businesses. As with entrepreneurs who are heavily invested in their businesses, employee ownership may sometimes contribute to improper diversification. The financial risk from employee ownership, however, does not appear to be a major problem in practice, as indicated by the following research findings:

**Employee ownership generally comes on top of standard pay and benefits.** It is important to reemphasize that workers do not pay for stock with their wages or savings in ESOPs, the most prevalent form of employee ownership in the United States. As noted above in the discussion of broad-based prosperity, there is strong evidence that most

employee owners receive fixed pay and benefits that are at or above market level, and that firms do not lower base pay as they adopt ESOPs except in rare situations, when they may make a concession. Employer stock generally adds to, rather than substitutes for, other forms of wealth. This greatly mitigates any financial risk, since workers are not sacrificing for risky pay—the employee ownership may be seen as “gravy” on top of regular pay, which appears to be crucial in improving employees’ performance-related attitudes and behaviors, as discussed above.

**Increased job security reduces financial risk.** The biggest form of financial risk faced by most workers is job loss, as opposed to market fluctuations in the value of their financial assets. If employee ownership does contribute to employment stability and firm survival, as suggested by past studies and as explored in this book, employee owners may face less financial risk than other employees.

**Even risk-averse employees tend to like these plans.** One surprising finding from the NBER study of more than 40,000 employees is that two-thirds of the most risk-averse employees reported that they would like at least some ownership, profit sharing, or stock options in their pay package. For example, among those who rated themselves as 3 or lower on a 0–10 scale of how much they like to take risks (with 0 = “hating to take any kind of risk” and 10 = “loving to take risks”), 66 percent said they would prefer to be paid at least in part with profit sharing, stock, or stock options as opposed to entirely with a fixed wage or salary. Also, 55 percent of this group wanted their next pay increase to be split between fixed wages and profit sharing, stock, or options, and 12 percent wanted it all to be in the form of profit sharing, stock, or options (Kruse, Blasi, and Park 2010). Risk aversion clearly influences attitudes toward variable pay, since the above figures were even higher among those who are less risk averse, but these results indicate that even risk-averse employees are open to employee ownership and other variable pay plans.

Along with these empirical findings, researchers find the following:

**Recent theory shows that employee ownership can be part of an efficient diversified portfolio.** Harry Markowitz, who won the Nobel Prize in economics for portfolio theory, explicitly rejects the idea that

risk aversion precludes employee ownership. His theory concludes that substantial amounts of a single asset—including stock in one’s company—can be part of an efficient portfolio as long as the overall portfolio is properly diversified (Markowitz, Blasi, and Kruse 2010).

In sum, employee ownership has been seen as relevant to economic performance, job security, macroeconomic stability, and economic inequality, with potential implications for firms, workers, the economy, and society as a whole. Prior studies provide evidence that it is often associated with better outcomes for firms and workers, and that the free rider and risk problems are important but may be overcome under the right circumstances. There is very little evidence, however, on how employee ownership relates to employment stability and firm survival, which is the focus of this book. We will spend the latter half of this book presenting new evidence on the link between employee ownership and employment stability and firm survival. However, before presenting our findings, it will be helpful to set the stage by first reviewing the history and current prevalence of employee ownership, which we turn to now in Chapter 2.

## Notes

1. The Employee Ownership Foundation provided significant funding for the collection of data from the employee ownership module of the GSS.
2. These methods include instrumental variables, two-stage least squares, and Heckman corrections.
3. In one study, only 4 percent of ESOPs were adopted as part of wage and benefit concessions (USGAO 1986). Of the nearly 1,000 public companies that developed sizable employee ownership stakes in the 1980s, there were only 26 cases of trading stock for wages and 41 cases of terminating defined benefit plans (Blasi and Kruse 1991, pp. 325–328).

# **How Did Employee Ownership Firms Weather the Last Two Recessions?**

**Employee Ownership, Employment  
Stability, and Firm Survival: 1999–2011**

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2017

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