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Employee Ownership:
a novel approach to business

Dissertation presented as part of the requirements for the attainment of a Master's Degree in Law and Management

Supervising Professor:

Rita Campos e Cunha

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I, Tomás Neves, hereby declare on my honor that the following dissertation is original, and that all my citations are correctly identified. I am aware that plagiarism constitutes a serious ethical and disciplinary offense.

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Abstract

The recent worldwide trends in the business world, and the economy at large, are cause for concern. Corporate governance standards are in decline and economic inequality has risen to absurd levels. People are experiencing increasing feelings of alienation. Employee ownership is not an entirely new concept; it is, however, unknown to the majority of the population, even those in the business sector. Employee-owned businesses tend to be more productive, are more resilient to negative economic shocks, promote integration in the workplace and reduce inequality by sharing profits with employees. Even companies with residual levels of employee ownership seem to outperform their traditionally run peers. The following dissertation places employee ownership under scrutiny, assessing the potential advantages and drawbacks of this business model. After analyzing a diverse body of research on the subject, the conclusion is clear: even though it is not a right fit for every business, employee ownership has incredible potential. Implementing it requires a great deal of strategic coherence in order to maximize its benefits, but if successfully executed, the positive results are undeniable.

Resumo

Os desenvolvimentos atuais no mundo empresarial e na economia, a nível global, devem ser encarados com uma certa preocupação. Os padrões de qualidade no governo das sociedades parecem estar a degradar-se. A desigualdade económica atingiu um ponto crítico, e prevê-se que ainda vá piorar. A inclusão dos empregados na estrutura empresarial não só de forma participativa, mas também na própria propriedade das sociedades para as quais trabalham apresenta-se como uma fonte de viragem conceptual relativamente às discussões tradicionais sobre a administração de empresas e os direitos dos trabalhadores. Empresas que implementam este modelo de gestão tendem a apresentar níveis mais elevados de produtividade, são mais resistentes contra recessões económicas, promovem uma integração significativa dos funcionários no seu local de trabalho e combatem a desigualdade económica através da partilha parcial dos lucros com os trabalhadores. Mesmo nos casos em que a participação na propriedade da empresa é reduzida e os níveis de codeterminação dos trabalhadores são baixos, alguns desses benefícios ainda se manifestam, se bem que de modo menos intenso. A presente dissertação constitui um esforço para averiguar até que ponto este novo modelo de gestão empresarial, desconhecido por muitos, tem potencial para melhorar o panorama económico atual, ou se não passa tudo de uma fantasia fracamente engendrada. Os resultados sugerem que a "employee ownership" (conceito que não foi, até hoje, adequadamente traduzido para o português) tem um enorme potencial, apesar de não ser um modelo adequado para todas as empresas. A maximização dos seus benefícios requer uma concretização estratégica complexa, mas os frutos de tal esforço revelam-se ponderosos.

1. Introduction

The importance of human and organizational capital (along with their development through strategic human resource management) is being acknowledged more and more in recent years, supported by academic findings (Wright, Dunford, and Snell 2001; Wagner, Parker, and Christiansen 2003; Bowen and Ostroff 2004; Becker and Huselid 2006; Collins and Smith 2006; Combs, Liu, Hall, and Ketchen 2006). In spite of these developments, employment practices appear to be changing in ways that promote mobility on the part of employees, devaluing loyalty and commitment. Regulations regarding employment security were slackened during the aftermath of the 2008 economic crisis, promoting labor market flexibility.

Employee ownership is a promising alternative model to the traditional business paradigm. It has been shown to increase productivity, improve work satisfaction and enhance the survivability of companies during economic recessions (Kurtulus and Kruse 2016). On top of that, it has the potential to reduce economic inequality by broadening access to capital income and, therefore, expanding the distribution of wealth.

Research on employee ownership has found mostly positive results (O'Boyle, Patel, and Gonzalez-Mulé 2016), but there are, of course, sceptics and critics. If it is indeed linked to so many positive outcomes, how does one explain the low levels of adherence to employee ownership? Could it be too good to be true, based on fantasies and wishful thinking? Or is the business world missing out on the next big thing?

Employee ownership is certainly not a panacea. Like everything in life, it flourishes under certain conditions, and is inadequate in others. It does, however, have a lot of unrealized potential, and deserves to be noticed and more broadly known.

This dissertation consists of a literature review, performed in order to better understand the effects of employee ownership, how to explain their occurrence, and

to assess in what scenarios its implementation is most viable. This requires an analysis of how employee ownership operates in different forms and environments, so as to determine potential synergistic and antagonistic factors. The confrontation (and subsequent integration) between conflicting points of view on the subject, presented by different authors, is also indispensable for determining the strengths and weaknesses of employee ownership.

1.1. Methodology

The quality of a literature review is heavily dependent on the foundational sources on which it is built. In order to assure the quality of the cited academic articles, only articles published in journals with a rating of 3 or higher in the Academic Journal Guide (published by the Chartered Association of Business Schools) were consulted. Articles published after the year 2000 were given preference, but in account of the relevance of a few older pieces, this criterion was not strictly adhered to.

The following keywords were utilized for the retrieval of relevant literature: employee ownership, broad-based employee ownership, employee stock ownership, employee share ownership, human resources, human resource management, high performance work practices. This process resulted in the analysis of 31 academic journal articles, 14 book chapters, 1 book, and 6 publications from assorted sources (such as the International Labour Organization and the Economic Policy Institute, among others).

Employee ownership has many facets that must be taken into consideration in order to perform a thorough assessment of the subject. As such, this dissertation has a somewhat compartmentalized structure, allowing for a separate discussion regarding each of the relevant topics retrieved from the literature, but with the necessary degree of permeability so as to avoid a fragmented verdict.

2. What is employee ownership and why does it matter?

2.1. What is employee ownership?

Employee ownership is not a new concept in the business world (O'Boyle, Patel, and Gonzalez-Mulé 2016), particularly in the United States of America where the adoption of employee ownership plans by companies has become somewhat of a common practice (Kruse, Blasi, and Park 2010; Kurtulus and Kruse 2016) – in spite of this, it remains relatively unknown to the general public. Put in simple terms, it refers to the ownership of a company, in part or in whole, by some or all of its employees. This short description, however, masks the myriad of intricacies that must be taken into account when contemplating its potential real-world application.

These complexities will soon be explored in greater detail. For now, a few introductory pointers shall suffice.

Employee ownership can take many different forms depending on various factors. Therefore, some clarifications must be made in respect to this particular dissertation.

The concept of employee ownership, as it will be discussed, refers only to cases in which the distribution of shares by employees, or the possibility of participating in stock ownership plans, are broad-based – in other words, available to all or most workers of a company (Kurtulus and Kruse 2016).

Share plans which are available only to a narrow section of top executives and managers, despite their extremely common usage, will not be considered as employee ownership. These compensation schemes have existed for quite some time, created as an attempt to align the executives' interests with the shareholders' goals or, in other words, to mitigate the agency problem. Seeing as they are mostly irrelevant to the bulk of the workforce, especially the lower tiers, they fall out of the scope of this discussion.

Broad-based employee ownership in large, publicly traded firms is very often residual, with the combined company stock of all employees who own shares being small and insignificant (Kurtulus and Kruse 2016; Mathieu 2018).

Employee ownership is said to be substantial when the combined stake owned by employees is large enough to have a meaningful impact on the control of the company. A firm's employees may also have a majority stake in its ownership, and at the extreme end of the spectrum, there are companies which are fully employee-owned.

Employee ownership can be exercised directly, indirectly or through a combination of both methods. Direct ownership means employees become individual owners of shares in their company. Indirect ownership takes place when company stock is held, collectively, in a trust on behalf of the employees.

2.2. Why does it matter?

2.2.1. Resilience against economic recessions

In a study focused on privately held companies with an established ESOP[1], based in the United States, Blasi, Kruse, and Weltmann (2013) concluded that, when compared with similar non-ESOP firms in the same industry (during the period between 1988 and 1999), the privately held ESOP companies were only half as likely as the non-ESOP firms to go bankrupt or close, and only three fifths as likely to disappear for any reason. Non-ESOP companies also had significantly higher employment variability and their average annual employment change was negative, while ESOP firms showed slight annual employment growth, and generally better performance.

Kurtulus and Kruse (2016) performed a thorough longitudinal analysis of the relationship between employee ownership programs and employment stability in the United States, spanning the period from 1999 to 2011, having found that companies

[1] Stands for Employee Stock Ownership Plan. They are one of the most common forms of employee ownership in the United States, typically arranged as trust-based retirement plans.

with employee ownership plans had more stable employment levels and a greater likelihood of surviving when faced with economy-wide and firm-specific shocks, specifically during the 2001 and 2008 recessions. Different measures of employee ownership were analyzed: employer stock per employee, percentage of the firm owned by employees, and percentage of total employees participating in the ownership plans. All of these metrics were linked to positive outcomes, but the most influential one was found to be the latter: the more broad-based the employee ownership structure was, the better the firms performed. This fact could mean that the improved productivity, employment stability and firm survivability are more related to a cooperative workplace culture than to direct financial incentives.

Positive effects have been observed after the implementation of employee participation plans with as little as a 1 percent stake in the corporation allocated to workers. As part of the aforementioned study, Kurtulus and Kruse (2016) compared firms with less than 5 percent of the company owned by employees to firms having over 5 percent worker ownership, with the results showing that the latter group performed substantially better regarding firm survival and employment stability.

2.2.2. Increased performance

The evidence points to a link between employee ownership and a multitude of performance benefits, such as heightened productivity, increased loyalty, more worker co-monitoring behaviors, additional willingness to work hard, and lower turnover (Blasi, Freeman, Mackin, and Kruse 2010). It has also been linked to higher levels of investment in formal and informal employee training (Kruse, Freeman, and Blasi 2010).

In most observed cases of shared capitalism[2], models of variable remuneration were implemented on top of regular pay and benefits, not as a substitution. As companies with employee ownership schemes have consistently been observed to survive longer and through worse economic environments than

[2] The "shared capitalist model of work and compensation" or "shared capitalism" is a term coined by Richard Freeman to describe employment relations where the pay or wealth of workers is directly tied to their workplace or firm performance, such as employee ownership and profit sharing.

traditional firms, Buchele, Kruse, Rodgers, and Scharf (2010) propose that the former group must be experiencing significant productivity gains in order to support the increase in retribution. This appears to be a manifestation of the effect proposed by efficiency wage theory: the extra compensation offered by a company can pay for itself through the consequent gains in productivity. Or, utilizing the model put forth by Akerlof (1982) in his exploration of labor contracts as partial gift exchanges: employees respond to the gift of higher wages, ownership, and better working conditions with a reciprocal gift of higher effort and cooperation, to the benefit of the firm and also of their fellow workers.

In the next section we will explore the mechanisms which explain the effects employee ownership can have in workers' performance and attitudes, and how to optimally potentiate their development.

3. Employee ownership and the workplace environment

One of the major recurring themes in the employee ownership literature is the notion that the contingent features of broad-based ownership have a greater effect on worker attitudes than the stock ownership itself (Pendleton 2010). The general consensus is that productivity gains are not likely to arise simply through the implementation of employee ownership of shares in isolation. The promotion of employee engagement is essential, namely through supportive workplace practices such as employee involvement in decision-making and firm-sponsored employee training. In fact, the implementation of employee ownership without high performance work policies, low supervision and fixed wages at or above market level has actually been shown to reduce job satisfaction (Blasi, Freeman, Mackin, and Kruse 2010; Kruse, Freeman, and Blasi 2010; Weltmann, Blasi, and Kruse 2015).

3.1. The psychology of ownership

Klein (1987) proposed and tested the validity of three distinct models regarding ESOP effects:

- The "intrinsic satisfaction model" is based on the idea that ownership itself is the critical factor driving employee morale in companies with employee stock ownership programs (the size of the ownership stake would be proportional to the commitment felt by the employees);
- The "extrinsic satisfaction model" suggests that the financial benefits of ownership are the biggest catalysts of employee satisfaction;
- Finally, the "instrumental satisfaction model" proposes that an increase in worker participation and influence in decision-making is the most relevant variable regarding employee satisfaction.

The results led to the conclusion that extrinsic rewards are correlated with higher employee satisfaction ("money matters") and that management style has a powerful impact on employee attitudes. Specifically, the presence of an employee ownership philosophy (defined as management's philosophical commitment to

employee ownership) and transparent communications about the stock plan were significantly positively related to employee outcomes and ESOP satisfaction.

While the extrinsic and instrumental satisfaction models were found to be valid, the intrinsic motivation, of ownership by itself, had little impact on workers. Klein's conclusion is that employee ownership is not intrinsically rewarding, but that when it is coupled with financial rewards, participative management practices, or both, it can lead to exponential increases in employee satisfaction and commitment.

Another conception that emerged in the employee ownership literature was the idea of "psychological ownership" and the effects it has on employees' perceptions. Pierce, Kostova, and Dirks (2001) proposed three interrelated sources in order to explain how organizational members come to feel psychological ownership. They are:

- Control of the target. The more an employee can control a particular factor, the greater the feeling of ownership he will have toward that same factor. A good example is job design – jobs that provide greater autonomy inherently provide a greater level of control, which in turn increases the associated feeling of ownership;
- Intimate knowledge of the target. The more information and the better the knowledge an individual has about an object, the stronger the feeling of ownership toward it. Information should, however, be coupled with other factors in order to magnify the perception of ownership – intensity and longevity of association also have a lot of influence;
- Investment of the self into the target. This self-investment is not limited to time. It can be an investment of ideas, skills, or energy (both physical, psychological, or intellectual).

Low levels of supervision, transparency about organizational goals and the ownership structure, easy accessibility of information, regular communications between management and the general workforce, promotion of employee involvement on various issues, worker training and skill development, job security and employee retention – all of these factors are related in some way to one of the three aforementioned originators of psychological ownership. In a nutshell, this means that the feeling of psychological ownership can be fostered through the

implementation of a high performance corporate culture (Poutsma, Ligthart, and Kaarsemaker 2017). Additionally, in their conception of an "ownership high performance work system", Kaarsemaker and Poutsma (2006) recommend that employees be trained for business literacy: the better they understand the information that is being shared about company business, the more they will feel integrated and empowered.

Feelings of psychological ownership have been linked not only to enhanced performance but also to increased organization-based self-esteem and organizational citizenship (Pierce and Rodgers 2004; Van Dyne and Pierce 2004).

3.2. Employee engagement and financial participation

Levine (1990) framed employee participation as a reward in and of itself for employees, but one with gradually decaying levels of satisfaction associated with it. In order for participatory systems to be successful over a long time horizon, employees must be rewarded for their extra effort by receiving a share of the increased profits. If workers are not adequately compensated on account of the benefits generated by their cost-saving ideas and additional efforts, they will react negatively. As the author puts it, "group-based gain sharing provides workers with incentives to maintain norms of high effort, to monitor each other, and to sanction workers who shirk. More positively, group-based pay also gives workers incentives to cooperate and not try to advance at the expense of their colleagues."[3]

Levine proposed that in order to garner lasting employee support for participation, maximizing its benefits, four characteristics must be present in firms:

- Some sort of profit or gain sharing;
- Job security and long-term employment relations;
- Measures to build group cohesiveness;
- Guaranteed individual rights.

[3] Levine (1990, p. 87)

Long-term employment is symbiotic with participatory systems for various reasons. Workers who are secure about the stability of their employment are more open to the idea of forgoing short-term gains in order to build up the company, because they expect to witness and participate in the firm's continued success. Group-based rewards are also more effective if employees expect to be part of the work group for a long period of time.

Many companies committed to assuring job security to their employees tend to prevent layoffs by establishing internal training programs and redeploying workers within the firm. In order for this investment in human resources to be justified, long-term employment relations are fundamental.

Kruse, Blasi, and Park (2010) also consider job security to be an essential factor. In their words, "it is hard to maintain worker commitment and cooperative teamwork if employees are afraid they will be laid off."[4] The authors found that a very high percentage of participants in shared capitalism schemes evaluated the possibility of being laid off as unlikely. Indeed, job security was reported to be significantly higher in such companies. In addition, workers participating in profit sharing or employee ownership plans reported "a higher expected likelihood of working at the company for a long time, and of seeing their current jobs as part of a long-term career."[4]

Employee-owned firms, or companies planning to implement employee ownership in the future, should adapt their recruitment standards to reflect this commitment. In order to effectively manage an employee-owned business, managers ought to be transformational leaders, able to inspire people to work together (Avey, Avolio, Crossley, and Luthans 2009). Non-managerial employees should also be screened for compatible personal characteristics on top of regular work-related competencies, while making sure they understand the kind of workplace they will be joining.

[4] Kruse, Blasi, and Park (2010, p. 60)

Compression of wage and status differentials, particularly between managerial and non-managerial employees, supports group cohesiveness. Narrow wage differentials can promote cooperation, while large wage gaps and competition for promotions will reduce it. Large differences in perceived status between workers and management have also been shown to inhibit participation.

In order to narrow the wage differential, a company must not only raise low-end wages, but also reduce the highest salaries. This compression of the wage gap may lead to difficulties in retaining high-achieving “star” employees, who in some industries (tech, for example) play a particularly pivotal role in a company’s success. A blend of individual and group-based incentives may alleviate this problem. In fact, shared capitalism is prevalent in the North American high tech industry (Kruse, Blasi, and Park 2010) – this higher than average recourse to employee ownership could be explained as an attempt to retain valuable workers.

Hansmann (1996) also proposed that employee-owned firms function more efficiently when utilizing a less differentiated wage structure, since it reduces dissent among workers. Akerlof (1982) discussed the issue of workers’ perception of fair treatment, noting how it is influenced mostly by comparing oneself with others rather than by some absolute standard.

Guaranteed individual rights increase the workers’ trust in the company. In order for employees to become committed to participation, they must be able to express their negative opinions and ideas for improvement without fear of reprisal by management.

It is now clear that for employee ownership to function optimally, several adjustments must be made in the workplace environment, and that this process requires an appreciable level of commitment and investment.

Having presented the various benefits of employee ownership, and identified how to synergistically develop an ownership culture though the strategic implementation of certain human resource management practices, it is now necessary to explore the counterarguments that some authors and researchers have advanced against it.

4. Objections to the employee ownership model

There are three primary arguments against the viability of employee ownership (Hansmann 1996; Kurtulus and Kruse 2016). They will be presented and addressed in the following sections.

4.1. The free-rider problem

One of the most common objections regarding the shared capitalism model of group incentives is anchored on the free-rider problem. Based on the principles of game theory, the claim is that employee ownership (and the resulting profit sharing) cannot succeed because each individual has an incentive to neglect his professional duties, allowing him to reap the rewards of his colleagues' hard work with little personal exertion (of course, if everyone thinks like this and assumes others do too, no one will put in the effort). In short, every worker would benefit if the whole team did a good job, but everyone has an incentive to shirk.

A strong counter-effect to the free-rider problem can be achieved through worker co-monitoring, the process through which coworkers keep tabs on each other and intervene when someone is not pulling their weight. Blasi, Freeman, and Kruse (2013) found unsurprising patterns regarding this topic:

- worker co-monitoring was higher in smaller firms in comparison to larger ones;
- the existence of employee stock ownership improves worker co-monitoring rates;
- the higher the intensity of profit sharing, the higher the likelihood of co-monitoring behaviors occurring.

The authors' conclusion is that co-monitoring is best achieved through the combination of employee ownership with personnel practices that create a positive ownership culture.[5] Another finding was that while large individual bonuses do

[5] The erosion of the cooperative spirit natural to employee ownership is also a cause for concern, but there are certain steps firms can take in order to prevent it. Sauser (2009, p. 153) identifies two important threats

increase individual productivity, they also have a negative effect regarding co-monitoring. It is possible that a combination of individual and group incentives could lead to more efficient results.

Workers who consider their employment status to be stable and plan to remain with their employer for a long time will be less inclined to shirk. When employees face a repeated game, free-riding behaviors are not as appealing. A solid commitment on the part of the company to the retention of its workers (avoiding layoffs, promoting training and internal redeployment, and so forth) may foster a strong relationship with the workforce, boosting employee loyalty.

According to Guthrie (2001), the implementation of high involvement work practices promotes employee retention. A lower turnover rate, coupled with the presence of high performance work practices, increases productivity. Conversely, in the absence of high performance policies, the retention of employees cannot be capitalized upon (since their human capital is not being properly developed) and does not lead to an increase in productivity.

4.2. Financial risk

One of the other major concerns regarding employee ownership is its financial risk. If considered purely from the perspective of a financial investment, workers owning shares in their own company leads to higher risk, because if the firm goes bankrupt the employees will have lost both their jobs and their investment. The common assumption is that workers should instead own stock in companies other than their own, in order to minimize risk through the diversification of their investments.

Blasi, Kruse, and Markowitz (2010) share these worries regarding the potential for poor diversification in employee-owners' portfolios. They suggest that

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to employee-owned companies in particular: the first is "the apparent degenerative life-cycle of employee-owned organizations" while the second relates to "the frailties of human nature, particularly as those frailties relate to the abuse of power." The author suggests that in order to avoid a possible accumulation of power, employee-owned companies should utilize a corporate governance structure which divides power among two or more bodies.

"the optimal portion of an otherwise diversified portfolio that could potentially be in company stock is 8.33 percent, while 10 to 15 percent would have a small effect on the volatility of the employee portfolio."[6] Employee ownership is, therefore, compatible with diversification – these considerations do, however, add weight to the argument that financial education should be provided to workers participating in shared capitalism schemes, since these concepts are probably not broadly known, especially outside of the financial sector.

There are other factors which may counteract the risks associated with low diversification. As previously discussed, employee ownership in the right circumstances can catalyze the productivity and the longevity of firms, which become particularly durable during recessions. These companies also tend to prioritize worker retention and job security.

In fact, one could argue that the biggest form of financial risk for most workers is not the loss of value regarding their financial assets, but job loss itself. As a result of the aforementioned increase in job security and firm survivability, employees of companies with some form of shared capitalism plan could actually be subject to less financial risk than traditional workers. On top of this, it has been observed that in the majority of ESOPs, workers do not pay for stock with their own savings or wages. There is strong evidence that most employee-owners receive fixed pay and benefits that are at or above market level. This means that the supposed financial risk associated with employee ownership (particularly in the case of ESOPs) is in fact much lower than expected, because ownership tends to add to regular pay instead of substituting a portion of it (Kurtulus and Kruse 2016).

Of course, there are situations in which employee ownership is used as a substitute for regular fixed pay. This arrangement tends to be appealing for executives and well-paid employees in general, but for financially challenged or otherwise low-wage workers, ownership as a substitute for fixed pay may not be a good fit – in respect to these employees, the positive effects of shared capitalism on

[6] Blasi, Kruse, and Markowitz (2010, p. 121)

attitudes and behaviors are much more likely to occur when employee ownership comes on top of market-level wages and benefits.

It has also been found that while risk averse employees are less inclined to buy their own company's stock on the open market, those same risk averse workers tend to show interest in participating in employee ownership through other means (Kruse, Blasi, and Park 2010).

Blasi, Kruse, and Markowitz (2010) offer further insights regarding this topic. They found that workers with high levels of economic insecurity responded poorly to shared capitalism arrangements, preferring fixed pay over variable pay. This negative response was less pronounced regarding ESOPs because, as discussed previously, these schemes tend to come on top of fixed pay and do not usually involve economic concessions by the workers.[7]

However, the negative effects of workers' economic insecurity regarding their perceptions and responses to shared capitalism were found to be significantly mitigated in good corporate culture environments, specifically regarding worker empowerment and positive employment relations. This means that "a substantial portion of the negative attitudes toward shared capitalism and the poor behavioral outcomes among the economically insecure is not due to economic insecurity per se, but to corporate cultures that provide little empowerment and poor employee relations."[8] The negative effects of economic insecurity can, therefore, be counteracted by policies that improve these factors.

In general, the presence of high performance work practices reduced the negative response of economically insecure employees. The authors suggest that "workers have more willingness to have a profit or stock share in their company if they perceive that the company invests more in their performance abilities through

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[7] Typically, when an ownership stake is for sale to employees instead of being attributed as an additional incentive, and buying it is not mandatory, only highly-paid employees, who may already have some investment experience, will tend to participate. Companies will be more successful at involving a broad range of workers in ownership plans if shares are given as a part of (or as an addition to) regular compensation. Generally, relying on employees to buy shares by themselves will lead to low adhesion, excepting cases in which workers are highly motivated, such as during organized employee buyouts or when starting a brand new company.

[8] Blasi, Kruse, and Markowitz (2010, p. 118)

a high performance work system"[9] and that even highly economically vulnerable workers are more open to variable performance-based pay when the work system is more progressive.

Economic insecurity has the potential to completely undermine the benefits associated with employee ownership, particularly if combined with a poor corporate culture in the workplace. Employee ownership plans must, therefore, be designed more carefully when they involve workers in poor financial health.[10] The above results do suggest, however, that employee ownership schemes need not be limited on account of the workers' economic situation, but merely adapted to it.

4.3. Employee involvement in corporate governance

Hansmann (1996) points to another potential problem associated with employee ownership, specifically regarding worker involvement in corporate governance – the fact that many employees do not possess management skills and experience. The author uses the example of blue-collar workers who may not have the necessary knowledge regarding management or finance in order to effectively select or police the firm's managers, or who may be short-sighted in their objectives for the company. However, the author does concede that "an individual employee need not herself have the expertise to make managerial decisions in order to exercise her voice effectively as an owner. She need only be able to vote intelligently in electing the firm's directors."[11]

Ginglinger, Megginson, and Waxin (2011) analyzed the relationship between employee ownership, employee representation on the board, and corporate financial policies in French publicly listed companies. They found that directors elected by

[9] Blasi, Kruse, and Markowitz (2010, p. 120)

[10] Experience suggests that if the full range of rights associated with property are readily available to financially challenged employees regarding their shares, these will rapidly be sold. This is precisely the opposite result employee ownership strives for. The goal is long-term shareholding, in order to intensify the workers' feelings of connection with their company and to add a capital-based source of income to their wages (labor income). In order to foster this kind of long-term relationship between the firm and its employees, the plan should include some form of lock-in for a certain period of time.

[11] Hansmann (1996, p. 115)

employee shareholders promoted an increase in firm valuation and profitability and did not significantly alter corporate payout policy. In contrast, directors elected by "regular" employees (non-owners) reduced payout ratios, but had no impact on company value or profitability. The authors conclude that "on balance, employee representation on corporate boards seems to be at least value-neutral, and may actually increase firm valuation and profitability when employee shareholders elect company directors."[12]

In fact, it could be argued that a company's workers are in some ways more qualified than outside investors to elect and police managers, based on the fact that they have access to a lot more internal information (especially regarding information circulating through informal channels) and are in contact with the firm on a day-to-day basis. Some institutional investors do not care to probe beyond the numbers provided in quarterly reports, which do not paint the whole picture.

Of course, as the number of employees grows, worker involvement in governance becomes more and more difficult.[13] Even in companies with a low number of workers, their direct involvement in governance may not be efficient or even desired by them. Representativeness has to come into play at some point. By fostering employee education programs and maintaining transparent channels of communication between management and the general workforce, firms can make sure that their employees' votes and inputs become more informed and, therefore, more valuable.

[12] Ginglinger, Megginson, and Waxin (2011, p. 869)

[13] The maximization of the benefits of employee ownership seems to be harder to achieve in large companies. Kruse, Blasi, and Park (2010) propose that profit sharing may be the most efficient method for promoting cooperative teamwork on a day-to-day basis, while ownership may be better at affecting other outcomes, such as identification with the company, loyalty, and turnover intentions. If this is indeed the case, a combination of short-term (e.g. profit sharing) with long-term (e.g. share ownership) forms of incentive should provide the best overall results.
Another problem can potentially arise from heterogeneity among workers. This caveat of employee ownership is often referenced in the relevant literature. Initially proposed by Hansmann (1996), the theory is that when the workforce is heterogeneous and has direct control of the firm, the differing employee interests and priorities result in substantial governance inefficiencies and costs. In contrast, when the employees involved in ownership are highly homogenous, employee ownership leads to significant benefits. The author suggests that the most suitable forms of employee involvement in governance in large corporations probably involve a combination of representative and fiduciary mechanisms. Employee shareholding trusts, when combined with transparent democratization practices, seem to be one of the most promising systems through which the heterogeneity inefficiencies could be minimized.

5. Employee ownership and the future of work

Employee ownership, if properly implemented and supported, provides the opportunity to include employees in the economic growth of the companies they work for. It also promotes a different way of thinking about business, which may prove to be of particular relevance in the near future, considering the current global scenario.

5.1. Wealth inequality

If one assumption can be made with a great deal of certainty about the current state of the global economy, it is that wealth inequality is on the rise. Most research regarding this issue[14] has focused on the United States of America, where the effects of inequality are felt with more intensity (Saez and Zucman 2016), but it is undoubtedly a far-reaching phenomenon.

Standard economic theory espouses the view that compensation's dynamics should reflect productivity's developments, and that therefore the two should grow together. However, in nearly all advanced economies, the distribution of income has changed substantially, with the share of labor income in decline since the 1970s. The analysis of long-term trends in compensation and productivity leads to a clear conclusion: even though both have grown over time, compensation has done so at a much slower rate, leading to a considerable difference between the two. These assertions are entirely supported by the International Labour Organization's recent Global Wage Reports.[15]

[14] An important side note regarding the literature on this topic: the standard measure utilized in many studies is average income. However, if such analyses were performed utilizing median income instead of the mean, the capital-to-wages gap would manifest itself as significantly more pronounced. When using average compensation instead of the median as a measure, the results are significantly distorted in regard to the middle and lower income classes. The average is kept up by a large redistribution of pay to the top tier of earners, such as financial sector professionals and corporate executives, which means that the situation is very likely to be even worse than the studies show for low and middle class families.

[15] International Labour Office's Global Wage Report 2016/2017: Wage inequality in the workplace (2016, p. 15-20) and Global Wage Report 2018/2019: What lies behind gender pay gaps (2018, p. 13)

Executive compensation in publicly traded companies typically takes three different forms, often used in conjunction: a cash salary, a bonus related to the firm's short-term profits, and stock options or some other method of compensation related to the company's share value. The wage component of executive compensation, despite having grown significantly in recent decades, has been losing relative weight, as stock option awards account for a rising percentage of executives' total pay package value.[16]

Seeing as the share of capital income has been steadily increasing over the last few decades, involving employees in the financial markets may be particularly important. Company-sponsored share plans, especially if implemented as a complement to retribution or at least in financially advantageous terms, broaden access to capital income beyond the constraints imposed by the employees' personal ability (financial or otherwise) to invest.

5.2. Stockholder theory and corporate sustainability

Milton Friedman famously argued in the 1970s[17] that the sole social responsibility of a firm was to maximize profits, and that corporate managers should conduct business in accordance with the shareholders' desires. The gist of the argument was that managers should strive to make as much money as possible for the owners of the corporations they work for.

This marked the beginning of the currently widespread adoption of the theory of shareholder value, both in the professional and academic spheres. The idea was soon expanded as Jensen and Meckling (1976) constructed a new "theory of the firm" conceptualizing the shareholders as the principal owners of a corporation, with original authority regarding its affairs, and managers as their agents with delegated powers.

[16] According to the International Labour Office's Global Wage Report 2016/2017: Wage inequality in the workplace (2016, p. 45) and Mishel and Schieder (2017, p. 8-10)

[17] Specifically, in an article published September 13, 1970 in The New York Times Magazine titled "The Social Responsibility of Business is to Increase its Profits."

Managers are not legally bound to the maximization of shareholder value in itself. It is, however, one of the most utilized metrics used in order to measure a corporation's success and financial health.

Short-term strategies to increase share value are beneficial to certain types of investors and to employees with stock options approaching the vesting date, but can prove to be disadvantageous for the sustained success of the company. Stock options may encourage executives to prioritize short-term profits, while curtailing investment in favor of buybacks that push earnings per share.

A stock market focused excessively on the short-term may lead companies to underinvest (Fang, Tian, and Tice 2014). The liquidity associated with the public markets makes it easy for shareholders to quickly sell their stock if a company shows the faintest signs of underperformance, rather than actively engaging with management. Poor corporate governance practices may take root more easily in this environment. Some defend that the markets will automatically resolve this problem – if management is lacking, a takeover will happen, because the buyer believes that a change in management will lead the company to produce better results, making the investment worthwhile.

Fang, Tian, and Tice (2014) observed that high stock liquidity had a causal negative effect on firm innovation. One of the authors' proposed explanations for this phenomenon is that because of the threat of takeovers, managers feel pressured to cut long-term investment on intangible assets (such as innovation). The other is that "high liquidity attracts transient investors, who trade frequently to chase current profits or quasi-indexers[18] who follow passive indexing strategies and fail to govern."[19] Firms with higher levels of quasi-indexer ownership have been observed to do more buybacks, and transient investors unsurprisingly prioritize short-term earnings over long-term sustainability.

[18] Funds with diversified holdings and low portfolio turnover. This concept includes both index funds and actively managed diversified mutual funds.

[19] Fang, Tian, and Tice (2014, p. 2123)

Asker, Farre-Mensa, and Ljungqvist (2015) observed that private firms tend to invest more than publicly owned companies (relative to their size), and are also more responsive to investment opportunities such as, for example, low interest rates. This insensitivity to positive investment climates exists in spite of the fact that public stock markets provide access to capital at a lower cost, and was pervasive in all but the highest decile of public corporations, which were observed to be substantially more responsive to such opportunities than public firms in the lower nine deciles.

The same results were found even when comparing within-firm variation in a sample of companies that went public without raising new capital – which means the only change was in ownership structure. After the transition, the investment sensitivity of these firms dropped significantly, becoming indistinguishable from that of other similar, already-public corporations.

The authors conclude that "a focus on a firm's short-term profits or its current share price will distort investment decisions from the first-best if investors have incomplete information about how much the firm should invest to maximize its long-term value."[20] Market information can never be perfect, especially so if related to factors dependent on long time horizons.

This short-sightedness may lead to twisted behaviors. For example, by forgoing projects with positive net present value (in other words, projects predicted to produce future profits), it is possible to boost current earnings and share price. This works because the required initial investment, by not being executed, does not lead to a reduction in current distributable earnings. Quarterly earnings reports, particularly the focus given to the earnings per share measure, contribute to this paranoia.

Can this maximization of shareholder value be considered value creation? Or is it simply a value transfer, from the company to the stockholders? Earnings that are disproportionately distributed instead of reinvested compromise the firm's sustainability. Common strategies aimed at raising share prices include layoffs, cost

[20] Asker, Farre-Mensa, and Ljungqvist (2015, p. 343)

cutting, and overall divestment. This seems to be at odds with sustainable long-term growth.

Graham, Harvey, and Rajgopal (2005) surveyed and interviewed more than 400 executives in order to determine the factors that guide reported earnings and disclosure decisions. 78 percent admitted to sacrificing long-term value to smooth earnings: “Managers candidly admit that they would take real economic actions such as delaying maintenance or advertising expenditure, and would even give up positive net present value projects, to meet short-term earnings benchmarks.”[21] CFOs feel the need “to meet or beat earnings benchmarks, especially analyst consensus forecasts, because they fear retribution from the stock markets.”[21]

In the public markets, earnings estimates (projected by external analysts or by the firm itself) are often utilized to evaluate performance. So even if a company reports positive growth, if these estimates are not reached, the manager may be seen as a failure.

Edmans, Fang, and Lewellen (2017) analyzed the link between the short-term concerns of CEOs and their real investment decisions, using the amount of equity scheduled to vest in a given quarter as a reference. The results showed that vesting equity is both significantly negatively related to investment growth and significantly positively related to analyst forecast revisions and positive earnings predictions. The authors conclude that this typically happens as a result of the CEOs’ attempts to maximize the value from the sale of their equity stakes in the same quarter as they vest.

The aforementioned results are indicative of the potentially negative effects of short-term executive incentives, like stock options, on long-term firm value. It must be noted that there is nothing inherently wrong with cost cutting, share buybacks, mergers, or acquisitions. The problem resides in the fact that these decisions are often made with a disproportionate amount of focus on short-term results.

[21] Graham, Harvey, and Rajgopal (2005, p. 66)

Prioritizing the short-term interests of external shareholders may lead to biased decision-making in favor of dividend payments and share price maximization over investments in research and development, since the latter course of action requires immediate expenses which pay off only on the long-term, with returns being uncertain or hard to quantify.

Support for the employee-owned model may lead to more sustainable business ventures, better equipped for long-term survival and growth.

5.3. Corporate governance standards

Theoretically, the voluntary disclosure of information to the capital markets leads to several benefits, such as increased liquidity and reduced cost of capital, for example. In perfect market conditions, therefore, firms should strive to eliminate information asymmetry (Hilary 2006; Bova, Dou, and Hope 2015). However, in the context of negotiations between labor and management, it seems that informational asymmetry is favorable to the latter's position, because transparent information sharing allows labor representatives to increase their demands (Hilary 2006).

Faleye, Mehrotra, and Morck (2006) assert that publicly traded firms with a high level of labor involvement in corporate governance (resulting from employee ownership rights) "deviate more from value maximization, spend less on new capital, take fewer risks, grow more slowly, create fewer new jobs, and exhibit lower labor and total factor productivity."[22] The authors propose that when allowed to influence corporate governance strategy, labor representatives' decisions will be at odds with shareholder interests.[23]

Curiously, Bova, Dou, and Hope (2015) reached entirely different conclusions. Their study revealed that, when employees have bargaining power, employee ownership increases voluntary information disclosure to the markets.

[22] Faleye, Mehrotra, and Morck (2006, p. 490)

[23] On the contrary, Fauver and Fuerst (2006, p. 703) found that "prudent levels of employee representation on corporate boards can increase firm efficiency and market value." However, this effect did not hold in the case of union representation.

Employee ownership is, therefore, associated with improved corporate governance practices, particularly regarding transparency with investors and other stakeholders. The authors do agree that firms should disclose less information when employees have a strong negotiating position; however, they argue that employee ownership decreases employees' incentives to extract above-market rents from the company, which in turn mitigates the firm's necessity to withhold information. The authors disagree with the assertion that employee ownership has decreasing returns with higher percentages of ownership[24], proposing that employees of fully worker-owned businesses are ideally aligned with the objective of maximizing profits.

Employee ownership, especially if a substantial part of the company is employee-owned, offers new solutions. The co-owning worker shareholders are in an advantageous position regarding the monitoring of management and have firsthand, direct experience with the business. Employee-owned firms tend to establish high standards of corporate governance, focusing on transparency and trust, resulting from an open line of communication between workers and managers.

Taking into account all of the preceding arguments, employee ownership presents itself as a solid business model, although certainly not one that is fitting for every company. Why is it, then, that it is so underexplored? In the following section, the discussion will focus on the principal detracting factors to employee ownership.

[24] The notion that employee ownership has diminishing economic returns is defended by a number of researchers. For example, Guedri and Hollandts (2008, p. 460) propose that there is an inverted U-shape relationship between employee ownership and accounting-based firm performance measures. According to the authors, the "performance implications of employee ownership are positive up to a certain point, after which the marginal effect of employee ownership on firm performance becomes negative." Kim and Ouimet (2014) also maintain that small ESOPs (comprising less than 5 percent of company shares) tend to accomplish better results than larger employee stock plans.

6. Obstacles to employee ownership

Market information is always imperfect to some extent. As such, investors and financial institutions prefer investments in tangible assets. When a manager claims to be building intangible factors, a process which can be very difficult to monitor and assess, lenders may fear that their investment could become unrecoverable or that the manager could instead be funneling the funds to some illegitimate purpose, such as for his personal benefit.

In order to foster the development of a participatory culture and management style, investments must be made, particularly in relation to human capital – these are, of course, investments in intangible assets, very hard to monitor from the outside. As such, a close, continual, and transparent relationship between investors and the firm may be particularly beneficial to non-traditional companies. As an example, Levine (1990) points to the fact that the close relationship between firms and their creditors was an important contributing factor to the growth of participatory firms in Japan.

Nuttall (2012) identified three main obstacles to the viability of employee ownership:

- A lack of awareness of the concept of employee ownership itself;
- Scarcity of resources available to support employee ownership;
- The legal and tax-related complexities of employee ownership, both real or perceived.

Lack of awareness has obvious consequences – if employers, advisors, and employees are unaware that it exists, how can employee ownership even begin to be considered as an option? In terms of policy and law, if legislators are not aware of its existence, employee ownership won't even be discussed.

The scarcity of resources is related to the lack of specialized services (both private and public) dedicated to providing assistance to businesses interested in converting to employee ownership. So even if a business owner and the employees

of his company know about employee ownership and are enticed by the idea, without counselling and guidance from experienced consultants or legal professionals who are knowledgeable about the subject, it is highly unlikely that the conversion could be achieved successfully.

The final point requires little explanation. If the transition process is overly cumbersome, the administrative and bureaucratic difficulties alone will stifle employee ownership's appeal. Policy-makers and legislators ought to create standard procedures of conversion in order to simplify the process. Fiscal incentives are also a possibility.

7. Employee ownership in Portugal

In a study focused on financial participation in the European Union, Hashi and Hashani (2013) found that large companies in the financial sector were the most likely to have financial participation schemes (both employee share ownership and profit sharing plans) available for their employees to join. Other factors that are associated with a greater likelihood of a firm adopting financial participation schemes include a higher proportion of high-skill employees and the existence of worker representation. Companies that offer training to their staff and organize the work in teams also displayed an advantage. As expected, employees in managerial positions are more likely to participate in these plans. This study also revealed that the popularity of employee financial participation plans is lower in the Iberian Peninsula (and Southern Europe in general) than in the remainder of Europe.

An analysis of the latest Annual Economic Survey of Employee Share Ownership in European Countries (relative to 2018), carried out by the European Federation of Employee Share Ownership, reveals the poor condition of employee ownership in Portugal. Not only is Portugal below the European average in respect to the percentage of capital held by employees[25], but after categorizing that small faction of workers as either "top executives" or "ordinary employees" the results emerge as extremely unbalanced, with the vast majority of capital held by employees being owned by the "top executives" group.[26]

Proper broad-based employee ownership plans, which implement both employee ownership and participation, seem to be close to nonexistent in Portugal.

[25] Portuguese employees hold under 2 percent of companies' capital, while the European average is just over 3 percent.

[26] Annual Economic Survey of Employee Share Ownership in European Countries: 2018, p. 49-50

8. Closing observations

8.1. Limitations

This literature review was executed taking into account the fact that employee ownership's full range of possible benefits needs more than just stock ownership on the part of a firm's employees in order to materialize. Various synergistic practices were scrutinized, duly integrated with an analysis of the psychological mechanisms through which workers come to develop feelings of ownership toward their company (and their role within it). Inevitably, however, there are certain limitations to the present review that must be mentioned ahead of the concluding remarks.

One of the problems with the academic body of literature on employee ownership stems from the fact that a great part of the research was conducted using data from public companies, which usually have a very minor percentage of company stock committed to their employee share plans. There are hints that employee ownership could produce even more positive results in the small and medium-sized sector if implemented at a more substantial level; however, this area of research is still vastly underexplored.

Another issue pertains to the fact that most studies are focused on companies from either the United States of America or the United Kingdom, especially the former. This is not surprising seeing as employee ownership is, both culturally and legislatively, more developed in those countries. This does mean, however, that the results may not be entirely transferable to other territories.

We have established that employee ownership needs a specific set of complementary factors in order to flourish effectively. While this notion is widely acknowledged in the literature, some researchers do not take these synergies (or lack thereof) into account in their data analyses. Without the presence of high performance work practices and a suitable management style, the adequate development of an ownership culture is compromised, and so are its benefits. This circumstance could explain some of the conflicting results of various studies.

Having clarified the limitations of the present literature review, we proceed to the final remarks.

8.2. Conclusion

Graeme Nuttall, a British expert on employee ownership, was approached by the English Government to undertake an independent review into employee ownership. In the resulting 2012 report, he identified three main strategic areas of intervention which should be prioritized in order to effectively promote employee ownership: raising awareness, increasing resources available to support it, and reducing its complexity. The Nuttall Review's recommendations resulted in the creation of the Finance Act of 2014.

Lampel, Banerjee, and Bhalla (2018) observed that in the United Kingdom, there was a notable boost in the number of employee-owned businesses after the aforementioned Finance Act of 2014 was approved (which, among many other provisions, redesigned tax incentives and established a new employee ownership model scheme). Personal interviews revealed that this piece of legislation was seen as important not only because of the tax benefits it introduced, but also for the role it played in increasing awareness about the existence of employee ownership itself.

Hansmann (1996) proposed that because ownership conversions can be brokered, the associated costs are often modest relative to the value of the firm, and therefore do not form an impediment to changes in ownership. That statement assumes that employee ownership is already a part of the local business and legal environment – because, as the author put it, "important economies derive both from the presence of established brokers who specialize in ownership transactions and from the existence of standardized procedures for handling those transactions. Where such institutions have not yet developed, the costs of adopting or converting to a particular form of ownership may be high."[27]

[27] Hansmann (1996, p. 46)

Employee ownership is undoubtedly an underdeveloped topic in Portugal, both academically and politically (not to mention in practice). Taking into account the European Union's recommendations on this topic[28], lawmakers could improve the situation by offering tax incentives and creating basic models for broad-based ownership schemes, so that employee share plans do not have to be built from scratch for every new adoption. The development of favorable financing arrangements specifically for leveraged employee buyouts would also make them a more attractive option.

Employee ownership has the potential to attract support across the ideological spectrum in Portuguese politics, as it has in other countries. On the one hand, it is a form of private ownership – there is a clear link between the private ownership and the return on capital, with the reward being market-based. On the other, it promotes a broad-based expansion in the distribution of corporate profits, a welcome step against the rising levels of wealth inequality. It depends on private initiative, with plan designers having a great degree of flexibility regarding its structure and characteristics. On top of this, employee ownership makes companies more resilient against economic recessions, which are all but inevitable in the economic system of the West. This idea has rallied bipartisan support in the United Kingdom and in the United States – a consensus could certainly also be achieved in Portugal, despite the (sometimes dogmatic) adversarial political climate.

Direct employee ownership is already an available option, but low levels of awareness and the lack of legal structures and professional services related to the field make its implementation overly cumbersome, especially for smaller businesses. Policy-makers can work to reverse this scenario through relatively simple means: a few strategic changes to the law, coupled with tax incentives, could certainly have a positive effect.

[28] The European Union has demonstrated ample support for employee ownership, and among many other publications on the subject, has commissioned the development of four reports regarding the promotion of employee participation in profits and enterprise results, also known as the PEPPER Reports.

Indirect employee ownership as it exists in the United States and United Kingdom is, on the other hand, currently not possible to implement in Portugal.[29] However, the idea of representative employee involvement in governance based on pooled voting rights merits consideration for future legislative developments.

Employee ownership appears to be a particularly promising option regarding business succession.[30] A focus on this particular transition point could lead to significant evolution in the small and medium-sized enterprise sector, strengthening local communities and the economy as a whole. Sadly, it seems that without some sort of political backing, this is unlikely to take place – on the other hand, as evidenced by the British example, a little support from the government can make a big difference.

Employee ownership is a solid option for many businesses, with strong potential for growth. It just needs a push in the right direction. As Graeme Nuttall put it: "Many in the employee ownership sector have said their awareness of the concept is because of serendipity. This must change. A great idea should not depend on a happy accident to spread awareness."[31]

[29] Recourse to an employee ownership trust is not an available option in Portugal, as trusts are not accepted under Portuguese law.

[30] Lampel, Banerjee, and Bhalla (2018) point to the fact that in the United Kingdom, more than 60 percent of small and medium-sized enterprises are estimated not to have a succession plan. If circumstances are even moderately similar regarding Portuguese companies, this represents an opportunity to promote long-lasting and stabilizing changes in the business environment.

[31] Nuttall (2012, p. 5)

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