

Research Report

**WHY DO EMPLOYEES PARTICIPATE IN  
EMPLOYEE SHARE PLANS?  
A CONCEPTUAL FRAMEWORK**

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Employee Share Ownership Project



The Employee Share Ownership Project is a joint initiative of the **Centre for Corporate Law and Securities Regulation**, the **Centre for Employment and Labour Relations Law** and **The Tax Group**. It is funded by an Australian Research Council Discovery Project Grant.

The project subjects the existing regulatory regime for employee share ownership plans in Australia – in tax, corporate and labour law – to technical and empirical scrutiny. It analyses how current legal regulation structures and constrains the use of ESOPs in Australian enterprises. It examines the current incidence and forms of ESOPs in Australia, the diversity of objectives that such schemes serve, the extent to which current corporate, tax and labour law inhibit ESOPs, and the case for reform of the regulatory framework.

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# WHY DO EMPLOYEES PARTICIPATE IN EMPLOYEE SHARE PLANS?

## A CONCEPTUAL FRAMEWORK

Michelle Brown,<sup>\*</sup> Ingrid Landau,<sup>\*\*</sup> Richard Mitchell,<sup>\*\*\*</sup> Ann O'Connell<sup>†</sup>  
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### I INTRODUCTION

Increasing numbers of companies in Australia are offering their non-executive employees the opportunity to own securities in the company through some form of employee share ownership plan (ESOP).<sup>1</sup> In many cases, shares or options in the company are provided to employees as a 'gift', either on a one-off or regular basis. Many plans, however, are structured so as to require employees to contribute to the value of the securities. In the cases of contributory plans, the reasons why employees choose to participate are not always clear. Do employees only invest in employer securities when they perceive the company to be a good financial investment? If so, to what extent is employee investment in employer securities driven by the concessional taxation treatment of ESOPs in Australia, which may make it financially more appealing for employees to take up shares in their employer than to purchase shares via the stock exchange? To what extent do company-provided financial incentives, such as the offer to 'match' every share purchased by the employee with a free share, influence an employee's decision? Do demographic factors, such as age, gender and income-levels affect participation rates?

The unique nature of the employer-employee relationship adds further complexity to the question of why employees choose to participate or not participate in an ESOP. Do 'non-financial' considerations, such as the desire to participate more in the company, figure in the decision to take up employer securities? Are employees' decisions to participate in an ESOP influenced by their degree of commitment to their employer? Do norms at the level of the workplace – that is, attitudes towards ESOP participation among colleagues, supervisors and/or trade unions – influence an individual's decision whether or not to participate? The answers to these questions have important implications for both designing and implementing employee share plans at the company level and for public policy.

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<sup>1</sup> For convenience, the terms 'employee share plan' or 'ESOP' are used in this paper to refer to all types of plans that are open to the majority of non-executive employees, including option plans.

This paper reviews existing studies and presents a tentative conceptual framework to explain why employees participate in ESOPs. It examines the relationship between the decision to participate in an ESOP and a number of demographic and workplace-specific variables. It also identifies key factors that may moderate this relationship, such as the extent of company communication on the plan and company performance. This conceptual framework has been developed on the basis of a synthesis of previous studies and twelve semi-structured interviews conducted with human resource (HR) managers and trade union representatives within publicly listed companies. In light of the small body of prior research in this area, the conceptual framework draws upon other bodies of work which have examined the determinants of employee's workplace participation decisions, such as studies examining employee pension contribution decisions and why employees join trade unions.

## **II WHY DO EMPLOYEE MOTIVATIONS FOR PARTICIPATING IN AN ESOP MATTER?**

Why workers choose to participate in employee share plans is an issue which has implications for corporate governance, HR practice and public policy. For example, understanding the factors that motivate participation in an ESOP may enable companies to better target their efforts to increase the number of employee shareholders. Examining the issue may also lead to a better understanding of the outcomes of employee share ownership: in particular, whether employee share ownership is likely to produce the kinds of benefits for which it is implemented by companies and/or promoted at the public policy level.

### **Company specific applications**

A greater understanding of employee demographics and motivations for ESOP participation has important ramifications for companies considering implementing a plan or for those who already have one. Companies who are implementing a new plan or considering making an offer under an existing plan need to be able to estimate the likely take-up of shares in the plan to forecast the effect on equity dilution.<sup>2</sup> For those companies that seek to increase participation rates in existing plans, a better understanding of factors that influence participation may assist them in designing and implementing ESOPs in a manner that maximises employee participation. Companies may also be able to target their education and communication efforts at particular groups that tend to be less likely to take up shares.

### **Public policy**

The former Federal Coalition Government was committed to doubling the incidence of employee shareholders by 2009.<sup>3</sup> It sought to pursue this objective largely through providing information to employers on the potential benefits of implementing an employee share ownership plan through its Employee Share Ownership Development

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<sup>2</sup> A Pendleton, 'Determinants of Participation and Contributions in Save as You Earn Share Option Plans', Paper presented at the Labour and Employment Relations Association (LERA) 59<sup>th</sup> Annual Meeting, 4-7 January 2007, 3.

<sup>3</sup> Kevin Andrews, Minister for Employment and Workplace Relations, 'Promoting Employee Share Ownership', Media Release, 25 February 2004.

Unit.<sup>4</sup> The Treasurer of the current Federal Labor Government has also, during his time as Shadow Treasurer, expressed his strong support for broad-based employee share ownership.<sup>5</sup> However, achieving the objective of increasing the number of employee shareholders requires not only employers to implement ESOPs but for employees to take up their offer to acquire company securities. This research project may contribute to understanding how to increase employee participation in ESOPs, where indeed this is a public policy objective.

Understanding the characteristics and motivations of employees who participate in ESOPs also has implications for the public policy rationales underlying the promotion of employee share ownership. Two commonly cited public policy objectives for promoting broad-based employee share ownership are, first, to broaden share ownership within Australian society generally and, second, to facilitate national savings.<sup>6</sup> With a limited understanding of the personal characteristics of employees who take up shares, however, it is impossible to ascertain the extent to which employee share ownership is capable of playing a significant role in the pursuit of these objectives. For example, if employees who participate in ESOPs tend to be those on higher incomes who already possess a considerable share portfolio, then the capacity of employee share ownership to facilitate broader wealth generation and contribute significantly to increasing national savings is limited.

The answers to the research questions posed in this paper are also important for understanding the desirability of regulatory reform. In corporate law, for example, the current regulatory regime governing employee share plans largely treats employees as ordinary investors: companies wishing to sell shares to employees must comply with the standard disclosure and fundraising requirements, which are primarily intended to ensure that investors have access to adequate information with which to make an informed decision.<sup>7</sup> If, however, employees are not bringing a financial orientation towards the decision as to whether to take up shares in their employing company – that is, they are not behaving as ordinary investors - this would suggest that the regulations governing employer communications to employees regarding employee share plans may need to be reassessed.

### **Understanding the effects and outcomes of employee share ownership**

Understanding employee motivations for ESOP participation may also contribute to our understanding of the *effects* of employee share ownership. Underlying much of the existing work on employee share ownership is the presumption that the decision of employees to become employee shareholders is a manifestation of their desire for

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<sup>4</sup> See <<http://www.workplace.gov.au/workplace/Programmes/ESO/>>.

<sup>5</sup> Wayne Swan, Shadow Treasurer, 'Australia's Economic Future', Keynote Address to the Labor Business Forum, Sydney, 19 September 2006.

<sup>6</sup> See, eg, House of Representatives Standing Committee on Employment, Education and Workplace Relations, *Shared Endeavours – An Inquiry into Employee Share Ownership in Australia (Majority Report)* (2000) and the Hon Peter Reith MP, Minister for Employment, Workplace Relations and Small Business, 'The Role of Employee Share Ownership in the New Workplace', Media Release, 29 June 2000.

<sup>7</sup> See I Landau and I Ramsay, 'Employee Share Ownership in Australia: The Corporate Law Framework' (Research Report, Employee Share Ownership Project, March 2007). Available at <<http://cclsr.law.unimelb.edu.au/go/centre-activities/research/employee-share-ownership-plans-current-practice-and-regulatory-reform/index.cfm>>.

greater influence and control over decision-making processes within the company. Employee satisfaction with share ownership, therefore, will depend largely on the extent to which mechanisms exist to facilitate greater participation and employee influence.<sup>8</sup> However, if workers have a financial orientation towards their shareholding, then factors such as the size and performance of their investment become much more significant.<sup>9</sup> The financial performance of the company will be very important in determining employee satisfaction and employee shareholders may only seek greater influence where they are dissatisfied with the way in which the company is being run.<sup>10</sup>

### III PRIOR RESEARCH

Writing in 1987, French observed that little was known about the expectations or orientations that employee shareholders bring to their ownership roles.<sup>11</sup> This observation largely holds true today. While there is a considerable body of theoretical and empirical work on employee share ownership, studies have tended to focus on the effects of employee share ownership on employee attitudes and levels of commitment and on enterprise productivity. Where authors have discussed the motivations for employee ownership, they have focused overwhelmingly on why employers implement ESOPs rather than why employees choose to participate

There has, however, been important recent work emanating from the United States on employee investment behaviour in relation to defined contribution retirement plans. A strand of this literature on financial behaviour has focused on employee investment in employer securities through 401(k) plans.<sup>12</sup> Large-scale corporate collapses (such as Enron), in which many employees lost not only their jobs but much of their savings, has inspired renewed attention on the desirability and effects of significant employee investment in employer securities among researchers, the media, non-profit agencies and the US Congress.<sup>13</sup> Three broad and interrelated strands of this literature are

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<sup>8</sup> J L French, 'Employee Perspectives on Stock Ownership: Financial Investment or Mechanism of Control?' (1987) 12 *Academy of Management Review* 427, 431.

<sup>9</sup> Ibid.

<sup>10</sup> Ibid. See also T H Hammer and R N Stern, 'Employee Ownership: Implications for the Organizational Distribution of Power' (1980) 23 *Academy of Management Journal* 78, 96.

<sup>11</sup> French, above n 8, 427.

<sup>12</sup> The 401(k) plan is an increasingly common form of employer-based retirement plan in the United States in which employees make contributions, which are often matched by employers, to a retirement trust account. These contributions are then invested in various stocks, bonds and money market investments. Importantly for our purposes, many companies offer employees the option of investing a proportion of their 401(k) assets in employer securities.

<sup>13</sup> See, eg, S J Stabile, 'Another Look at 401(k) Plan Investments in Employer Securities' (2002) 35 *John Marshall Law Review* 539 and S J Stabile, *401(k) Special Supplement: Lessons from Enron*, Panel Publishers, 2002; L Muelbroek, 'Company Stock in Pension Plans: How Risky Is It?' (2005) 48 *Journal of Law and Economics* 443; and the symposium issue 'Lessons from Enron: How did Corporate and Securities Law Fail?' (2003) 48 *Villanova Law Review* 1. See also numerous working papers produced by the National Bureau of Economic Research and the Employee Benefits Research Institute. This literature has been drawn upon by Andrew Pendleton to examine employee share ownership participation in the UK: see A Pendleton, 'Sellers or Keepers? Stock Retentions in Stock Option Plans' (2005) 44 *Human Resource Management* 319, A Pendleton, 'Determinants of Participation and Contributions in Save as You Earn Share Option Plans' (Paper presented at the Labour and Employment Relations Association 59<sup>th</sup> Annual Proceedings, Chicago, 4-7 January 2007, April 2006) and A Pendleton, 'Who Invests Too Much in Employer Stock, and Why Do They Do It?'

particularly relevant to our research question. The first is the demographic determinants of employee voluntary investment in defined contribution plans and the extent of this investment. The second is explanations as to why employees behave financially irrationally through choosing to invest heavily in employer securities, thus violating the basic financial precept of investment diversification. Authors here have identified and empirically assessed the influence of a range of emotional and psychological biases, such as employee feelings of loyalty towards their employer and familiarity.<sup>14</sup> Finally, some studies have emphasised the critical role played by plan design in influencing the investment decisions of employees. Authors have explored the effect of company practices in designing plans with ‘opt-in’ or ‘opt-out’ features;<sup>15</sup> discounting company securities; or company ‘matching’ of employee investments in company securities.<sup>16</sup>

The findings of the existing research on why employees participate in employee share plans outlined above can be divided into four broad and overlapping categories. First, authors have examined, in theory and in practice, whether employees have a *financial* or a *control* orientation towards employee share ownership. A financial orientation perceives of share ownership purely as a financial investment; a control orientation suggests that employees become shareholders because they see it as a potential means through which to enhance their participation in the company. The second and third categories are concerned with the determinants of the decision to participate in an ESOP: attitudinal variables and demographic variables respectively. The final category is concerned with workplace-level influences on employees’ participation decisions, such as the influence of supervisors and colleagues and the important role played by plan design.

### **A control or financial orientation towards share ownership?**

Existing studies appear to support the conclusion that employees bring a financial rather than a control orientation to ESOP participation. In 1981, Kruse discussed the possibility that employee shareholders may define ownership purely in terms of rights to the profits generated by the investment capital.<sup>17</sup> In 1984, French and Rosenstein found from their survey of around 500 employees within a company that had converted to employee ownership that three quarters of employees viewed shareholding as an investment rather than the chance to become an owner.<sup>18</sup> Several

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Some Evidence from UK Stock Ownership Plans’ (Working Paper No. 24, Department of Management Studies, University of York, August 2006).

<sup>14</sup> See, eg, S Benartzi, ‘Excessive Extrapolation and the Allocation of 401(k) Accounts to Company Stock’ (2001) 56 *Journal of Finance* 747; G Huberman, ‘Familiarity Breeds Investment’ (2001) 14 *Review of Financial Studies* 659, O S Mitchell and S P Utkus, ‘Company Stock and Retirement Plan Diversification’ (Working Paper 2002-4, Pension Research Council, University of Pennsylvania, August 2002). For a useful summary of this literature, see J Bailey, J R Nofsinger and M O’Neill, ‘A Review of Major Influences on Employee Retirement Investment Decisions’ (2003) 23 *Journal of Financial Services Research* 149.

<sup>15</sup> J Beshears et al, ‘The Impact of Employer Matching on Savings Plan Participation under Automatic Enrolment’ (Working Paper No. 13352, National Bureau of Economic Research, August 2007).

<sup>16</sup> See, eg, Benartzi, above n 14, and N Liang and S Weisbenner, ‘Investor Behavior and the Purchase of Company Stock in 401(k) Plans – The Importance of Plan Design (Working Paper 9131, National Bureau of Economic Research, 2002).

<sup>17</sup> Kruse, as cited in French, above n 8, 429.

<sup>18</sup> J French and J Rosenstein, ‘Employee Ownership, Work Attitudes, and Power Relationships’ (1984) 27 *Academy of Management Journal* 861, 867.



years later, Klein developed three theoretical models to explain the conditions necessary for employee ownership to have a positive influence on employee attitudes, one of which – the extrinsic satisfaction model – posits that employees only participate in plans where it maximises their personal wealth.<sup>19</sup> She noted that the lack of attention given in the employee share ownership literature to the notion that employees value employee ownership because it is financially rewarding was surprising given the availability of data supporting the model.<sup>20</sup> In the same year, French argued that many authors studying employee share ownership had failed to take into account the fact that employees may have a range of motivations for becoming shareholders.<sup>21</sup> In particular, studies tended to proceed from the presumption that employees valued share ownership because of a desire for increased control over company decision-making, overlooking the possibility that employees have a financial orientation rather than a control orientation towards share ownership. Workers may perceive their shareholding in the company simply as a financial investment and limit their expectations to a satisfactory rate of return on their investment.<sup>22</sup> Like Klein, French pointed to the findings of a number of studies that appeared to be consistent with this hypothesis. For French, an important implication of the hypothesis that employees view participation in an ESOP in terms of a financial investment was that the employee's assessment of the particular plan – its expected financial return, the level of risk and the availability of finance – will play a key role in an employee's decision to participate.

The hypothesis that employees hold a financial orientation towards participation in an ESOP has been supported by several subsequent studies. From their analysis of participation rates in Save-As-You-Earn ('SAYE') share option schemes in two UK companies, Baddon et al found that over 90 percent of participants surveyed rated the potential financial rewards as 'very' or 'quite' important in their motives for participation in the SAYE plan; and over 80 percent rated the fact that no risk was involved and that it was an 'easy way of saving' as 'very' or 'quite' important.<sup>23</sup> The authors concluded that the financial aspects of share ownership appear to dominate the motives for participation in SAYE plans.<sup>24</sup>

More recently, Pendleton has drawn upon a data source of 2638 employees in three UK companies with well-established SAYE schemes to analyse the demographic and attitudinal factors which influence the decision of employees to participate in employee share ownership plans.<sup>25</sup> Pendleton sought to assess the orientation of employees towards the share plan through constructing two variables: one single item five-point scale asked employees whether share plans were a good way for employees to secure greater control of the company and a similar scale asked respondents to indicate the extent to which they saw the share plan as delivering financial benefits to

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<sup>19</sup> K Klein, 'Employee Stock Ownership and Employee Attitudes: A Test of Three Models' (1987) 72 *Journal of Applied Psychology* 319.

<sup>20</sup> *Ibid.*, 320.

<sup>21</sup> French, above n 8, 429.

<sup>22</sup> *Ibid.*

<sup>23</sup> L Baddon et al, *People's Capitalism? A Critical Analysis of Profit-Sharing and Employee Share Ownership*, London and New York: Routledge, 1989.

<sup>24</sup> *Ibid.* 255.

<sup>25</sup> Pendleton, 'Determinants of Participation and Contributions in Save As You Earn Share Option Plans', above n 13.

workers. Pendleton found that a control orientation had a slight effect on the decision to participate, but financial orientation was positive and significant. He also found that employee attitudes towards the plan itself appeared to be much more significant in influencing the decision-making process than attitudes towards the company, concluding that participation is influenced by instrumental considerations: workers who emphasised the financial benefits associated with participation were most likely to participate.

### **Attitudinal determinants**

Several studies have examined the extent to which employee attitudes and views towards the company and employee share ownership more generally influence the decision to take up shares or options in a plan. A common hypothesis in the employee share ownership and 401(k) literature is that the employees with higher levels of commitment towards their employer will be more likely to participate in an employee stock ownership plan.<sup>26</sup> In the UK, Dewe et al found from their analysis of the responses from 296 workers on their intention to participate in a soon-to-be-introduced all-employee share option scheme (SAYE scheme) that the decision to participate in the ESOP did not appear to be influenced by the degree of commitment to, or satisfaction with, the firm.<sup>27</sup> In Baddon et al's survey, 73 percent of the respondents rated the fact that it was a means of 'gaining a stake in the company' as very or quite important in their motivation to participate and 64 percent of the participants identified as 'very' or 'quite' important the fact that it was a way of being more involved in the company's future.<sup>28</sup> Drawing upon these studies, Pendleton has recently re-examined the hypothesis that attitudinal factors influence employees' decision to participate in employee share plans.<sup>29</sup> He found that the degree of employee commitment towards the company did not appear to have any bearing on whether or not an individual decided to participate in the share plan. The only attitudinal variable which appeared to influence employee decisions to participate was their attitude towards risk, which again would tend to suggest employees adopt a strong financial orientation towards share ownership.

There is very limited empirical evidence on how employees view employee share ownership in general.<sup>30</sup> In the only such study identified by the authors, Dewe et al found that 69 percent of workers surveyed agreed with the statement 'These days it's right for workers to own part of their company.'<sup>31</sup> For the authors, this '... suggests that share ownership in itself is important to people; that such schemes are not just about saving, but about having a stake in the company'.<sup>32</sup>

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<sup>26</sup> Mitchell and Utkus, above n 13; and P Dewe et al, 'Employee Share Option Schemes: Why Workers are Attracted to Them' (1988) 26 *British Journal of Industrial Relations* 1.

<sup>27</sup> Dewe et al, above n 27, 19. The scheme required the individual to save a certain amount each month for a period of five to seven years, after which time he or she could elect to receive the investment in cash or take up the option.

<sup>28</sup> Baddon et al, above n 24, 253–5.

<sup>29</sup> Pendleton, 'Determinants of Participation and Contribution in Save As You Earn Share Option Plans, above n 13.

<sup>30</sup> Mitchell and Utkus, above n 13, 21.

<sup>31</sup> Dewe et al, above n 27, 10.

<sup>32</sup> *Ibid.*

In the United States, the tendency of employees to invest significant proportions of their retirement savings in employer securities has inspired researchers to examine the attitudinal and emotional influences on employee investment behaviour. For Huberman, employee investment in employer securities may be explained by individuals' tendency to invest in the familiar.<sup>33</sup> As Pendleton points out, this hypothesis is difficult to test empirically.<sup>34</sup> Benartzi has suggested that employees tend to invest heavily in employer securities because they are overly optimistic about their employer's prospects vis-à-vis other potential investment opportunities and think that other companies are more likely to experience problems than their own.<sup>35</sup>

The 401(k) literature in the US has also identified employee sentiments of loyalty and/or obligation as possible explanations for their heavy investment in employer securities.<sup>36</sup> In some cases, such expressions of loyalty may be the result of employer pressure. Stabile explained in the wake of Enron:

It appears that investment in employer securities is very much an emotional issue. Even employees who understand the value of diversification in the abstract and who say they would never advise a friend or relative to be so heavily invested in a single security, put large portions of their own account balance in the stock of their employer.... Closely related to their own feelings of loyalty is the sense on the part of many employees that they are expected by their employer to invest heavily in company stock, that is, that the corporate culture encourages such investment or that employers will perceive as loyal those employees who so invest.<sup>37</sup>

A further potential variable identified in the US 401(k) literature is the perception among employees that their employer's securities are somehow a safer investment than other companies. Stabile explains, 'Employees feel a greater comfort and certainty with the stock of their employer, feeling that an investment there is less risky than an investment elsewhere.'<sup>38</sup> This investment 'myopia' has been supported by empirical research in the US, indicating that employees consistently err in assessing the risks of their company shares.<sup>39</sup>

### **Demographic determinants**

Studies have consistently found that demographic variables, particularly income and age, are stronger determinants of participation in ESOPs than attitudinal variables.<sup>40</sup> The 401(k) literature has, in general, found income, age, education and job tenure to

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<sup>33</sup> Huberman, above n 13.

<sup>34</sup> Pendleton, 'Determinants of Participation and Contribution in Save As You Earn Share Option Plans, above n 13, 8.

<sup>35</sup> Benartzi, above n 14. See also Stabile, 'Another Look at 401(k) Plan Investments in Employer Securities', above n 13, 548–50.

<sup>36</sup> See, eg, Stabile, above n 13, 550–2 and S Stabile's testimony before the Senate Governmental Affairs Committee, *Retirement Security: 401(k) Crisis at Enron, Hearings before the Senate Governmental Affairs Committee*, 107<sup>th</sup> Congress (5 February 2002), available at <[http://www.senate.gov/~gov\\_affairs/020402stabile.htm](http://www.senate.gov/~gov_affairs/020402stabile.htm)> (last accessed 7 November 2007).

<sup>37</sup> Stabile, *Retirement Security: 401(k) Crisis at Enron*, above n 35, 2.

<sup>38</sup> *Ibid* 3.

<sup>39</sup> See Mitchell and Utkus, above n 14, 22–3.

<sup>40</sup> See, eg, Baddon et al, above n 24, Pendleton, 'Determinants of Participation and Contribution in Save as You Earn Share Option Plans, above n 13.

be associated with increased participation in 401(k) plans.<sup>41</sup> In his recent analysis of the determinants of participation and contributions in three SAYE option plans, Pendleton found that income is the most powerful determinant of employee participation, followed by age.<sup>42</sup> Pendleton summarises the four typical explanations for the strong effect of income identified in the behavioural finance literature: those on higher incomes face lower liquidity constraints; high income earners enjoy greater financial benefits from participation as a result of marginal tax rates; lower income earners are able to rely more on social security for retirement benefits; and lower income earners are likely to be less educated and thus face greater challenges in deciding whether, and how, to participate.<sup>43</sup> In relation to age, participation tends to increase with age up to a certain point after which it declines, being a function of nearing retirement.<sup>44</sup>

A recent study conducted by Morris, Bakan and Wood in the UK found that the significance of demographic variables appeared to vary between different categories of employee.<sup>45</sup> Among managers, participation in the ESOP was positively associated with age, job status and working full-time. Education, gender and marital status had no statistical effect on participation rates. For non-managerial employees, variables that had a positive association with participation rates were gender (females were more likely to participate), age, full-time employment and tenure. While managers who were union members were less likely to participate, non-managerial employees were more likely to participate if they were union members.<sup>46</sup>

### **Workplace-level determinants**

Researchers in the United States have identified plan design as exerting a key influence on employee investment behaviour.<sup>47</sup> Two features of plan design that are identified as particularly influential are the discounting of shares to employees and company ‘matching’ of shares. For Benartzi et al, employees perceive the employer’s offer to match their investment in employer shares “as an endorsement or as implicit investment advice.”<sup>48</sup> Studies by the US Employee Benefits Research Institute have found that employer matching has the effect of inducing employees to invest a higher percentage of their own self-directed funds in employer securities.<sup>49</sup>

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<sup>41</sup> See, eg, W F Bassett, M J Fleming and A P Rodrigues, ‘How Workers Use 401(k) Plans: The Participation, Contribution, and Withdrawal Decisions’ (1998) 51 *National Tax Journal* 263.

<sup>42</sup> Pendleton, ‘Determinants of Participation and Contribution in Save As You Earn Share Option Plans, above n 13, 5.

<sup>43</sup> Ibid.

<sup>44</sup> Ibid 6.

<sup>45</sup> D Morris et al, ‘Employee Financial Participation: Evidence from a Major UK Retailer’ (2006) 28 *Employee Relations* 326. The authors surveyed 1000 employees in a large retail organisation in the UK, achieving a total survey sample of 430.

<sup>46</sup> Ibid 333.

<sup>47</sup> Commentators have argued that significant employee investment in employer securities benefits the employers as employee shareholders tend to vote in ways that support the current management: see, eg, J Rauh, ‘Own Company Stock in Defined Contribution Pension Plans: A Takeover Defense?’ (Working Paper, Department of Economics, Massachusetts Institute of Technology, 2003), Stabile, *Retirement Security: 401(k) Crisis at Enron*, above n 33, 3 and S Benartzi et al, ‘The Law and Economics of Company Stock in 401(k) Plans’ (2007) 50 *Journal of Law and Economics* 45, 61–2.

<sup>48</sup> Benartzi, above n 14, 1752.

<sup>49</sup> J L VanDerhei, ‘The Role of Company Stock in 401(k) Plans’, Written Statement for the House Education and Workforce Committee Subcommittee on Employer-Employee Relations, Hearing on

A group of possible determinants for employee participation in ESOPs largely neglected in the existing literature is the influence of key referent groups, such as peers and supervisors. There does not appear to have been any examination of these issues in the employee share ownership literature. This also appears to be an under-explored area in the 401(k) literature in the United States.<sup>50</sup> Duflo and Saez, who are amongst the few authors to have examined the influence of peers on employee participation in tax deferred savings plans (including 401(k) plans), identify two reasons why it is reasonable to expect that colleagues play an important role in influencing employee investment decisions.<sup>51</sup> First, plans tend to be complicated and their advantages may not be immediately apparent to individuals who have not considered them carefully. This means that, even where people have decided to invest, they may lack the information necessary to make investment decisions and thus be receptive to information from co-workers. Second, savings decisions may be influenced by social norms or beliefs about social norms: individuals may seek to conform to common behaviour in their social group. From their analysis of individual data from employees across a number of departments within a university, the authors concluded that peer effects appeared to play an important role in determining employee investment decisions within work groups.

This brief literature review reinforces the need for further research in this area. The first observation that can be made based on the existing literature is that there is no Australian data on our research question of why employees participate in employee share plans. Different regulatory frameworks and work norms may translate into different considerations in different national contexts. Secondly, while existing studies have made important contributions to understanding the effect of some ‘non-financial’ variables on an individual employee’s decision to participate in an ESOP, there are other factors which could conceivably significantly influence this decision. These include, for example, the nature and frequency of company communication with its employees regarding the plan and the influence of key reference groups and individuals on the decision-maker.

#### IV QUALITATIVE DATA

To explore the relevance of the issues identified above in the Australian context, we conducted twelve semi-structured interviews within nine publicly-listed companies in

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“Enron and Beyond: Enhancing Worker Retirement Security”, 13 February 2002, 5; ‘Contribution Rates and Plan Features: An Analysis of Large 401(k) Plan Data’ (Issues Brief, Employee Benefits Research Institute, June 1996). Available at < <http://www.ebri.org/pdf/briefspdf/0696ib.pdf>> (last accessed 7 November 2007); J VanDerhei and C Copeland, ‘A Behavioral Model for Predicting Employee Contributions to 401(k) Plans’ (2001) *North American Actuarial Journal*. See also W E Even and D A Macpherson, ‘The Effects of Employer Matching in 401(k) Plans’ (2005) 44 *Industrial Relations* 525.

<sup>50</sup> E Duflo and E Saez, ‘Participation and Investment Decisions in a Retirement Plan: The Influence of Colleagues’ Choices’ (2002) 85 *Journal of Public Economics* 121. See also E Duflo and E Saez, ‘The Role of Information and Social Interactions in Retirement Plan Decisions: Evidence from a Randomized Experiment’ (2003) 113 *Quarterly Journal of Economics* 815.

<sup>51</sup> Duflo and Saez, ‘Participation and Investment Decisions in a Retirement Plan: The Influence of Colleagues’ Choices,’ above n 51, 2–3.

the months May to June 2007 inclusive.<sup>52</sup> These interviews were undertaken with the objective of identifying the most appropriate hypotheses to test in a later stage of the project, involving the administration of a survey to employees. We also sought to explore whether there were any explanations for employee participation in ESOPs that were not present in the existing literature. We sought to conduct interviews with individuals with different perspectives to ensure that we obtained a clear and comprehensive understanding of potential motivations. Interviewees were human resource managers and trade union representatives. Of the twelve interviewees, nine were HR managers and three were trade union representatives. The limited number of trade union representatives interviewed is explained by the fact that not all companies that participated had trade union members and, in two cases, the relevant trade unions declined to participate in our study. The companies in which the interviewees worked were all publicly listed and all had over 1000 employees. They were located in a range of industries. The percentage of company equity owned by employees through broad-based employee share plans within these companies was under 5 percent. The rate of participation in the employee share plans within the companies varied greatly: between 30 percent and over 99 percent.

The interviews were approximately one hour in duration and involved around 25 questions being put to the interviewees. These questions covered the following topics: the company's motives for establishing an ESOP; the structural features of the plan(s) and participation rates; how the plan was communicated to employees; employee motives for participation or non-participation; whether the respondents thought there were any discernible patterns in the take up of shares and possible demographic and workplace-level reasons for these. We also asked respondents whether, and to what extent, they thought the tax concessions acted as an incentive for employees to participate in the ESOP. The interview data was then analysed using Nvivo, a qualitative data analysis software program.

## **V A CONCEPTUAL FRAMEWORK**

Based on the existing literature and the twelve interviews we carried out, we have developed a conceptual framework within which we identify and order variables that influence the participation decision.

The existing literature suggests that there is a basic dichotomy between those who have principally a financial motivation to participation in an employee share plan and those who have 'non-financial' motivations. This can be depicted very simply (Figure 1).

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<sup>52</sup> The authors would like to thank Computershare and Link Market Services for facilitating the interviews and the interviewees for their participation.



**Figure 1: Basic dichotomy**

In our interviews, we found evidence for both financial and non-financial motivations. Interviewees were quick to identify the financial motivations behind participation:

I guess it's about the cash, you know, not a lot of them say "Yes I really want to own [name of company] shares," but most of them, especially in recent years where employees are actually making money out of our share schemes again, it's monetary.<sup>53</sup>

...So one, can I afford it and then, secondly, if I can afford it is it a reasonable investment or can I get better returns elsewhere .... they're probably the two primary drivers.<sup>54</sup>

The interview data did not uncover any evidence to suggest that employees participate in ESOPs in an effort to increase influence or control over workplace or company decision-making. This is probably a reflection of the fact that the companies interviewed were all relatively large companies with diverse shareholdings, in which employees would not individually or collectively hope to exercise a meaningful controlling influence through shareholdings. However, interviewees identified other 'non-financial' motivations. In particular, the nebulous idea of 'having a stake in the company' held some appeal to employees:

I'm sure there's more reasons but the ones that I'm aware of are basically so [to own] part of the company or to be able to actually, you know, [have] some pride in where they work so they like to actually be involved...<sup>55</sup>

I've taken up quite a few of the share offers, and I feel like I own part of the company, it's partly my business too...<sup>56</sup>

However, it soon became clear from our interviews that financial and non-financial motivations are not dichotomous: in practice, they are often interwoven and inseparable:

<sup>53</sup> Interviewee 1A. In the following footnotes, the letter A is used where the interviewee was an HR managers and the letter B where the interviewee was a trade union representative.

<sup>54</sup> Interviewee 4A.

<sup>55</sup> Interviewee 3A.

<sup>56</sup> Interviewee 7B.

... look, there's an element of pride: not only do you work for the company but you hold company shares. So there's the financial benefit and then, if you step back from that, there's the pride benefit. I think, you know, there's an element for saving which is a little bit different to just looking at the financial benefit in isolation.<sup>57</sup>

I've taken up quite a few of the share offers, and I feel like I own part of the company, it's partly my business too... And when the dividends come through, I see the advantages also. So it's good, all good.<sup>58</sup>

Nonetheless, while our interviews revealed the presence of 'non-financial' considerations, financial motivations were overwhelmingly identified as the predominant reason for employees choosing to participate in an ESOP. As noted above, the dominance of an instrumental approach towards participation in plans is supported by earlier studies. Accordingly, our conceptual framework is based on the premise that employees will be inclined to participate in employee share plans where they see a financial benefit in doing so. Nonetheless, our model recognises that, although employees will approach the question of participation in an employee share plan with a financial orientation, there are 'non-financial' variables that influence the decision whether or not to participate.

In our interviews, we asked interviewees about their views on the potential influence of a number of variables. Where variables were identified as being important, they were added to our framework. We organised our framework according to variables that were company-specific - that is, that the company could directly influence - and those that were individual-specific (Figure 2). Each of these variables is expanded on below.

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<sup>57</sup> Interviewee 9A.

<sup>58</sup> Interviewee 7B.



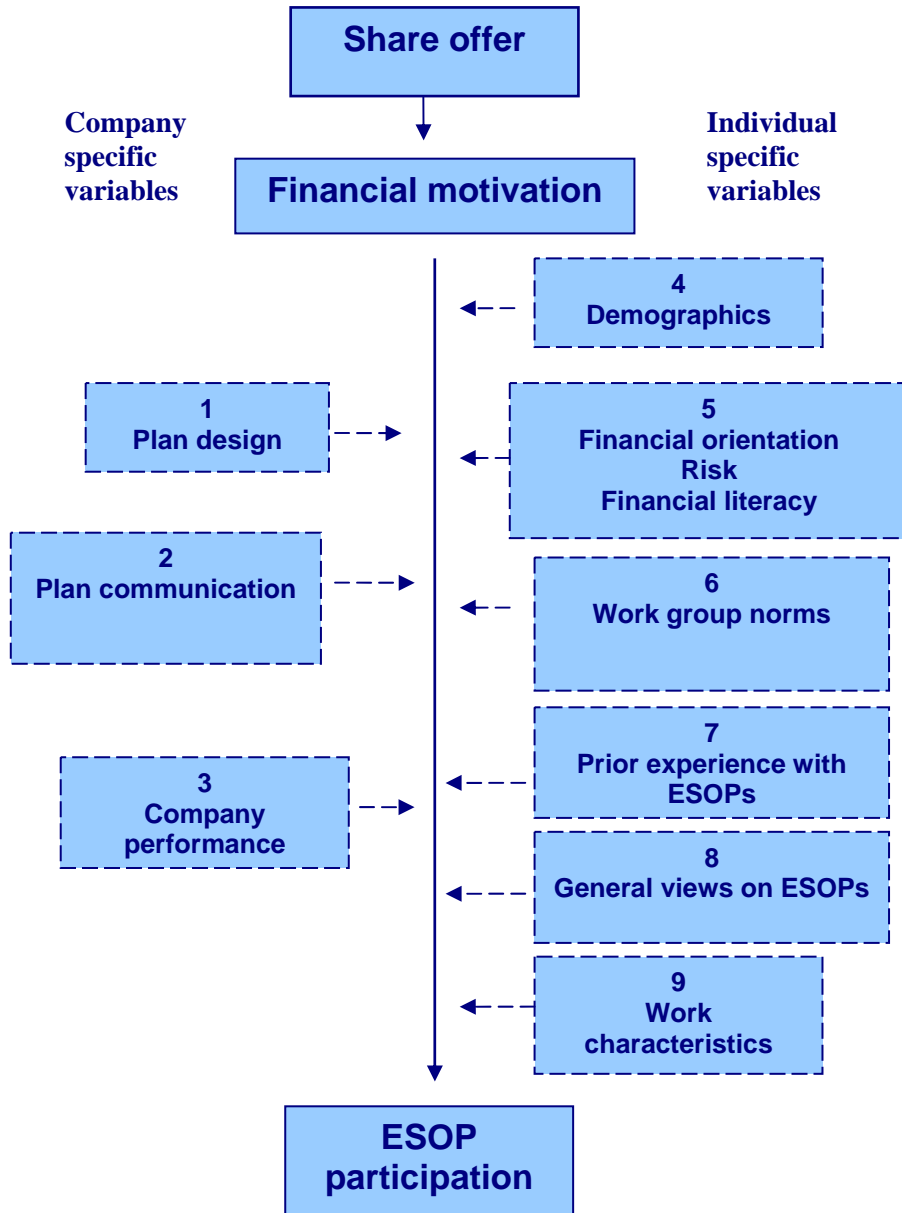


Figure 2: Final model

### 1 Plan design

Plan design appears to play a key role in determining participation rates. Where shares are provided as a gift, companies will naturally have high participation rates. Rates will be even higher where companies adopt an ‘opt out’ mechanism rather than the more common ‘opt-in’ approach (in which employees must actively elect to participate in the plan). One interviewee, for example, worked in a company in which employees were required to ‘opt out’ of the plan: the company achieved a 99.8 percent participation rate.<sup>59</sup>

<sup>59</sup> Interviewee 8A.

Plan design is influenced by the availability of tax concessions in Australia for plans that meet specific criteria.<sup>60</sup> Under Division 13A of the *Income Tax Assessment Act 1936* (Cth), an employee may elect to receive a tax exemption of up to \$1000 on the discount of the shares or rights. Alternatively, they may defer taxation on the discount of the shares or rights received for a maximum of 10 years. These two concessions make it financially rational to take up shares in the employer rather than in other companies: explaining why, if employees approach ESOPs with a financial mindset, they take up shares in their employer, thereby heightening their exposure to risk by having some of their savings and their employment security tied up in the same company. Furthermore, many plans enable employees to purchase shares with their pre-tax salary. If the plans meet these criteria, the employee shares will be taxed more favourably than ordinary shares.

Many interviewees identified the current tax concessions as an important influence on employees' decision to take up shares.<sup>61</sup> One interviewee noted, "the fact that it's got financial benefits by taking advantage of the tax concessions, I think that's probably the thing that sparks their interest in the first place."<sup>62</sup> Other relevant observations include:

Well interestingly Australia is one of the few countries that has the salary sacrifice arrangement where you can buy shares pre-tax. So I suspect that would have a significant impact on the take up rate ... I don't know that but I suspect it would because you're able to buy more shares for your dollar by doing it that way.<sup>63</sup>

Why wouldn't you if you get \$1,000 worth of shares pre-tax when you're on the top marginal rate of tax, say you're on the 30 per cent, you're buying \$1,000 worth of shares for \$685.<sup>64</sup>

You know, if you have to pay \$1,000 to buy shares, that's a big investment; but if say, okay, we're going to take \$82 ... pre-tax out of your pay... a month, that's not a huge amount of money.<sup>65</sup>

The financial benefit of purchasing shares on pre-tax salary reduces for those on lower incomes (where the marginal tax rate is lower). Thus those on higher incomes have a stronger financial incentive to participate in salary sacrifice plans.

Another common plan design feature which has the effect of increasing participation rates is company 'matching' of employee shares: for example, for every 1 or 2 shares purchased by the employee, the company will provide the employee with another share free. This means, of course, that employees receive considerably more value for

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<sup>60</sup> For discussion of the taxation framework regulating employee share ownership in Australia, see A O'Connell, 'Employee Share Ownership in Australia: The Taxation Framework' (Research Report, Employee Share Ownership Project, March 2007). Available at <<http://cclsr.law.unimelb.edu.au/go/centre-activities/research/employee-share-ownership-plans-current-practice-and-regulatory-reform/index.cfm>>.

<sup>61</sup> Interviewee 2A, 3A, 3B, 4A and 7A.

<sup>62</sup> Interviewee 3A.

<sup>63</sup> Interviewee 4A.

<sup>64</sup> Interviewee 7A.

<sup>65</sup> Interviewee 7A.

their dollar than they would if they purchased shares on market. As one interviewee explained the principal reasons he saw for participation:

...one, can I afford it and then, secondly, if I can afford it is it a reasonable investment or can I get better returns elsewhere and that's where the matching and loyalty shares become quite significant.<sup>66</sup>

Plan design may also work in more subtle ways. One theory in the behavioural finance literature in the US, for example, suggests that an employer's offer to match employee investment in company shares is an implicit endorsement of the company as a desirable investment. Participants perceive the company's offer to match employee's shares as an endorsement or as 'implicit investment advice'.<sup>67</sup> Employees who are unsure as to how to invest funds may take their employer's matching contribution as a sign of how they should behave.<sup>68</sup>

## 2 Plan communication

The employee share ownership literature identifies communication as a key criterion in determining the success of a plan, including high participation rates. This was borne out by the interviews. There was a strong sense, both among HR and trade union interviewees, that employees were more likely to participate where the company had invested considerable time and effort in communicating the plan. One HR manager interviewed explained:

So I introduced a guide book, [name of plan] guide book, you know, things like posters, just some education, and the participation last year went up 28 percent just through education...<sup>69</sup>

It was clear from the interviews that communication was not only important for explaining how the plan works. Communicating the potential benefits of plan participation also appeared to play an important role in increasing participation. As one interviewee explained:

... if you actually look at that poster up there, ...which is for the 2007 offer—you'll see that over the course of the last five years if you had have participated in the [name of plan] each year, your share value would be worth \$11,380 now for a contribution of \$3,400 after tax and that's without dividends.<sup>70</sup>

... the poster there just puts it in dollar terms: this is the wealth you would have – and a lot of people have come back saying, Oh God, I didn't know that. That wasn't communicated well before.<sup>71</sup>

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<sup>66</sup> Interviewee 4A.

<sup>67</sup> Benartzi, above n 15, 1752.

<sup>68</sup> Ibid.

<sup>69</sup> Interviewee 7A.

<sup>70</sup> Interviewee 7A.

<sup>71</sup> Interviewee 7A.

### 3 Company performance

Consistent with the hypothesis that employees have a predominately financial orientation towards share ownership; the performance of the shares would appear to exert a strong influence on participation rates. As one interviewee explained, in the past, poor company performance had the effect of discouraging participation in the ESOP:

Five years ago when the share price was \$4, people didn't see a lot of value in the plan because the share price hadn't appreciated.<sup>72</sup>

Conversely, there appears to be greater interest and participation in ESOPs where the company share price is performing strongly:

There's a lot of talk about [the plan] at the moment because our share price is going up and I suspect that had people anticipated it going up like it has, that 43 per cent of share participation would be significantly higher.<sup>73</sup>

The hypothesis that company performance influences participation rates presumes, of course, that employees are cognisant of the performance of company shares. This would appear to depend to a large degree on the extent to which the company communicates the movement of its share price to employees. In some companies in which interviewees worked, for example, the company's share price featured prominently on the company's web and intranet site.

### 4 Demographics

The interviews confirmed the findings of existing studies that demographics play a key role in determining participation. Particularly important variables identified by interviewees were income and age. None of the interviewees identified gender as a potential determinant for participation. The data collected on whether membership of particular occupational groups was an important determinant was ambiguous.

Where employees are required to contribute their own money to purchase shares, income is likely to play an important role in determining participation. Most of the interviewees identified affordability as a primary reason why employees decline to participate. Affordability was also identified by an interviewee as a reason why a company would be reluctant to promote the share plan too vigorously:

we have to be conscious that we have a lot of blue-collar workers as well and although \$1,000 to some people is not a lot of money to [contribute] pre-tax, it is when you're on \$45,000 and you've got three kids. So I think it's a double-edged sword; you don't want to push it too hard because there's the capacity to pay as well.<sup>74</sup>

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<sup>72</sup> Interviewee 7A.

<sup>73</sup> Interviewee 4A.

<sup>74</sup> Interviewee 7A.

Turning to the influence of age, a number of competing considerations arose from the interview data. On the one hand, it was suggested that younger workers are more likely to understand how the share market works. One interviewee explained:

... we tend to have, you know, more hurdles to jump in terms of educating the older end of the workforce about shares and share markets. Whereas the younger guys coming up through the ranks are ... a lot more aware of how stock markets work and what shares are...<sup>75</sup>

On the other hand, younger workers were also identified as those who may be least likely to be able to afford to participate.<sup>76</sup> It may also be that employee shares are seen as a form of long term savings and younger employees have different priorities, such as purchasing a house. One trade union delegate explained:

As the younger guys go, ... they've got houses to pay for, cars to pay for, families to start and ... they don't always see the benefit of taking up something that [only] some years from now might be an advantage to them.<sup>77</sup>

Older workers may have developed more firm-specific skills and deferred benefits within the company and be more inclined to make long term investments in their employer. Older workers also tend to be those more focused on retirement, in which case they may be more likely to save at higher levels, including through employee share ownership plans. Studies on investment behaviour in the US suggest that investment in employer securities increases with age up to a certain point, and then declines as workers reaching the age of retirement tend to diversify their investments and reduce their investment in employer securities.<sup>78</sup>

The views of interviewees on whether occupation had any impact on participation rates were mixed:

Your corporate centre will have very high participation and that's generally because they're a little bit more financially savvy, they work in the corporate area so some are accountants, some are lawyers and they'll be, oh yeah, I can understand this. ... then you'll have those working at, say, a chemicals manufacturing site who are blue-collar workers who won't be as financially literate or savvy, won't have access to a computer, so the participation rates are less...<sup>79</sup>

A large proportion of our workforce is blue-collar and also working at mine sites, working at manufacturing sites. So they probably get that stuff [the plan rules and invitation], I suspect a number of them wouldn't read it and, if they did read it, some might not understand... hence ... we've tried to draft it in very simple, concise language. But unless you did road shows...<sup>80</sup>

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<sup>75</sup> Interviewee 1A.

<sup>76</sup> Interviewee 3B.

<sup>77</sup> Interviewee 3B.

<sup>78</sup> J Agnew, P Balduzzi and A Sunden, 'Portfolio Choice and Trading in a Large 401(k) Plan' (2003) 93 *American Economic Review* 193.

<sup>79</sup> Interviewee 7A.

<sup>80</sup> Interviewee 7A.

Another interviewee, after noting the high participation rates in their sales group, observed:

People in sales ... they understand the gross margins and they're probably more financially astute .... These people probably have a better understanding of return on investment.<sup>81</sup>

For another interviewee, however, it was precisely the opposite:

this is my experience in talking to other companies and doing the presentations—blue collar workers have to be a lot more shrewd with their investments than white collar workers. And again I think it is when you think of white collars there's also a lot of people doing very administrative low level roles who are not interested [in the employee share plan], they probably just don't understand it, it's just a job and they'll move on. Whereas in the blue collars I find people probably are there longer, they're based in smaller towns, the people live there and they work in the same place, but they also get paid quite good money due to bonuses, etcetera... that they get in that industry. So you find people who have a lot more money to invest are very well aware of their superannuation so when you do presentations to blue collar workers you really get a lot of questions and a lot of interest. So I think blue collar industries tend to have a bit more understanding and participation in the plan.<sup>82</sup>

### **5 Financial orientation; risk and financial literacy**

Risk was not identified in the interviews as a common reason why employees do not participate in plans. This is probably due to the structure of many plans in Australian companies. Where shares are provided to employees at no cost, there is no risk that employees will lose income. Even where employees are required to contribute some of their own money, pre- or post-tax, the tax concessions operate so that the value of the shares would need to decrease significantly before employees experienced any loss.<sup>83</sup> A number of interviewees emphasised that the way plans were structured meant that there was little risk to employees. When asked whether risk was a consideration, one trade union delegate responded, "No, because the way the tax advantages work, the share price would have to go down by about half before I lost money, so no, it doesn't bother me."<sup>84</sup> Another interviewee emphasised:

You've got to remember ... you salary sacrifice so if you're on 30 cents in the dollar and you get \$1,000 worth of shares, they're costing you \$700. The share price still has to drop 30 per cent for you to lose any money plus you get dividends as well. So the dividend's paying five per cent, the share has got to drop \$35 before you've

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<sup>81</sup> Interviewee 4A.

<sup>82</sup> Interviewee 2A.

<sup>83</sup> Contrast employee investment in 401(k) plans in the United States, where many employees invest considerable retirement savings in their employer: of the twenty three million workers who have access to company shares through their 401(k) plans, an estimated eleven million employees hold more than twenty percent of their assets in company shares and an estimated 5.3 million employees hold more than sixty percent of their assets in company shares: Mitchell and Utkus, above n 15, 11.

<sup>84</sup> Interviewee 7B.

actually crystallised a loss on those shares and admittedly those losses can be applied to other gains and you could, you know, you can ride out the loss.<sup>85</sup>

The extent of variation in employee share plan design in Australia, however, means that there are many plans in operation that do have the potential of exposing employees to considerable risk through facilitating considerable employee investment in employee securities. It would appear important to note that while risk did not appear to be a prominent consideration among the interviewees, it may be so in other companies.<sup>86</sup>

Several interviewees identified lack of understanding about shares and options as a key reason for employees not participating:

There's people that just don't understand how it works and it's in the too hard basket.<sup>87</sup>

They don't understand how shares work, that's the biggest problem, they don't understand how shares work, how the dividends come.<sup>88</sup>

It's more about the education process so normally the areas that we get to that have sufficient numbers of employees for us to visit and educate them, take it up. And ones that are maybe more remote and don't have any knowledge of the schemes really just see it and don't really understand it.<sup>89</sup>

A related issue is whether employees understand how the relevant tax concessions work. Given that the tax concessions in Australia appear to play an important role in making employee share plans an appealing investment for employees, understanding the effects of these concessions would appear to be a precondition to deciding to participate. Several interviewees identified employees' lack of understanding of how the tax concessions work as a common reason for non participation.<sup>90</sup>

## **6 Work group norms**

A further set of factors which may influence participation is the influence of key groups on the decision maker. While such influences have not, to the authors' knowledge, been extensively explored in the employee share ownership literature,

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<sup>85</sup> Interviewee 7A.

<sup>86</sup> The exposure of employees to risk through greater ESOP participation is a concern, for example, of the Australian Council of Trade Unions (ACTU). The ACTU is generally supportive of employee share plans which meet certain policy requirements, including that they are self-financing, to minimise the financial risk to employees: ACTU, Submission to the House of Representatives Standing Committee on Employment, Education and Workplace Relations Inquiry into Employee Share Ownership in Australian Enterprises, Submission No. 27, May 1999. Writing from the US, Mitchell and Utkus note that risk is not limited to employees who invest heavily through employee share plans, as participants who have relatively little money in employee shares but the company has performed poorly over a significant period of time may 'have suffered real economic losses due to a gradual decline in a stock's value': Mitchell & Utkus, above n 15, 2.

<sup>87</sup> Interviewee 3A.

<sup>88</sup> Interviewee 3B.

<sup>89</sup> Interviewee 1A.

<sup>90</sup> Interviewee 2A; Interviewee 3B; and Interviewee 7A.

they are a common feature of studies examining influences on employees' other workplace-related decisions, such as trade union membership.<sup>91</sup> The possible influence of co-workers has also been identified in the 401(k) literature in the US.<sup>92</sup> In the context of employee share plans, there are three social groups within the workplace that may conceivably exert some influence on the decision-maker: colleagues, supervisors and unions. The interviews explored the potential influence of these groups. Interview data provided some support for the influence of work group norms, though it did not feature prominently.

While interview responses were mixed as to whether supervisors significantly influenced participation rates, the general impression was that supervisors did not play a significant role overall. One interviewee emphasised the important role played by supervisors: in particular, in being knowledgeable about the plan and able to explain it to employees.<sup>93</sup> For most HR interviewees, however, supervisors played a negligible role: the company communicates the plan directly to employees and there is no formal involvement by supervisors. It appears that the potential influence of supervisors depends largely on the company's ESOP implementation strategy: there are companies, for example, which designate 'employee share ownership champions' in each workplace, to inform employees as to the benefits of participation in the plan.

Colleagues appear to play an important role in influencing an employee's decision to participate in a plan. A number of interviewees observed that colleagues played an important role in encouraging or discouraging employees from participating in the ESOP:

I think the other reason people do it is it's probably part of our culture; it's been around for like six years now. People have benefited very well from it, like I as a personal participant have done quite well out of it, therefore word of mouth has been very good and ... people are aware when it comes out<sup>94</sup>

Well it's basically word of mouth. Like, I've been with the company for a while and seen the advantages and I've passed on my learnings to others. Other people who have taken the option up and also seen the advantages so it's just gone on from there.<sup>95</sup>

There's a fair bit of discussion on whether [employees] can afford to take it up and the advantages of taking it up, there is a lot of discussion around that but the people who take it up have already made their decision so they just keep signing up.<sup>96</sup>

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<sup>91</sup> See, eg, S Deery and H De Cierci, 'Determinants of Trade Union Membership in Australia' (1990) 29 *British Journal of Industrial Relations* 59. In the trade union membership literature, *interactionist theories*, sometimes referred to as *social identity theories*, emphasise the embeddedness of individuals in social groups and the influence of these groups and key individuals on individuals' decisions. This approach takes account of the individual's social context both within and outside the workplace.

<sup>92</sup> See Stabile, 'Another Look at 401(k) Plan Investments in Employer Securities', above n 13, 552 and Duflo and E Saez, 'Participation and Investment Decisions in a Retirement Plan: The Influence of Colleagues' Choices', above n 51.

<sup>93</sup> Interviewee 1A.

<sup>94</sup> Interviewee 2A.

<sup>95</sup> Interviewee 7B.

<sup>96</sup> Interviewee 3B.



... when a share plan's been around for a long time, it becomes part of the culture and so I think there is a, there's almost a little bit of peer pressure too: you're a dill if you don't take advantage of this because it's, it's just one of the planks of our reward platform.<sup>97</sup>

## 7 Prior experience with ESOPs

Workers who have previously had a negative experience with employee share plans themselves or who have colleagues, friends or family who have lost money through an employee share plan will presumably be less likely to participate. This hypothesis was confirmed by two interviewees:

we had a period where our share price absolutely fell out of it and all of the exercise prices were below the market price. So for a lot of years none of the employees made any money out of the share schemes so it made motivation to participate in the future ones very low.<sup>98</sup>

I've got a couple of guys that were burnt from the [name of company], who worked there and they'll bury the share plan every time – bought all these shares ... and then [name of company] collapsed.<sup>99</sup>

Conversely, employees who have had a positive prior experience with an employee share plan will presumably be more likely to be supportive of, and participate in, the plan. As one trade union delegate explained:

Our area was instrumental in convincing people that an employee share plan should be introduced in the company... we had an employee share plan from [previous company] and there was a huge amount of benefits for our people in that plan and we wanted to see it continue over with [name of company].<sup>100</sup>

## 8 General views on ESOPs

The decision to participate in an ESOP may be influenced by the individual employee's norms and values. The employee share ownership literature has noted that employees may have differing perceptions of legitimacy and expectations regarding employee ownership.<sup>101</sup> While these differing perceptions have generally been used to understand the effects of employee share ownership, they also would appear to be important in understanding the initial decision to participate. Workers who hold a negative attitude towards employee share ownership in general will presumably be less likely to participate. This hypothesis appears to be borne out in a number of the interviews:

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<sup>97</sup> Interviewee 9A.

<sup>98</sup> Interviewee 1A.

<sup>99</sup> Interviewee 3B.

<sup>100</sup> Interviewee 3B.

<sup>101</sup> J Pierce, S A Rubinfeld and S Morgan, 'Employee Ownership: A Conceptual Model of Process and Effects' (1992) 16 *Academy of Management Journal* 121,128–9.

We still get people who are a bit suspicious, you know—What are they—you know, you don't get anything for nothing. What do they want?<sup>102</sup>

... like I just think of my own parents, they have a real distrust, especially my father, a real distrust. They say, Oh well, you know, this has got to be a scam somehow or I don't understand it and they can change the rules...<sup>103</sup>

... I've never owned a share in my life so I'm probably one of those people but I mean, yeah, a lot of people just can't wait to get them so they can sell them, you know, like they just sort of don't, they don't want shares in [name of company]... certainly a lot of people don't like the kind of graphic of owning a share in their employer so they, you know, they're more than happy to, as soon as they vest, to sell them off or, you know, even if they own other shares they quite often don't want [name of company] shares.<sup>104</sup>

I mean it's precisely the flipside of why [name of company] institutes the processes, ... I don't want to be beholden to this organisation in that kind of way, I'm quite happy to work there and, you know, subscribe to their principles and to work well and make lots of profit for them but I don't want to be a shareholder.<sup>105</sup>

## 9 Work characteristics

As most plans are structured to retain employees and act as long term incentives through 'locking in' shares for a particular period of time, it follows that employees who did not anticipate staying long with a company may be unlikely to take up shares. Somewhat surprisingly, however, turnover was not commonly identified by interviewees as a reason for not participating in a plan. Only 2 of the 12 interviewees identified intention to remain with the organisation as a determinant.<sup>106</sup> This may be because virtually of all interviewees were employed in companies whose ESOPs permitted employees to continue to hold their shares after they left the company.

## VI CONCLUSION

The dynamics of employee participation in broad-based employee share plans in Australia remains largely unexplored. Overseas studies have identified and tested a number of variables which may potentially influence an individual employee's decision whether or not to participate in a plan. A key finding of the existing literature appears to be that employees approach the decision whether or not to participate in an ESOP with a primarily financial orientation: that is, whether or not taking up shares in the company would be a financially rational course of action. Following from this hypothesis, several studies have found that demographic variables – particularly age and income – are the most important determinants of participation. This finding highlights the important role played by regulatory initiatives, particularly tax concessions, which may operate to make investment in employer securities a more attractive investment than it otherwise would be. Adding further complexity to the

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<sup>102</sup> Interviewee 9A.

<sup>103</sup> Interviewee 7A.

<sup>104</sup> Interviewee 5B.

<sup>105</sup> Interviewee 5B.

<sup>106</sup> Interviewee 3A and 8A.

question of why employees participate in employee share plans, however, is the potential presence of psychological and workplace variables that may influence an individual's decision-making, such as a desire to feel like a part-owner of the company or to conform to social norms in the workplace.

The interviews conducted for this project have helped us develop and refine a conceptual framework explaining employee participation in ESOPs. In key aspects, they have lent further support to the findings of earlier studies conducted in the UK and the US: in particular, interviewees emphasised the predominance of financial considerations, the importance of age and capacity to afford to participate, and plan design. However the interviews also revealed several other relevant variables which warrant further empirical exploration, such as the extent of company communication about the plan, the influence exerted by colleagues and financial literacy.

The conceptual framework developed in this paper has been informed by existing studies and by data obtained from interviews with human resource managers and trade union delegates within large companies. It is important to note that the framework may not be relevant to smaller companies, where the dynamics of employee influence may be very different. It should also be emphasised that we have yet to obtain the views of those who have chosen to participate in the plan and those who have chosen not to. The next step in this project is to test key aspects of this conceptual framework through quantitative research with employees themselves.