The wider context of employee share ownership - high time for a better understanding in Australia?

(Submission to the Senate Inquiry into the operation of Employee Share Ownership Schemes - Economics Reference Committee)

I am starting this submission with my contribution to the ***Australian 2020 Summit***. I will add to that on the basis of an article I wrote for the website of the Australian Employee Ownership Association a few years ago and close with relevant policy statements by the AEOA and the EOG. The submission links in directly with the term of reference: **"benefits of employee ownership".** However, I will extend the discussion to Australia's adversarial industrial relations culture and its supporters. I see this culture and its linkage to the old class conflict of the 19th century as THE major barrier towards the development of a healthy workplace democracy, including ESO.

1. The Economy (Topic 1) - Industrial Relations and Workplace Democracy

Amazingly, this aspect of Australia's economy is not at all mentioned in the ***Future Direction of the Economy*** backgrounder. It is quite unbelievable that Australia is still stuck in the beginning of the previous century as far as industrial relations is concerned. Originating from the British IR culture and reinforced by class ideology, as well as by the associated two-party tradition, the gulf between capital and labour has always been huge, tempered only by the 1904 Arbitration and Conciliation Act and the concept of a fair wage (1907). Perhaps for that reason many of the sensible recommendations in the ACTU's *Australia Reconstructed* (1987) report soon went into the "too hard basket". Adversarial IR seems not to belong to an egalitarian society at all, a cultural heritage that is dysfunctional and out of place. What does belong to an egalitarian society are legislation and practices for employee share ownership and employee voice in business organisations. Workplace democracy has progressively been introduced in many European countries since the early 1950 and ESOPs saw the light of day in the US, since the early 1980s. Also in Europe, especially in the UK since the Pepper Reports of 1991 and 1996 have employee share schemes been encouraged by the Blair Government.
Several Australian academics have recently again reiterated the need for ***Partnership at Work*** in a 2003 publication by that name by Gollan and Patmore. They argue that "rights to work" must include the right to own shares in the business as well as the right to participate in decision-making. The evidence shows clearly that this combination is indeed good for productivity, staff commitment and loyalty, employee satisfaction and profitability. It also enhances transparency and reduces the need for strike action. In all countries where the practice of participation exists unions are involved and, especially in the Scandinavian countries as well as the UK, businesses with high levels of participation and/or ESO also have high union density. The argument that such practices undermine union power or reduce union significance is simply incorrect. The evidence suggests otherwise.

2. Employee Ownership combined with Workplace Democracy: US and Europe

Introduction

The American initiated ESOP culture is part and parcel of capitalist philosophy - not without its critics - rather than belonging to the extensive, longer established culture of worker cooperatives, European workplace democracy and socialism. This is not to say that employee ownership plans cannot be combined with various forms of workplace democracy. In the United States evidence of high performance is reported where participatory arrangements are combined with ESOPs. Recent interest and innovations in Europe have been highlighted by the PEPPER Reports (1991 & 1996). In Australia, with a few notable exceptions, employee ownership has been sporadic. Workplace democracy is still the exception rather than the norm. Australia is well and truly behind on both fronts, some 20 to 30 years in fact. However, there are some signs that this is going to change.

The United States

Employee ownership in the US is characterised by pluralism. Much of its considerable growth in the last three decades has occurred through employee stock ownership plans (ESOPs). Although pioneered in the 1950s federal legislation in 1974 paved the way for rapid growth. Logue & Yates (1999), quoting Rosen (1998), claim that

"today some 11,000 companies are owned in whole or in part by 7.7 million workers (about 7% of the private sector labour force) through ESOPs and stock bonus plans, the value of their ownership approximates $400 billion. An additional 2 million share ownership in another 2000 companies through profit-sharing and voluntary, tax-deferred 401 (k) savings plans which invest primarily in employee stock."

Spear, R. (1999) estimated the percentage at about 12% (private sector) and suggests that there are a total of 10,000 significant ESOPs, 1000 of them in the larger corporations which dominate US economic life, including 30% of the Fortune 500 industrial companies. Because American companies and employees have "wide latitude within federal law to design and implement their own models of employee ownership", there are a large variety of schemes. Significantly, Logue and Yates found that "most participatory employee-owned schemes outperform their conventionally owned competitors while anchoring capital and high wage jobs in the community and increasing employee participation in decision-making".

The growth in these schemes has been promoted by fiscal and legislative measures making it attractive for both companies and employees to invest in employee ownership. They provide a vehicle to facilitate the raising of loans from financial institutions for the purpose of setting up and ESOP Trust and buying shares for employees. The loans are repaid (tax free) from company profits and share dividends, and the shares are gradually allocated to employees. The overall purpose is to align more closely the interests of employees and employers.

Logue & Yates found that the employee ownership sector represents a "microcosm of the American economy. Partly or wholly employee-owned firms can be found in practically every industrial branch.....they include both large, publicly traded firms, such as Mobil Oil, Proctor and Gamble and ATT, as well as small, closely held companies. Reasons for adoption of employee ownership are as varied as averting shutdowns, corporate divestitures, obtaining low cost financing for expansion, replacing an existing company benefit plan, and sale to employees by retiring owners".

These researchers analysed 167 ESOP firms in Ohio and reported in 1993 on their study. They focused on "participatory employee-owned firms" and concentrated on governance and training. In their study 30% were majority employee-owned and 7% were 100% employee owned - which is somewhat higher than the all-US average. In the study one quarter of ESOP companies provided no means for employee participation (the US law is silent on that aspect), about half make a modest effort and one quarter have significant employee participation - in decision-making, etc. Quoting Conte (1992) they claim that

"The American evidence is compelling that firms which combine employee ownership with employee participation systematically outperform their conventionally owned competitors. In a key study, the US Government's General Accounting Office (GAO, 1987) found no association between employee ownership and corporate performance by itself but that ownership coupled with participation improved performance".

The Ohio study entirely confirmed what the GAO had found - and what several other researchers have found as well. Open communication, information shared decision-making, in other words high levels of democratic governance, coupled with employee ownership results in high performance, high levels of profitability and good rating at the stock exchange as well. In fact shop floor participation as well as Board level participation rated significantly more highly than open communication and training.

McHugh, Cutcher-Gershenfeld & Polzin (1999), in another study of 68 ESOPs, examined factors such as union member participation impacted on the structure, operation and success of their ESOPs. They point out that American unions have not been strong advocates of ESOPs in the past. For various reasons ESOPs pose a complex dilemma for unions (as in Australia). However (as in Australia) unions have recently been willing to "cautiously" endorse ESOPs. The **AFL-CIO** have produced a set of Guidelines on ESOPs which reflect their reservations and contain recommendations regarding pension plans, participation, voting power, ESOP trustees, equitable allocation of stock and vesting.

A comparison of companies with and without union involvement in the setting up and management of the ESOP, from their sample of 68, shows that union participation in ESOPs has an important influence on the nature of employee-ownership arrangements. In particular employee participation is greater where there is union involvement, a significant plus in itself for all stakeholders.

The European PEPPER Projects

Employee ownership is enjoying a growing interest in many European countries but, as Poutsma, E., de Nijs, W. & Doorewaard, H. (1999) found, there is a great deal of diversity and the schemes adopted reflect very much the flavour of the national circumstances. Furthermore, as Poutsma, E. & Huijgen, F. (1999) argue that

"on the European level the issue of involvement and new forms of work organisation is seen as a major step forward towards improved quality of production and improved quality of working life as expressed by the European Commission's Green

Paper Partnership for a New Organisation of Work" (1997). The need for direct participation in the organisation of work has become a new conventional wisdom "but this wisdom cannot be discovered for financial participation. Although the European Commission has developed resolutions and studies to promote this participation, the spread and use in Europe is rather low (PEPPER II, 1996)"

PEPPER stands for: Promotion of Participation by Employed Persons in Profits and Enterprise Results. Two major Reports were completed in 1991 and in 1996.

PEPPER I set the tone for the survey and as well as promotion of financial participation schemes. The Second Report, published in 1996, presents an overview of the dissemination of such schemes after five years. The scholars (from the University of Nijmegen, Nl.) quoted here did most of the research for it. Lack of space precludes extensive discussion of their work but its significance should be noted. The PEPPER Project II concentrates on France, Germany and the UK and includes all forms of financial participation although particularly profit sharing and employee share ownership.

The main reasons for the European Commission (July, 1992) to promote such schemes are to achieve benefits for both employees and the company, detailed as follows:

* achieving a wider distribution of wealth generated by the enterprises which the employed persons have helped to produce;
* encouragement of greater involvement of employees in the progress of their companies;
  development of positive effects on motivation and productivity of employees;
* enhancing the competitiveness of enterprises through wage flexibility;
* sustaining employment

The development of these schemes have to be seen against the background of an extensive existing system of participation in decision-making in the form of company Work (Enterprise) Councils, both at the national and European levels, and the Social Charter of the Maastricht Treaty - which, at last, in 1997 was also signed by the UK Government.

Poutsma & Huigen (1999) state that "*financial* participation in Europe is rather limited. Employee share ownership in particular is not popular, only a little fewer than 9% of workplaces have some form of employee share ownership, while more than 31% of workplaces exhibit medium to high direct participation. Such representation includes Works Councils and Employee Representation on Corporate Boards. Recent developments at the EU level towards employee financial participation: Excerpt of a recent "EESC Opinion"

At its 397th plenary session (meeting of 26 February 2003), the Economic and Social Committee of the European Union adopted the following opinion by 98 votes to five with six abstentions:

"The question of employee financial participation in company profits and results has been the subject of numerous Community initiatives aimed at supporting and encouraging action by national governments and the social partners to create an appropriate framework for the general introduction of this form of participation. The work of the Foundation for the Improvement of Working and Living Conditions figures prominently among such initiatives, bringing considerable knowledge and careful analysis to bear on this issue. In addition, the European Parliament will shortly adopt a report on the matter, having held a constructive meeting with the EESC.

The purpose of the present communication is to give fresh impetus to the Community initiative in this area in the light of the strategy defined at the Lisbon summit in March 2001, which set as its objective to increase the competitiveness and dynamism of the European economy in order to develop knowledge and social cohesion.

The EESC warmly welcomes the Commission's communication, in the belief that financial participation can play a major part in European strategy. It also believes that the conditions governing the applicability of financial participation should be looked at more closely, giving proper consideration not only to the opportunities, but also to the associated risks and problems".

The content of the communication

The communication sets out to provide a framework for Community action to promote the widespread introduction of financial participation, in accordance with the principle of involving as many employees as possible both within each company and throughout the entire production system, by means of the active involvement of the social partners.

This overall framework is built around three points:

* *identifying general principles for financial participation, with the aim of forging a common approach for initiatives by the Member States and by the social partners;*
* *identifying the main transnational obstacles currently impeding adoption of financial participation initiatives on a European or international scale, and devising the appropriate measures to address such obstacles;*
* *identifying instruments for promoting wider dissemination of financial participation, encouraging exchanges of information and experience, and research into this area.*"

While the Nelson Report (2000) at long last heralded the possible start of changes in tax legislation in favour of widening employee ownership in Australia the union movement has been slow to adopt European style workplace democracy.

A recent newspaper article (SMH, 18/08/03) reported that Greg Combet favoured an ACTU initiative to introduce Works Councils in enterprises. Background papers prepared for the August 2003 ACTU Annual Congress revealed that several discussions have in fact taken place regarding that objective in the last three years. Regrettably, and rather surprisingly, the Combet proposal did not even make the Agenda of that Congress. Apparently the left unions oppose such a policy. However, such a well developed proposal was already in existence the 1980s, especially in the ***Australia Reconstructed Report*** of 1986 prepared by the ACTU/TDC but, quite disappointingly, was shelved by the Hawke Government. Hawke claimed that it "it did not suit the Australian industrial relations culture **(footnote).**
Works Councils have been operating successfully in a large number of European countries since the early 1970s. In most cases their scope has been expanded substantially 10 or 20 years later. The adversarial Australian industrial relations culture can be changed of course. It can be improved substantially and one would think that it is high time that it is. Culture, in the final analysis, is about survival of an organization. One cannot escape the conclusion that the left unions that oppose such developments are stuck in a groove. Their conservatism has become a severe hindrance to survival. There is nothing progressive about such an attitude. Combet fully recognizes what the now extremely low density of membership (23%) means.

While a major objective of Combet's proposal is to provide scope for collective representation of employees in work places where unions are not represented, it would also go a long way not only to halt the membership decline but, very likely, to reverse the fortunes of the union movement altogether. As to the fears of left unions that the Works Council reform would undermine their power base the reality is that union activity and workplace democracy combine well in European countries. The fears of some unions that Works Councils would put them out of business is demonstrably unfounded. It is hard to believe that after all these years their leadership is apparently not aware of this.

Employee ownership and workplace democracy combined would produce what Professor John Matthews rightly described in an AEOA video (1995) as "having a turbo effect", in terms of employee commitment, productivity, corporate planning, sharing of wealth, and transparency of executive behaviour and remuneration as well. Let the adversarialism die by the wayside please. Hundred years of it is more than enough. The Australian Republic will need a new industrial relations culture to thrive.

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Policy Statements by AEOA and EOG

Australian employee Ownership Association: Employee Ownership + Voice = Business Success (extract from AEOA Policy Document)

1. Research shows that where company leadership is committed to creating a workplace environment where people share more equitably in rewards, have a meaningful say in their work, are provided with detailed information on the company and are treated with dignity and respect, this generates superior performance for that company.   2. All the research evidence available shows that employee participation - especially when combined with employee ownership - contributes to increasing prosperity, productivity and employee satisfaction in those

enterprises willing to take this step.

3. As well, companies with strong ownership and participation cultures have an enhanced sense of community, which produces lower turnover rates, and stronger feelings of engagement and purpose amongst employees, whilst also supporting better work/life balances. 4. It is clear that creating and maintaining an "ownership and participation" culture requires formal employee involvement in work-level issues. It is known that employees will relate to corporate purpose better if they have a role in creating it and recreating it.

5. It is also clear that effective employee involvement and participation strategies need to be driven as much as possible by empirical data on what works in your organisation, rather than on theory, assumptions, and doing what others do. Communication and education are essential elements of an effective participation plan.

6. In practical terms, the research indicates that an applied approach to employee ownership and participation requires a number of key activities:

• **Education on employee ownership and participation basics**

Companies need to provide adequate opportunities for employees to understand how they will benefit through employee ownership and participation.

• **Advanced Communications Systems**

Companies need to establish strong and predictable systems for information sharing, as well as training and education to support all employees in their ability to use that information.

• **Employee Voice**

Companies with strong ownership and participation cultures generally have extensive structures to involve a substantial number of employees in decision making, and they extend a substantial degree of employee voice to both workplace issues and strategic, company-wide issues.

The (Australian) Employee Ownership Group, E. O. G. lists nine major research studies in the US on its website to show the positive effects of ESO but three of them are reproduced here because they are a combination of ESO and participative structures. These results are particularly revealing.

http://www.employeeownershipgroup.com.au/default.asp?id=20

3. The 1986 NCEO study 3

This study by Michael Quarry and Corey Rosen of the U.S. National Centre for Employee Ownership (NCEO) was the first to show a specific causal linkage between employee ownership and corporate performance. It found that ESOP companies had sales growth rates 3.4% per year higher and employment growth rates 3.8% per year higher in the post-ESOP period than would have been expected based on pre-ESOP performance. ESOP companies with highly participative management structures showed by far the biggest gains, growing three to four times faster than ESOP companies without such structures. Other studies suggest that worker ownership without participation can be short-lived or ambiguous. Ownership appears to provide “the cultural glue” to keep participation going.

4. The New York and Washington studies 4

In 1997 economist Gorm Winther and colleagues followed up the NCEO study with a study of 25 employee ownership firms in New York and 28 in Washington State. In both studies, employee ownership *per se* had little or no impact on corporate performance, but a substantial impact when combined with participative management. In Washington ESOP companies grew in employment by 10.9%, and in sales by 6% per year more than would have been expected. The New York results were similar. In Washington, majority employee owned firms that were participatively managed did even better.

5. The GAO Study 5

In 1987 the US General Accounting Office (GAO) studied 110 firms focusing on productivity and profitability. The study found that while ESOPs had no impact on profits, participatively managed employee ownership firms increased their productivity growth rate by 52% per year. In other words, if a company's productivity growth rate were 3.0% per year, it would be 4.5% after an ESOP. Due to the particular methodology used these results are considered conservative.

Footnote:

The Fair Work legislation of 2009 is still in that mould. It is evidence of a disgraceful backwardness inherent in the Australian industrial relations scene. One would think that the time is overdue for a" Fast Forward" Movement. N0 culture is static and just going back to the situation of around 1993 with the nonsense about " Bargaining in Good Faith" and an " Independent Umpire" surely is very much old hat.

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