Research Report

EMPLOYEE SHARE OWNERSHIP: A REVIEW OF THE LITERATURE

Ingrid Landau, Richard Mitchell, Ann O'Connell and Ian Ramsay

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Employee Share Ownership Project

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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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EMPLOYEE SHARE OWNERSHIP: A REVIEW OF THE LITERATURE

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1 INTRODUCTION

Employee share ownership ('ESO') is a form of employee financial participation that confers on employees the right to share in the wealth of the company and, in theory at least, the right to exercise some degree of control over company affairs. In Australia, interest in employee share ownership is reflected in the inquiry held by the House of Representatives Standing Committee on Employment, Education and Workplace Relations into ESO in 2000;[1] the establishment in 2003 of a promotional Employee Share Ownership Development Unit ('ESODU') within the Commonwealth Government's Department of Employment and Workplace Relations; and, in February 2004, the announcement by the Minister for Employment and Workplace Relations of a target of doubling ESOPs in workplaces from 5 to 11 percent of employees by 2009.[2] In addition, there are several organisations and networks within Australia devoted to promoting employee ownership.[3] Despite this interest, literature on employee share ownership in Australia remains scarce. What literature exists tends to be written from a practitioner's perspective,[4] is limited to brief magazine articles,[5] or is preliminary and tentative in nature.[6]

The majority of the literature on employee share ownership comes from the UK and the US. An increasing amount also comes from Europe generally, as a result of increased promotion of financial participation, including ESO, by the European

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[1] House of Representatives Standing Committee on Employment, Education and Workplace Relations, *Shared Endeavours – An Inquiry into Employee Share Ownership in Australia (Majority Report)* (2000)('*Shared Endeavours'*).
[2] The Hon Kevin Andrews, Minister for Employment and Workplace Relations, 'Promoting Employee Share Ownership', Media Release, 25 February 2004.
[3] See the Australian Employee Ownership Association (www.aeoa.org.au) and the Employee Ownership Group (http://www.eogroup.org/).
[4] See, eg, J Sartori, 'Employee Share Ownership Plans – Issues Confronting ASX Listed Companies' (2005) 23 *Company and Securities Law Journal* 71.
[5] See, in particular, articles published in *Business Review Weekly* and *In the Black.*
[6] See, eg, D Peetz 'Financial Participation by Employees: A Review of Theoretical and Practical Issues' (Department of Industrial Relations, Canberra, 1988); M J Aitken and R E Wood, 'Employee Stock Ownership Plans: Issues and Evidence' (1989) 31 *Journal of Industrial Relations* 147; R Brown and C Wah Lau, 'The Extent and Industrial Pattern of Employee Share Ownership Plans in Australia: Preliminary Evidence' (1997) 10 *Accounting Research Journal* 34; and J Lenne, R Mitchell and I Ramsay, 'Employee Share Ownership Schemes in Australia: A Survey of Key Issues and Themes (2006) 14 *International Journal of Employment Studies* 1.

Commission since the early 1990s.[7] There is also some, but very limited, attention paid to ESO in Africa,[8] Asia[9] and the transitional countries in Eastern Europe.[10]

The diversity of the literature on employee share ownership makes compiling a literature review a challenging task. Literature on employee share ownership is found in a range of disciplines: Finance, Financial Economics, Labour Economics, Corporate Finance, Human Resource Management, and Industrial Relations.[11] The various disciplines are interested in different issues posed by employee share ownership and tend to use different data.[12] In particular, a distinction can be drawn between research and analysis that focuses on the *control potential* of financial participation and that which focuses on the *productivity potential*. Those who adopt the former view are concerned with the potential for employee share ownership to enhance employee control over the organisations in which they work, that is, to contribute to some form of industrial democratisation. Those who focus on the latter emphasise the effect that ESO may have on organisational performance.[13]

This literature review organises the material as follows. Part 2 looks at the rationales provided for employee share ownership, focusing in particular on the Australian perspective. Part 3 identifies the key criticisms of employee share ownership. Part 4 provides an overview of the principle streams of research conducted into employee share ownership. In Part 5, the interaction between employee share ownership and corporate governance is considered. Finally, the review identifies the strand of literature that has taken a comparative approach to employee share ownership in different countries.

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[7] In 1992, the EC issued its *Recommendation Concerning the Promotion of Employee Participation in Profits and Enterprise Results* (known as the PEPPER recommendation). Since this time, the issue of financial participation has been explored and affirmed by the EC in numerous reports and recommendations. See, eg, E Poutsma and W de Nijs, 'Broad-Based Employee Financial Participation in the European Union' (2003) 14(6) *International Journal of Human Resource Management* 863.
[8] M Wright, A Pendleton and K Robbie, 'Employee Ownership in Enterprises in Africa and Asia' (2000) 11 *International Journal of Human Resource Management* 90.
[9] See, eg, T Holland, 'A Piece of the Pie', *Far Eastern Economic Review,* 3 August 2000, 40; W Chiu, X Huang and H Lu, 'When Marx Borrows from Smith: the ESOP in China' (2005) 14 *Journal of Contemporary China* 761; B Cin, T Han and S Smith, 'A Tale of Two Tigers: Employee Financial Participation in Korea and Taiwan' (2003) 14 *International Journal of Human Resource Management* 920; B Cin and S Smith, 'Employee Stock Ownership and Participation in South Korea: Incidence, Productivity Effects, and Prospects' (2002) 6 *Journal of Development Economics* 263; D Jones and T Kato, 'Employee Stock Ownership Plans and Productivity in Japanese Manufacturing Firms' (1993) 31 *British Journal of Industrial Relations* 331; D Jones and T Kato, 'The Scope, Nature and Effects of Employee Stock Ownership Plans in Japan' (1993) 46 *Industrial and Labor Relations Review* 352.
[10] See, eg, P Kalmi, 'The Rise and Fall of Employee Ownership in Estonia: 1987 – 2001' (2003) 55 *Europe – Asia Studies* 1213 and B Galgoczi, 'Employee Ownership in Hungary: The Role of Employers and Workers Organisations' (Enterprise and Cooperative Development Department, ILO, Geneva, 1998).
[11] A Pendleton et al, 'Theoretical Study on Stock Options in Small and Medium Enterprises' (Final Report to the Enterprise-Directorate General, Commission of the European Communities, October 2002) 5.
[12] Ibid 10.
[13] See E Poutsma and W de Nijs, 'Financial Participation in the 1990s – Dissemination and Challenges' (1999) 20 *Economic and Industrial Democracy* 163, 166.

1.1 Scope and methodology

This literature review explores the law and policy issues arising in the context of broad-based employee share ownership. It focuses on broad-based employee share schemes: that is, schemes in which a majority of employees are eligible to take up shares. The major focus is on 'conventional' employee share schemes, which are generally introduced by management and confer only a small proportion of equity on employees.[14] Some discussion, however, focuses on schemes which transfer a substantial portion of equity to employees. Executive-based share plans are not discussed as they raise different issues and public policy considerations.[15]

This review takes a broad overview approach. It does not examine the 'mechanics' of ESO plans (ESOPs) in any detail, such as how the shares should be funded; the limitations on the issue of shares; restrictions on the disposal of shares by employees; or whether the shares are placed under the control of the individual workers concerned or under the control of a collective agency (trustee) on their behalf. Finally, this review has attempted to draw upon the international literature relevant to the Australian context. Nevertheless, some of the rationales and research findings on employee share schemes inevitably reflect the institutional and regulatory contexts in which they are embedded.

2 RATIONALES FOR EMPLOYEE SHARE OWNERSHIP

There are many rationales offered to support employee share ownership, 'informed by a variety of ideologies and intentions.'[16] Some justifications are focused on the enterprise level, whereas others see ESOP as part of a broader social or macro-economic project. A summary of the principal rationales is provided below.

Employee share ownership is identified as a means of enhancing enterprise performance through promoting worker productivity.[17] The theoretical basis for this rationale is generally located in agency theory.[18] In the corporate governance context, agency theory has highlighted the 'corporate governance problem' arising out of the separation between 'ownership' and 'control'. Shareholders and managers may have divergent interests and shareholders may find it difficult and expensive to monitor management, particularly where they hold small stakes in many different firms.[19] Agency theory has also been used as a theoretical framework in studies of financial

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[14] For a discussion of the various types of employee ownership and of classificatory criteria that can be employed to distinguish between the various types, see D J Toscano, 'Toward a Typology of Employee Ownership' (1983) 36 *Human Relations* 581 and Aitken and Wood, above n 6.

[15] For a discussion of the regulatory framework and potential reforms, see *Shared Endeavours,* above n 1.

[16] Cited in ibid 30.

[17] Bagchi terms this the 'utilitarian view' of employee share ownership: A Bagchi, 'Varieties of Employee Ownership: The Unintended Consequences of Corporate Law and Labor Law' (May 2005) 2.

[18] A Pendleton, 'Incentives, Monitoring, and Employee Stock Ownership Plans: New Evidence and Interpretations' (2006) 45 *Industrial Relations* 753.

[19] For a brief discussion of agency theory and its application in the Australian context, see R Mitchell, A O'Donnell and I Ramsay, 'Shareholder Value and Employee Interests: Intersections between Corporate Governance, Corporate Law and Labor Law' (2005) 23 *Wisconsin International Law Journal* 417, 423–31.

participation. It is argued that agency costs arise as a result of the divergent interests between employees and other stakeholders in the company (principally managers and owners). Managers may seek to ameliorate these agency costs through directly monitoring employees and/or through adopting incentive-based forms of remuneration.[20] Employee share ownership is one such incentive mechanism by which to reduce costs to the company through more closely aligning the interests of employees with those of other stakeholders in the company.[21]

There is a range of industrial relations or human resource management ('HRM') rationales for employee share ownership. Employee share ownership is viewed by some as a potential means of enhancing industrial democracy or of bringing the employee into corporate governance.[22] For some, ESO is a means of increasing employee understanding of how the company for which they work operates and, more broadly, of 'absorbing the principles on which the economy of the country is run'.[23] For others, ESO is seen as a means of facilitating labour-management cooperation through breaking down the 'them' and 'us' mentality. Some identify ESOPs as a substitute for salary or wages when business is not performing well. More recently, employee share ownership, as a means of financial participation, is identified by HRM scholars as one practice within a 'bundle' of HR practices that together constitute a high performance work system.[24] Employee share ownership also intersects with the discourse on labour-management 'partnerships'.[25]

In relation to corporate governance, ESOPs are identified as a potential defence against hostile take-over bids or as a means of rescuing companies in financial difficulties. ESOPs may also be a mechanism through which employees can 'buy out' a company or a government can privatise a government enterprise. Finally, employee share ownership may facilitate the development of 'sunrise' enterprises. At the macro-economic level, employee share ownership is seen as a means of raising capital and of dispersing ownership within capitalist societies.[26] ESOPs are also recognised as a potential means of ameliorating the shortage of long term savings in Australia.[27]

The *Shared Endeavours* Majority Report identified three inter-related objectives: 'ownership objectives', whereby plans are used to transfer all or part ownership of a

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[20] Pendleton, 'Incentives, Monitoring and Employee Stock Ownership Plans: New Evidence and Interpretations', above n 18, 756.

[21] See Pendleton's discussion of this strand of the literature in A Pendleton, *Employee Ownership, Participation and Governance: A Study of ESOPs in the UK* (2001) 10–11.

[22] G Winther and R Marens, 'Participative Democracy May Go a Long Way: Comparative Growth Performance of Employee Ownership Firms in New York and Washington States' (1997) 18 *Economic and Industrial Democracy* 393, 394.

[23] See discussion in Lenne, Mitchell and Ramsay, above n 6, 7–8.

[24] P Gollan, E Poutsma and U Veersma, 'Editors' Introduction: New Roads in Organizational Participation?' (2006) 45 *Industrial Relations* 499, 507–8; S Wood, 'High Commitment Management and Payment Systems' (1996) 33 *Journal of Management Studies* 1.

[25] See, eg, Poutsma and de Nijs, 'Financial Participation in the 1990s – Dissemination and Challenges', above n 13, 167. In Australia, see K Woldring, 'Employee Share Ownership Should Be Part of the HRM Repertoire' (2005).

[26] This perspective is strongly associated with the US. In the 1950s, Louis Kelso, an investment banker, promoted employee share ownership on the basis that it would spread ownership and strengthen the capitalist economic system. See L Kelso and M Adler, *The Capitalist Manifesto* (1958).

[27] See, eg, Employee Ownership Group, 'Employee Share Ownership in Australia: The Future' (undated) 3.

company; ‘remuneration objectives’ whereby shares are used as an incentive for employees; and ‘workplace change objectives’, whereby shares are used to ‘change the culture’ of a company.[28] The importance of these objectives may vary according to the company, and the country context. According to the Australian Employee Ownership Association (AEOA), for example, ownership considerations are predominant in the US whereas in Australia, remuneration and cultural change motives appear dominant.[29]

The *Shared Endeavours* Majority Report concluded that public policy should be formulated so as to promote ESOPs for four purposes: to better align the interests of employees and employers; to develop national savings; to facilitate the development of sunrise enterprises; and to facilitate employee buyouts and succession planning.[30]

3 THE COSTS OF EMPLOYEE SHARE OWNERSHIP

The most widely identified cost arising from employee share ownership is the financial risk it imposes on employees. In general, employees have less discretionary income and a lower ability to diversify their risks than conventional investors. The wage system allocates the greater proportion of risk upon shareholders who are more capable of bearing the risk. Employee share ownership shifts some of this risk back on employees.[31] Through broad-based ESOPs, an ‘employee is asked to make an equity investment in the same firm in which his or her labour is invested. Should the firm fail, the employee loses on both investments.’[32] The extent to which ESOPs expose employees to risk will, of course, vary significantly depending on the way the ESOP is structured and the regulatory framework. In the US, for example, ESOPs have been criticised for exposing employees to high levels of risk as employees’ pensions, personal wealth and wages may all be tied to the same company.[33]

Trade unions have historically taken a cautious approach to employee share ownership.[34] Pendleton identifies three principal issues that trade unions in the UK have had with ESOPs. First, ESOPs in the UK have generally fallen outside the scope of collective bargaining, meaning that they are often not subject to negotiation. Second, concerns have been raised that ESOPs may diminish the employee’s need for trade union representation. Finally, ESOPs are seen as potentially confusing and undermining the representative role of trade unions through putting them in a position where they are representing both employees and owners, and perhaps even involved

[28] *Shared Endeavours*, above n 1, 30.
[29] AEOA submission to the House of Representatives Standing Committee on Employment, Education and Workplace Relations’s Inquiry into Employee Share Ownership in Australian Enterprises (April 1999) 4.
[30] *Shared Endeavours*, above n 1, 54, Recommendation 5.
[31] Peetz, above n 6, 16–17.
[32] Aitken and Wood, above n 6, 159.
[33] See, eg, W R Levin, ‘The False Promise of Worker Capitalism: Congress and the Leveraged Employee Stock Ownership Plan’ (1985) 95 *The Yale Law Journal* 148, 168. Levin argues that this level of risk is sufficient to justify the elimination of ESOP subsidies in the US. For a recent discussion, see A Maggs, ‘Enron, ESOPs and Fiduciary Duty’ (2003) 16 *Benefits Law Journal* 42 and S Ball, ‘Eggs Lay’d in One Basket’, *Employee Benefits*, January 2002, 23.
[34] In the Australian context, see, eg, ACTU, ‘Employee Share Ownership Plans – Handle with Care’ (1993).

in governance institutions.[35] Wariness towards the impact of ESOPs on trade unions is strongly associated with Harvie Ramsay's Marxist critique of employee participation. Ramsay's 'cycles of control' thesis contends that employers have introduced mechanisms for financial participation by employees, including share ownership schemes, at times when the power of labour has been strong as a means of gaining workers' compliance.[36] Through promoting employee identification with the firm, employers have sought to undermine or avoid trade union representation.[37] Such an approach, however, is not successful in the long-term in achieving identification of employees with the firm as the proportion of equity transferred to employees is generally so minimal as not to have a significant effect on employee attitudes or behaviour.

Pendleton has argued that financial participation by employees is a much more complex phenomenon than described by Ramsay. First, Pendleton notes that Ramsay's 'cycles of control' thesis fails to account for the sustained interest in ESOPs in the UK since the late 1970s. Second, a number of studies suggest that employers' reasons for introducing ESOPs are much more complex than simply based on a desire to undermine trade unionism.[38] While employers may be attracted by ESOPs for their potential to increase employee commitment, industrial relations considerations are rarely at the forefront of employers' considerations. Adopting an institutional perspective, Pendleton argues that the character, practices and outcomes of financial participation arise from the interaction between actor interests and behaviours in specific institutional contexts.[39]

Employee share ownership may also impose costs on non-employee shareholders. While generally not a concern for large companies, employee share ownership has the potential to dilute a company's capital base, thus disadvantaging non-employee shareholders. It may also lead to a loss of control of the company where it is small or where the shares are closely held. Some managers may be wary of the potential for ESOPs to lead to greater control of the company by employees through employees voting as a block. There are a range of ways around this problem, including restrictions on voting or the use of 'shadow' shares.[40] Stradwick, writing on ESO in Australia in 1996, dismisses this fear as 'so remote as to be almost nil.'[41] Finally, concerns are raised over the potential for ESOPs to be used as a means of avoiding tax.[42]

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[35] Pendleton, *Employee Ownership, Participation and Governance: A Study of ESOPs in the UK,* above n 21.

[36] See Pendleton, 'Employee Share Ownership, Employment Relationships and Corporate Governance' in B Harley, J Hyman and P Thompson (eds) *Participation and Democracy at Work: Essays in Honour of Harvie Ramsay* (2005) 75.

[37] As discussed in ibid, 77–78.

[38] Ibid.

[39] Ibid.

[40] R Stradwick, *Employee Share Plans: Equity Participation for Employee Commitment* (1996) 32.

[41] Ibid.

[42] See, eg, the House of Representatives Standing Committee on Employment, Education and Workplace Relations's Inquiry into Employee Share Ownership in Australian Enterprises, Minority Report, 2000.

4 RESEARCH INTO EMPLOYEE SHARE OWNERSHIP

Research into employee share ownership can be grouped into two broad categories.[43] The first perspective, located largely within the field of labour economics, seeks to establish whether employee share ownership has an impact on firm performance. The second broad perspective focuses on the industrial relations and human resource management issues posed by employee share ownership. Authors within these disciplines have explored a range of issues. These include the relationship between employee share ownership and participation by employees, both at the workplace level and in corporate governance; how participation in an ESOP affects employee attitudes and levels of commitment to the firm; the relationship between employee share ownership and trade unions; employer and employee perceptions of ESOPs; the characteristics of companies adopting ESOPs; and particular issues arising out of majority employee-owned firms. Each of these areas of inquiry is summarised briefly below.

4.1 The labour economics literature

4.1.1 *Do ESOP firms perform better than those without ESOPs?*

There is a considerable amount of empirical research that attempts to assess whether the implementation of employee share ownership leads to enhanced organisational performance. As noted above, the theoretical departure point for much of this research is the principal-agent problem.[44] There are two commonly identified ways in which ESO schemes reduce agency costs: through increased productivity as a result of employee's feeling they have a direct interest in the performance of the enterprise (thus enhancing commitment to the objectives of the firm); and through lowering monitoring costs through aligning employee interests with those of the firm.[45]

A number of theoretical explanations have been proffered for the precise way in which ESOPs lead to increased organisational performance.[46] First is the 'pure incentive effect of financial involvement' by employees as they receive some income (deferred or cash) which is directly linked to the performance of the enterprise. Second, ESOPs cause the employee to identify with the firm, thus leading to reduced employee turnover and absenteeism. Finally, ESOPs may provide incentives for employee owners to share information at all levels, resulting in increased organisational efficiency. All the above, however, are predicated on the finding of some 'psychology of ownership' arising from ESOPs.[47]

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[43] For similar attempts to categorise the research on ESO, see E Poutsma, W de Nijs and M Poole, 'The Global Phenomenon of Employee Financial Participation' (2003) 14 *International Journal of Human Resource Management* 855, 858–9; Pendleton, *Employee Ownership, Participation and Governance: A Study of ESOPs in the UK*, above n 21, 10–12.
[44] Pendleton, 'Incentives, Monitoring, and Employee Stock Ownership Plans: New Evidence and Interpretations', above n 18.
[45] Ibid. See also N Wilson, *ESOPs: Their Role in Corporate Finance and Performance* (1992) 24–6.
[46] Conte and Svejnar identify six potential linkages between employee ownership and improved organisational performance: M A Conte and J Svejnar, 'The Performance Effects of Employee Ownership Plans' in A S Blinder (ed) *Paying for Productivity: A Look at the Evidence* (1990) 143.
[47] Ibid 26.

Australian research into the link between employee share ownership and productivity is very limited. There are no extensive studies on the existence of, or reasons for, any link between the ESOPs and increased productivity.[48] In 1997, Brown and Wah Lau argued that, for employees, the perceived link between increasing their own effort and improved value of their equity holding was so tenuous as to be non-existent, thus there is no real incentive to improve performance.[49] However, data drawn from the AWIRS 1995 indicated a positive correlation between companies with ESOPs (particularly those with broad based participation practices) and lower rates of absenteeism and higher productivity.[50] In contrast, based on a survey conducted among delegates in 1999, the Australian Manufacturers Workers' Union argued that the presence of a share scheme did not have an observable impact on productivity.[51] The *Shared Endeavours* majority report noted a correlation between ESO and higher rates of industrial action. This finding contrasts with the supposed 'industrial harmony' benefits of ESO. The report, however, dismissed this correlation, arguing that it merely reflected the fact that workplaces with ESOPs tended to be large, unionised ones.

While the findings of the international literature are mixed, the majority of evidence suggests that ESOPs alone do not improve company productivity.[52] Corporate performance is only improved where ESOPs are accompanied by increased employee participation in decision-making.[53]

Several studies have argued that ESOPs may impact negatively upon productivity. In 2005, Hadi Elhayek and Sonja Petrovic-Lazarevic, from Monash University, conducted a study on the relationship between ESO schemes and organisational performance.[54] The negative findings in this study were reported in The Age.[55] This study sought to resolve whether Australian firms with higher ESO plan participation rates exhibit improved financial performance as measured by common accounting ratios. This quantitative study involved statistical analysis of the correlation between financial performance indicators and levels of ESO participation in Australian companies. The authors conclude that their research suggests that large employee shareholdings are not of themselves instrumental in improving firm performance. Other human resource policies are much more important. They found that firms with lower ESO participation rates have better organisational performance across many

[48] *Shared Endeavours*, above n 1, 41.
[49] Brown and Lau, above n 6.
[50] Ibid 40–1.
[51] Australian Manufacturers' Workers Union, *Employee Share Ownership Inquiry Submission*, May 1999, 3.
[52] Aitken and Wood, above n 6, 166; Lenne, Mitchell and Ramsay, above n 6; Wilson, above n 45, 28. This is also the conclusion drawn by Sesil, Kruse and Blasi from their review of over 50 large-scale empirical studies on ESO: J C Sesil, D L Kruse and J R Blasi, 'Sharing Ownership via Employee Stock Option' (Discussion Paper No 25, United Nations University, 2001) 2.
[53] See discussion of literature in Pendleton, *Employee Ownership, Participation and Governance: A Study of ESOPs in the UK*, above n 21, 10–11; Brown and Lau, above n 6, 35 and sources cited therein; Peetz , above n 6, iv; and R McNabb and K Whitfield, 'The Impact of Financial Participation and Employee Involvement on Financial Performance' (1998) 45 *Scottish Journal of Political Economy* 171.
[54] H Elhayek and S Petrovic-Lazarevic, 'Are Employee Share Ownership Programs Really Improving Organisational Performance' (Working Paper 12/05, Department of Management, Monash University, March 2005).
[55] P Robinson, 'Workers Not Won Over By Shares', *The Age*, 5 April 2005.

financial areas. The authors argue that their findings contradict existing studies by suggesting that high ESO scheme participation may not be effective at motivating employees because they do not align organisational and employee objectives, thus resulting in little to no improvement in performance.[56] Unsurprisingly, the Elhayek and Petrovic-Lazarevic study attracted criticism from the Australian Employee Ownership Association (AEOA). The President of the AEOA has argued that the study is unconvincing and based on a flawed methodology.[57]

There are a number of limitations inherent in the literature that seeks to measure whether employee ownership has a positive effect on productivity.[58] Attempts to establish a direct relationship between ESOPs and higher organisational productivity inevitably encounter difficulties in causal uncertainty.[59] It may be, for example, that it is the most productive enterprises that are choosing to introduce ESO schemes. Secondly, the small number of shares held by employees may mean that the financial entitlement from participation in an ESOP is 'marginal, uncertain and disconnected from day-to-day working life', rendering tenuous any perceived link between ESOPs and higher productivity.[60] Thirdly, researchers often fail to consider why particular firms initially adopt ESO plans. Firms may implement ESO plans for a range of reasons that are not necessarily linked to a desire to improve productivity: they may be motivated by a desire to resist a take-over or to take advantage of tax concessions. The structure and performance effects of ESOPs are likely to be strongly influenced by the circumstances in which employee ownership is introduced and the motives for it.[61] Finally, the heterogeneity of ESOPs – in their structure, objectives and the divergent workplace cultures in which the schemes are introduced, renders problematic any attempt to establish a link between productivity and ESOPs.[62]

McHugh, Cutcher-Gershenfeld and Bridge adopted a more nuanced approach to the question of the relationship between ESOPs and company productivity.[63] The authors move beyond the literature that tends to contrast ESOP and non-ESOP companies or ESOP firms pre-adoption and post-adoption. They note that there is great variation among ESOPs in relation to the degree of employee input and influence and that most studies fail to take this diversity into account.[64] Through comparing companies with ESOPs against each other, McHugh et al have sought to examine how variations in ESOP structures impact upon company performance. The authors hypothesise that three ownership attributes (the level of employee influence in decision making; the amount of ESOP information given to employee shareholders; and the extent to which ESOP design provides employee shareholders with equity) are positively related to

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[56] Elhayek and Petrovic-Lazarevic, above n 54, 5–6.
[57] See K Woldring, 'Critique of Monash ESO Study', Available at <http://aoea.org.au/0024/-_forum/topic.asp?TOPIC_ID=40> (accessed 10 June 2006).
[58] Pendleton, *Employee Ownership, Participation and Governance: A Study of ESOPs in the UK* , above n 21, 11–2.
[59] Lenne, Mitchell and Ramsay, above n 6, 19; Sesil, Kruse and Blasi, above n 52, 11.
[60] Lenne, Mitchell and Ramsey, above n 6.
[61] Pendleton, *Employee Ownership, Participation and Governance: A Study of ESOPs in the UK,* above n 21, 11; Wilson, above n 42, 23.
[62] A Robinson and N Wilson, 'ESOPs and Corporate Performance' in N Wilson (ed) *ESOPs: Their Role in Corporate Finance and Performance* (1992) 243.
[63] P McHugh, J Cutcher-Gershenfeld and D Bridge, 'Examining Structure and Process in ESOP Firms' (2005) 34 *Personnel Review* 277.
[64] Ibid 278.

ESOP company performance. The authors concluded from their empirical study, based on survey responses from management at 61 companies with ESOPs, that employee influence in operational related decisions and employee ESOP information was positively correlated to managerial perceptions of enhanced company performance. Employee influence in strategic level decisions, however, was not related to perceptions of enhanced company performance. While the authors conceded the limitations of their study, including their reliance on subjective rather than objective indicators of company performance, they argue that the findings do have implications for management, policy makers and researchers. In particular, those interested in improving firm performance should increase opportunities for employee influence in the firm.[65]

4.2 The industrial relations/ human resource management literature

4.2.1 *Employee share ownership and employee participation*

A number of authors have explored the relationship between employee share ownership and participation.[66] There appear to be two broad strands of this literature. The first is concerned with the question of whether employee share ownership leads to greater levels of employee participation in workplace-level and board-level decision making. The second strand focuses more broadly on the relationship between employee participation and financial participation. This second strand is examined below, in ‘Characteristics of companies adopting ESOPs’. In relation to the former, there is little evidence to support the view that ESOPs automatically lead to increased employee participation, either at the workplace or board level.[67] Writing on ESOPs in the UK, Pendleton has repeatedly observed that there is little evidence to suggest that firms with conventional share schemes develop mechanisms for employee participation in decision-making. In an article published in 1995, Pendleton et al emphasise that the extent to which an ESOP will facilitate employee participation within a specific company depends to a large extent on the goals of those who implemented it.[68] The authors distinguish between three different ‘constellations’ of ESOPs: the ‘technical ESOP’ (conventional ESOPs introduced by management as a technical measure and generally driven by corporate finance issues); the ‘paternalistic ESOP’ (where an owners seeks to give employees an opportunity to share in the well-being of the firm but the ESOP is established with minimal involvement by employees or their representatives); and the ‘representative ESOP’ (where employee representatives are involved extensively in the creation of ESOPs). Significant innovations in representative forms of employee participation are only present in the latter form.

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[65] See also Bagchi who notes that union-negotiated ESOPs tend to have more expanded voting rights: above n 17, 19.

[66] See, eg, A Pendleton, *Employee Ownership, Participation and Governance: A Study of ESOPs in the UK*, above n 21; P Kalmi, A Pendleton and E Poutsma, ‘The Relationship Between Financial Participation and Other Forms of Employee Participation: New Survey Evidence from Europe’ (Discussion Paper No 3, Helsinki Centre of Economic Research, April 2004).

[67] See Pendleton, *Employee Ownership, Participation and Governance: A Study of ESOPs in the UK*, above n 21, 119.

[68] A Pendleton et al, ‘The Impact of Employee Share Ownership Plans on Employee Participation and Industrial Democracy’ (1995) 5 *Human Resource Management Journal* 44, 45.

In a 1996 article, the same authors argued that, while conventional firms with ESO do not generally confer rights upon employees to participate, there is evidence to suggest that share schemes tend to form part of a broader package of workplace initiatives to develop individualistic forms of employee involvement.[69] The authors observe that, in firms with conventional share schemes, the evidence suggests that 'employee participation focuses on direct employee involvement in task-related rather than strategic decisions, and that it is generally individualistic rather than collectivist in form.'[70] They attribute this tendency largely to the fact that in such firms employee share ownership tends to be a management-driven initiative. In contrast, where other actors are involved in the initial design and implementation of ESO, employee participation may be more collectivist in nature.[71]

Evidence from the US suggests that, although there is significant variation in ESOP firms with respect to employee participation, most firms with ESOPs do not display significant innovation in employment participation.[72]

4.2.2 *Does participation in an ESOP influence employee attitudes and levels of commitment to the organisation?*

A number of studies, located largely within the human resource management field, have focused on the capacity of ESOPs to lead to improved employee attitudes and levels of commitment. More recently, employee share ownership has been identified as a means through which to facilitate employee commitment in an era where 'shareholder value' is predominant and firms no longer provide 'traditional' returns such as long-term employment.[73]

Authors have sought to explain how ownership translates into improved employee attitudes. Particularly influential on both the subsequent US and the UK literature has been Klein's formulation of three models.[74] The first (the intrinsic model) posits that the simple fact of ownership will increase employee commitment to the company. The second (the instrumental satisfaction model) suggest that ownership will only translate into improved employee attitudes and levels of commitment where ownership allows for greater employee participation in company decision-making. The third model (the extrinsic model) posits that employee ownership will increase employee commitment and satisfaction where it is financially rewarding to employees.

A range of strategies have been used in an effort to test the proposition that employee share ownership generates increased employee commitment to the firm. These include examination of the relation between employee attitudes and the number of shares held

[69] A Pendleton et al, 'Employee Participation and Corporate Governance in Employee-Owned Firms' (1996) 10 *Work, Employment and Society* 205, 211.
[70] Ibid 212.
[71] Ibid 212–13.
[72] Pendleton, *Employee Ownership, Participation and Governance: A Study of ESOPs in the UK*, above n 21, 118–19.
[73] H Gospel and A Pendleton, 'Corporate Governance and Labour Management: An International Comparison' in H Gospel and A Pendleton (eds) *Corporate Governance and Labor Management: An International Comparison* (2005) 1; and Pendleton, 'Employee Share Ownership, Employment Relationships and Corporate Governance', above n 36, 75.
[74] K Klein, 'Employee Stock Ownership and Employee Attitudes: A Test of Three Models' (1987) 72 *Journal of Applied Psychology* 319.

by an employee; comparison of the attitudes of employee owners and non-owners; longitudinal comparisons of employee shareholder attitudes; and interviews asking respondents for their perceptions on whether and how share ownership has changed their attitudes towards the firm.

The findings in the literature are mixed, both as to whether and how ESOPs have an impact on employee attitudes. Studies range from those that find extensive attitudinal change to those that find no differences. A considerable number of studies in both the UK and US offer strong support for Klein's 'instrumental' model and considerable support for the 'extrinsic' model. Most of the studies from the UK and the US have emphasised that share ownership *per se* is unlikely to significantly influence employee attitudes or levels of commitment. This is particularly the case where the proportion of equity transferred is small. Other variables, such as participation in decision-making and financial reward, are necessary for ownership to be associated with increased satisfaction and commitment.

Efforts to assess the impact of employee share ownership on employee attitudes inevitably encounter obstacles. There are methodological difficulties in evaluating employee responses to the specific effects of employee share ownership and to causally relating any changes to participation in a share ownership scheme.[75] A number of authors have criticised studies that focus on the manipulation of large, publicly available data sets, for failing to account for other factors that may have influenced employee perceptions. Blasi, for example, has suggested that researchers should focus more on detailed studies of individual firms with ESOPs.[76] Finally, as Pendleton has argued, a number of studies are limited by their failure to take into consideration employee perceptions of what the ESOP was intended to achieve: the capacity of ESOPs to engender positive attitudes among participating employees towards their employer is a function of employee perceptions of the purpose of the plan and the extent to which these purposes are seen to be consistent with, and meet, employees' objectives and interests.[77]

4.2.3 *Employee share ownership and trade unions*

A strand of the industrial relations literature has empirically examined the relationship between trade union representation and employee ownership. This literature can be divided into two broad areas of inquiry. The first examines the impact of employee share ownership on trade unions. The second looks at how trade union involvement influences the structure and nature of ESOPs.

There is little empirical evidence from the UK or US to suggest that ESOPs result in a decreased desire among employees for trade union representation.[78] From their

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[75] A Pendleton, N Wilson, and M Wright, 'The Perception and Effects of Share Ownership: Empirical Evidence from Employee Buy-Outs' (1998) 36 *British Journal of Industrial Relations* 99, 100. See also the authors' critique of the UK studies to date: at 101–3.
[76] See ibid 103 and discussion in D Hallock, R Salazar and S Venneman, 'Demographic and Attitudinal Correlates of Employee Satisfaction with an ESOP' (2004) 15 *British Journal of Management* 321, 331.
[77] Pendleton, 'Employee Share Ownership, Employment Relationships and Corporate Governance', above n 36, 84–5.
[78] D Kruse, 'Research Evidence on Prevalence and Effects of Employee Ownership' (Paper presented in testimony before the Subcommittee on Employer-Employee Relations, Committee on Education and the Workforce, US House of Representatives, 13 February 2002) 5; A Pendleton et al, 'Employee

research in Europe, Pendleton et al note that the wide range of workplace and employment issues tends to create sufficient employee demand for collective industrial relations structures and organisations.[79] Lenne, Mitchell and Ramsay have observed that ESO schemes may in fact increase trade union voice through share holder activism, by highlighting particular employee issues.[80]

Writing from the US, Cramton, Mehran and Tracy in a recent paper explore the impact of ESOPs on the collective bargaining role of trade unions.[81] The authors focus on enterprises in which union members have a non-controlling ownership interest. They suggest that ESOPs create incentives for trade unions to become weaker bargainers. The authors examined data on union contract negotiations for the period 1970 – 1995, as collected by the Bureau of Labor Statistics. According to the authors, the data indicated a decline in both the incidence of labour disputes and strikes following the adoption of an ESOP. The authors suggest that ESOPs increase the efficiency of labour negotiations by reducing the incidence of labor disputes and shifting the composition of disputes from more costly strikes towards 'hold-outs'.[82]

A number of studies from the US have found that unionisation has had some discernible effects on the structure and operation of employee share ownership. In a recent study, Yates compared organisational structures and practices among companies with four distinct relationships between organised labour and employee stock ownership.[83] She concluded that work practices in the unionised, majority employee-owned companies were characterised by more equality, better communication, more training, more opportunities to participate and a more cooperative relationship between management and employees. In firms where union members held a minority share of the firm, there was some evidence, though more limited, of more participative management. The lowest levels of communication, training and participation were found in the non-unionised ESOP firms.[84] Yates concluded that 'economic democracy through share ownership contributes to favourable working conditions for unionised employees in rough proportion to their share of ownership.'[85] McHugh, Cutcher-Gershenfeld and Polzin found from their study of 68 Michigan ESOPs that union members' participation in the ESOP was broadly correlated with more participation in employee relations but not in company management and governance; that ESOPs with unionised participants were more likely to own a majority of their company shares, that the benefits of employee ownership where union members were participants were allocated in a more egalitarian manner; and that ESOPs with unionised members were more likely to offer

Share Ownership and Profit Sharing in the EU' (European Foundation for the Improvement of Living and Working Conditions, Dublin, 2001) 5.
[79] Pendleton et al, *Employee Share Ownership and Profit Sharing in the EU,* above n 78.
[80] Lenne, Mitchell and Ramsay, above n 6, 12.
[81] P Cramton, H Mehran and J Tracy, 'ESOP Fables: The Impact of Employee Stock Ownership Plans on Labor Disputes' (September 2005).
[82] A hold-out is a labor dispute in which the trade union agrees to work under the terms of the expired agreement while negotiations continue.
[83] J Yates, 'Unions and Employee Ownership: A Road to Economic Democracy?' (2006) 45 *Industrial Relations* 709.
[84] Ibid 728.
[85] Ibid 729.

participation in selecting board members and to have union representation on the board.[86]

4.3 Why do employers implement ESOPs and why do employees participate?

In Australia, there has been little empirical research into why firms adopt employee share ownership plans. Barnes et al conducted two case studies of enterprise-level ESO schemes, seeking to gain insight into how supposed objectives of ESO are understood by business managers and employees.[87] From their interviews, the authors reach the tentative conclusion that both management and employees adopt a 'nebulous' employee engagement rationale for the implementation of ESO schemes, rather than focusing on the potential for ESOPs to provide incentives for specific kinds of behaviour. This research also looked at the role the tax concession regime has played in shaping the implementation and management of the two companies' ESOPs. The authors found that the tax concessions did not operate as a significant incentive for these two companies.

In 2004, the Employee Share Ownership Development Unit commissioned a large-scale survey of business in Australia which sought to measure how businesses with and without plans regarded the benefits of ESOPs. It found that businesses were more likely to agree that ESOPs provided benefits related to organisational culture and workplace relations/ human resource strategies rather than rationales based on improved performance, a better working environment, competitive salary packaging or tax benefits for employees. Finally, the *Shared Endeavours* report cites research conducted by Stradwick in 1999 for the AEOA, which involved a survey of ESOPs in most of the Australian Stock Exchange's top 500 companies. Preliminary findings suggested that 90% of companies introduced ESOPs to increase employee identification with the interests of shareholders; 80% to provide a benefit for employees; 40% because it was an tax effective way of rewarding employees; 29% to increase labour productivity and 7% to enhance recruitment and retention.[88]

Research from the UK has found that employers adopted ESOPs for a diversity of reasons, though employers are often vague about the precise nature of the incentive or motivation.[89] Writing in 2001 from the US, Sesil, Kruse and Blasi identified at least 16 large-scale empirical studies into this question. They conclude that the studies do not support any one dominant explanation for the adoption of ESOPs.[90]

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[86] P McHugh, J Cutcher-Gershenfeld and M Polzin, 'Employee Stock Ownership Plans: Union Influence and Stakeholder Interest' (1999) 20 *Economic and Industrial Democracy* 535.
[87] A Barnes et al, 'Employee Share Ownership Schemes: Two Case Studies' (2007) 35 *Australian Business Law Review* (forthcoming).
[88] See, eg, L Baddon et al, *People's Capitalism: A Critical Analysis of Profit-Sharing and Employee Share Ownership* (1989) 89–90, 280; P Dewe, S Dunn and R Richardson, 'Employee Share Option Schemes: Why Workers Are Attracted to Them' (1988) 26 *British Journal of Industrial Relations* 1, 1–2.
[89] See, eg, L Baddon et al, *People's Capitalism: A Critical Analysis of Profit-Sharing and Employee Share Ownership* (1989) 89–90, 280; P Dewe, S Dunn and R Richardson, 'Employee Share Option Schemes: Why Workers Are Attracted to Them' (1988) 26 *British Journal of Industrial Relations* 1, 1–2.
[90] Sesil, Kruse and Blasi, above n 52, 8.

Research focusing on employee perspectives of ESOPs is scarcer.[91] Employee perceptions of employee share ownership is recognised as an area in which further research is needed.[92] In Australia, research appears to consist of Barnes et al's two case studies and data collected by the ESODU in 2004 which found that employee resistance was among the most frequently cited barriers for businesses in relation to the implementation of ESOPs.[93]

In Europe, there is limited research on how employees perceive ESOPs. This research on employee perceptions and behaviour towards ESO tends to draw upon the theoretical literature relating to risk aversion and portfolio diversification. In the UK, Pendleton has examined whether employee stock option holders choose to keep or sell their stock on exercise and the influences on their decisions to do so.[94] Through analysing data from a survey of over 24,000 employees (with a 24% response rate) in 11 publicly-listed companies with all-employee stock option plans in the UK, Pendleton found that over 40% of employees retain their shares for a year or more after exercise, and that the most important individual-level influences on the decision whether to keep or sell their shares were the structure of investment portfolios, the reasons for participating in the stock option plan and age. His findings suggested that income and risk preferences have little direct influence.

In the late 1980s, Dewe, Dunn and Richardson surveyed employees within a single UK company with an employee share option scheme, with the purpose of understanding why workers were attracted to the scheme.[95] In particular, the authors sought to explore the relationship between attitudes to work, opinions of employee share schemes held by employees and the intention to join such a scheme.[96] The authors found that workers favoured joining when they felt positive towards share option schemes in general, regardless of their particular attitude toward the firm. To the authors, the most striking finding of their study was that work attitude variables did not have a strong association with intention to participate in the scheme: that is, 'workers who feel a strong sense of commitment to the firm are no more likely to want to take part in the scheme than those who do not.'[97] They reasoned from this finding that such schemes had greater potential for widespread attitudinal change than if they had found the scheme simply attracted workers that already had the level of

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[91] This observation is also made in A Pendleton, 'Sellers or Keepers? Stock Retentions in Stock Option Plans' (2005) 44 *Human Resource Management* 319, 321; and in D Kruse, 'A Guide to Doing Academic Research on Employee Ownership' (National Centre for Employee Ownership) <http://www.nceo.org/library/research.html> (accessed 31 August 2006). Both authors also note that existing work was largely conducted in the 1980s and thus is likely to be out of date.
[92] Pendleton, 'Sellers or Keepers? Stock Retentions in Stock Option Plans', above n 91, 331. See also E Poutsma and F Rondeel, 'Complementarities of Financial Participation and Other Forms of Participation: Human Resource Management for Performance' (Report of the workshop held on 14 October 2005, Leiden, The Netherlands, January 2006) 22.
[93] This research (based on qualitative interviews) identified a number of factors as influencing employee willingness to take up shares. These included the performance of the share price; the size and age of the company; the value and type of the shares; previous experience with share schemes; life stage and current financial position; understanding of share ownership generally; and existing employee relations and trust of management.
[94] Pendleton, 'Sellers or Keepers? Stock Retentions in Stock Option Plans', above n 91.
[95] Dewe, Dunn and Richardson, above n 89.
[96] Ibid 13.
[97] Ibid 19.

commitment to the firm that the firm was aiming to achieve through implementing the scheme.

A more recent study from France was conducted on employee decisions whether to participate in shares offered by France Telecom as it underwent a partial privatisation.[98] The authors' results were largely, though not entirely, consistent with theoretical models of investing behaviour.

4.4 Characteristics of companies adopting ESOPs

A further strand of the literature has sought to identify the characteristics of firms that adopt ESOPs.[99] Some authors interested in this issue have approached the question from the basis of economic theory, while others have adopted an industrial relations perspective. The studies within the economic/ organisational literature make a number of broad predictions concerning the characteristics of firms adopting ESO.[100] First, employee share ownership is more likely to be used where employee performance is difficult to monitor because of certain features of work organisation and job design (such as firms where intellectual capital is the main source of customer value, in large firms or in firms experiencing fast growth).[101] The second prediction is that group-based rewards such as ESOPs will be attractive to firms when individual incentive-based pay is costly to operate. Thus ESOPs tend to be viewed as an alternative to individual incentives, such as individual performance-based pay mechanisms.

In a 2006 article, Pendleton has examined the economic literature that draws upon agency theory to explain the existence of ESO in firms. He examined the data from the UK Workplace Employee Relations Survey (1998) to ascertain whether share plans substituted for direct monitoring or individual incentives. He found that ESO was often implemented alongside individual incentives. This suggested, according to Pendleton, that broad-based ESOPs, while providing weak incentives themselves, are used to mitigate dysfunctional effects of individual incentives by engendering cooperation and trust, and by encouraging employees to think and act about performance outcomes by reference to a longer time frame.[102]

The studies that have taken an industrial relation perspective to the question of what type of firms adopt ESOPs have focused on the relationship between ESO and other forms of employee participation. The findings of these studies vary greatly. Some studies have found a positive relationship between financial participation and other forms of employee participation.[103] Several of these earlier studies, however, failed to

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[98] See F Degeorge et al, 'Selling Company Shares to Reluctant Employees: France Telecom's Experience' (2004) 71 *Journal of Financial Economics* 169.
[99] For a brief analysis of this literature, see Pendleton, 'Incentives, Monitoring, and Employee Stock Ownership Plans: New Evidence and Interpretations', above n 18, 756–61.
[100] Ibid.
[101] M C Kroumova and J C Sesil, 'Intellectual Capital, Monitoring, and Risk: What Predicts the Adoption of Employee Stock Options?' (2006) 45 *Industrial Relations* 734, 735.
[102] Ibid 753.
[103] M Poole, 'Factors Affecting the Development of Employee Financial Participation in Contemporary Britain: Evidence from a National Survey' (1988) 26 *British Journal of Industrial Relations* 21; and A Pendleton, 'Characteristics of Workplaces with Financial Participation: Evidence from the Workplace Industrial Relations Survey' (1997) 28 *Industrial Relations Journal* 103.

distinguish between ESO and profit-sharing.[104] In 1997, Pendleton examined data from the UK Workplace Industrial Relations Survey conducted in 1990 in an attempt to identify what kinds of firms implement broad-based employee share schemes.[105] He found that the characteristics of workplaces with ESO varied significantly from those with profit-sharing arrangements or to those with no form of financial participation. Pendleton argued that his findings provided little support for economic-based explanations for the adoption of ESO (as outlined above) but considerable support for the industrial relations-based findings.[106] According to Pendleton, workplaces that have implemented ESOPs tended to have other forms of employee representation and participation, such as joint consultative committees, to determine pay by collective bargaining and to have high levels of union density.[107] He notes that his findings support the conclusion that firms may use multiple forms of incentives and that employee share ownership plans may be complementary to other forms of financial participation.[108] In Australia, Tuberville has conducted a study similar to that conducted by Pendleton, using data from the Australian Workplace Industrial Relations Surveys in 1990 and 1995. Tuberville's findings suggested that financial participation (defined as collective forms of profit sharing or employee share schemes) did not seem to coexist with 'representative forms of employee representation', such as joint consultative committees and worker representation on company boards. Rather, financial participation was strongly associated with continuous improvement and total quality management techniques.[109]

In contrast, drawing upon data collected from listed companies in Finland, France, Germany, the Netherlands, Spain and the UK, Kalmi, Pendleton and Poutsma concluded in 2004 that while there is some evidence to suggest the co-existence of profit sharing and other participatory practices, this conjunction is not found with employee equity plans.[110]

4.5 Majority employee-owned firms

A small strand of the ESO literature from the UK and the US has focused on firms which have transferred substantial portions of equity to employees. [111] Given the higher levels of equity held by employees in such firms, ESOPs in these firms embody the potential to facilitate much greater levels of employee participation,

[104] Pendleton, 'Characteristics of Workplaces with Financial Participation: Evidence from the Workplace Industrial Relations Survey', above n 103.
[105] Ibid.
[106] Ibid 116.
[107] Ibid 113.
[108] Pendleton, 'Incentives, Monitoring, and Employee Stock Ownership Plans: New Evidence and Interpretations', above n 18, 753.
[109] See S Tuberville's oral submission to the House of Representatives Standing Committee on Employment, Education and Workplace Relations's Inquiry into Employee Share Ownership in Australian Enterprises: Official Committee Hansard, 8 September 1999, Melbourne, 290–2.
[110] Kalmi, Pendleton and Poutsma, above n 66.
[111] In the UK, see, eg, Pendleton et al, 'The Impact of Employee Share Ownership Plans on Employee Participation and Industrial Democracy', above n 68, 44; Pendleton et al, 'Employee Participation and Corporate Governance in Employee-Owned Firms', above n 69; L Trewhitt, 'Employee Buyouts and Employee Involvement: A Case Study Investigation of Employee Attitudes' (2000) 31 *Industrial Relations Journal* 437 and Pendleton, *Employee Ownership, Participation and Governance: A Study of ESOPs in the UK*, above n 21. In the US, see J Logue and J Yates, 'Worker Ownership American Style: Pluralism, Participation and Performance' (1999) 20 *Economic and Industrial Democracy* 225.

particularly at the level of corporate governance.[112] These studies have generally adopted a case study approach, exploring the origins, forms and performance of employee-owned firms.

Much of the work on employee-owned firms in the UK has focused on the bus industry, where ESOPs were a common mechanism to facilitate management-employee buyouts in the context of privatisation of the industry in the late 1980s. Focusing on ESOPs within the bus industry, Pendleton et al have conducted an extensive empirical study on the extent to which ESOPs extend employee involvement in decision-making.[113] In an article published in 1996, Pendleton et al examined the possibility that companies with ESOPs that confer majority ownership on employees have different levels of employee participation than found in 'conventional' firms. The authors concluded that companies with majority employee ownership often did develop different structures for employee participation. In particular, they tended to implement forms of employee participation that were more representative-based, and that tended to focus on strategic rather than task-related decisions.[114] More broadly, Pendleton has argued that UK ESOPs vary widely in the extent to which they lead to greater levels of employee participation. Pendleton has argued that 'the objectives, philosophies and interests of the key actors involved in conversions to employee ownership have a critical influence on the reasons for employee ownership, the level of employee shareholding, and the forms of participation and governance adopted.'[115]

There does not appear to be any study conducted in Australia concerning if and how majority employee-owned companies differ from those companies that transfer smaller amounts of equity to employees.

5 EMPLOYEE SHARE OWNERSHIP AND CORPORATE GOVERNANCE

The relationship between employee share ownership and corporate governance has been explored from a number of different perspectives.[116] Hollo identifies three main ways in which ESOPs may affect corporate governance.[117] First, they may provide corporate directors with a means to manipulate corporate control in their favour. The second issue relates to shareholder neutrality: in particular, the potential issues arising from the capacity of ESOPs to dilute holdings of shareholders.[118] The third way in

112 Pendleton et al, 'Employee Participation and Corporate Governance in Employee-Owned Firms', above n 69, 205; C Mackin and F Freundlich, 'Representative Structures in Employee-Owned Firms' (1995) 7 *Journal of Employee Ownership Law and Finance* 91.
113 The results of this study are published in numerous articles and in Pendleton, *Employee Ownership, Participation and Governance in the UK,* above n 21.
114 Pendleton et al, 'Employee Participation and Corporate Governance in Employee-Owned Firms', above n 69, 222–3.
115 A Pendleton, *Employee Ownership, Participation and Governance: A Study of ESOPs in the UK* , above n 21, 182.
116 This review adopts a broad understanding of corporate governance as concerned with 'who controls the firm, in whose interest the firm is governed and the various ways whereby control is exercised': H Gospel and A Pendleton, 'Finance, Corporate Governance and the Management of Labour: A Conceptual and Comparative Analysis' (2003) 41 *British Journal of Industrial Relations* 557, 560.
117 See E R Hollo, 'The Quiet Revolution: Employee Stock Ownership Plans and their Influence on Corporate Governance, Labor Unions and Future American Policy' (1991-2) 23 *Rutgers Law Journal* 561, 577–92.
118 Ibid 586.

which ESOPs may affect corporate governance is the potential for employees, through ESOP participation, to have a greater say in the governance of the company.

The first and second issues appear to have received little attention in Australia. The concern that ESOPs are used by corporate directors as a means of securing or reinforcing their own autonomy appears to be dominant in the United States but not elsewhere.[119] The concern here is that directors structure an ESOP in a way that entrenches their own power through, for example, appointing an ESOP trustee that is sympathetic to their interests or simply passing a large block of shares to employees, who are generally aligned to management. [120] ESOPs have been a common defence in the US to hostile takeover bids and there has been a considerable amount of US case law on this issue.[121] Fine concludes from his survey of the US literature: 'Whatever the historical and specific motives that informed the formation of ESOPs, they have become more and more heavily embroiled in the general process of corporate strategy, with limited actual and potential deference to the interests of employees.'[122] In Australia, however, Aitkin and Wood have noted that ESOPs are too small a proportion of issued capital to be a useful defence against takeover.[123]

Many authors have referred to the potential for employee share ownership to increase employee influence in corporate governance. Employee share ownership is regarded as a means of overcoming the perceived deficiencies inherent in the view that the maximisation of shareholder interests is paramount,[124] with employees as 'outsiders' in corporate governance.[125] Employee share ownership can provide a means of 'internalising the stakeholder-firm relationship'.[126] There are two principal mechanisms through which the interests of employees may be taken into account in corporate governance – via expansion of the fiduciary duties of directors and secondly, by rights of participation in the corporate decision-making process.[127] Through employee share ownership, employees become shareholders and thus theoretically are able to protect their interests through the mechanism of share ownership.[128] As noted by Pendleton, one of principal attractions of employee share ownership in Anglo-

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[119] Ibid 577–8. See also L Gordon and J Pound, 'ESOPs and Corporate Control' (1990) 27 *Journal of Financial Economics* 525; W Pugh, S Oswald and J Jahera, 'The Effect of ESOP Adoptions on Corporate Performance: Are There Really Performance Changes?' (2000) 21 *Management Decision Economics* 167, 169.
[120] Pugh, Oswald and Jahera, above n 120, 167. See also Dhillon and Ramirez, who find that ESOPs have primarily been adopted in the US as a defensive measure against hostile take-overs: U Dillon and G Ramirez, 'Employee Stock Ownership and Corporate Control – An Empirical Study' (1994) 18 *Journal of Banking and Finance* 9.
[121] Hollo, above n 118, 577–86.
[122] B Fine 'ESOP's Fable: Golden Egg or Sour Grapes?' in J Toporowski (ed) *Political Economy and the New Capitalism: Essays in Honour of Sam Aaronovitch* (2000) 178, 188.
[123] Aitken and Wood, above n 6.
[124] In Australia, see J Hill, 'At the Frontiers of Corporate Law and Labour Law: Enterprise Bargaining, Corporations and Employees' (1995) 23 *Federal Law Review* 204, esp at 222 and A Reynolds, 'Do ESOPs Strengthen Employee Stakeholder Interests?' (2001) 13 *Bond Law Review* 95.
[125] Lenne, Mitchell and Ramsay, above n 6, 9.
[126] S Thomsen, 'Corporate Values and Corporate Governance' (2004) 4 *Corporate Governance* 29, 35. See also H Hansmann, *The Ownership of Enterprise* (1996).
[127] Hill, above n 125, 209.
[128] As Hill notes, this presumes some level of adequacy of shareholders rights of participation: ibid 222.

Saxon economies is that it gives employee stakeholders additional rights to those they possess as workers without violating the principles of existing company law.[129]

Only a few authors in Australia have addressed this issue in any depth. In their recent paper, Lenne, Mitchell and Ramsay noted 'the distance between the current debate on ESO and the fundamental question of employee participation in corporate governance.'[130] A decade earlier, Hill conceded that employee share ownership had rarely been accompanied by participation in corporate governance. However, somewhat optimistically, Hill noted that there were 'signs of major changes'. She pointed to a number of 'progressive' companies that had structured their plans in a way so as to achieve employee participation in corporate decision-making, '… such as through pass-through voting of shares, ability to direct the trustee how to vote, or representation at the level of trustee.'[131] However, she supports these observations purely by references to the United States.

Writing in Australia, Adam Reynolds has examined the legal basis upon which employees as shareholders could promote their claims within the context of Australian corporate law, either as members of an ESOP or as independent investors.[132] He begins by emphasising the fact that, as a distinct group, there is little legal support for the view that employees should be regarded as legitimate stakeholders in Australian corporate governance and emphasises that employees have no directly enforceable interests under the *Corporations Act*. Reynolds then raises the question of whether participation in an ESOP may change this situation. He examines a range of provisions in the *Corporations Act* that could be used by employee shareholders to promote their unique set of interests.[133] He concludes, however, that these remedies are all unlikely to impact upon the governance of the firm in a practical sense or enable employees to promote their interests as *employees.* Reynolds concludes that employee shareholders have only a 'slightly higher level of enforceable interests' in Australia.

A number of authors have sought to justify employee share ownership on the basis that it has the capacity to improve company economic performance. In contrast to other types of shareholders which may be interested only in short-term dividend returns or share price maximisation, employee shareholders may be more interested in good governance and in the long-term success of the companies.[134] For Michie and

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[129] A Pendleton, 'Stakeholders as Shareholders: The Role of Employee Share Ownership' in G Kelly, D Kelly and A Gamble (eds) *Stakeholder Capitalism* (1997) 169, 172. This point is also made in Lenne, Mitchell and Ramsay, above n 6, 7.
[130] Lenne, Mitchell and Ramsay, above n 6, 28.
[131] Hill, above n 125, 222.
[132] Reynolds, above n 125.
[133] In particular, Reynolds notes that employee groups, as minority shareholders, have the legal capacity to be heard through calling shareholder meetings and to propose resolutions (referring to *Corporations Act* ss 249D, 249F, 249N(1)); the potential for employee shareholders to enforce their stakeholder rights under the Minority Oppression provisions of the Act; and the potential for employee shareholders to form a distinct 'class'.
[134] See, eg, in the United Kingdom: J Michie and C Oughton, 'Employee Share-Ownership Trusts and Corporate Governance' (2001) 1 *Corporate Governance* 4. While the authors concede that to make employees shareholders would not of itself be sufficient to remedy the current problems – the interests of other stakeholders also need to be taken into account – they identify employee share ownership as one means through which positive reform could take place. In the United States, see S M Jacoby,

Oughton, employee share ownership provides a means of overcoming the "short termism" which has long been recognised as a problematic for UK industry: 'the continual pressure to deliver "shareholder value" above all can have a damaging effect not only on the interests of other stakeholders but on long-term investment in the business itself.'[135] Employee owners are likely to have a longer time horizon and to have additional objectives to simply the short term maximisation of profits, such as long term job security.[136] In addition, unions have maintained that favourable working conditions for employees means that companies will be more productive and better able to manage risk, thereby ensuring secure economic performance of the company and in turn, affording greater potential returns for shareholders.[137]

For Michie and Oughton, the benefits of increased employee participation in corporate governance are not limited only to better corporate governance. The authors point out that it makes more financial sense for employees to invest somewhere else, not in the company for which they work. Thus, they reason, there needs to be (as well as public policy justifications for ESO) some form of incentive for employees to take and hold shares in their companies. Michie and Oughton argue that this incentive may be convincing employees that they do – through their shareholdings – indeed have meaningful influence on the company.

For others, however, it is the potential for employee participation in corporate governance that is one of the least appealing aspects of ESOPs.[138] Writing from the US, Hansmann has argued that greater participation by employees in corporate governance with ESOPs leads to inefficiency in these companies. Hansmann examines the extent to which various forms of worker ownership, including 'partial' ownership through ESOPs, are more efficient than others. He proceeds from the presumption that the market tends to select relatively efficient organisational forms.[139] Therefore, he suggests, it is possible to draw inferences about the efficiency of worker ownership as an organisational form by examining the circumstances under which it thrives and the particular configurations it takes.[140] He identifies and examines a range of costs and benefits implicit in worker ownership. Benefits, for example,

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'Corporate Governance and Employees in the United States' in H Gospel and A Pendleton (eds) *Corporate Governance and Labor Management: An International Comparison* (2005) 33, 37.

[135] Michie and Oughton, 'Employee Share-Ownership Trusts and Corporate Governance', above n 135, 6.

[136] Pendleton, 'Stakeholders as Shareholders: The Role of Employee Share Ownership', above n 130, 173.

[137] See K Anderson and I Ramsay, 'From the Picketline to the Boardroom: Union Shareholder Activism in Australia' (Research Report, Corporate Governance and Workplace Partnerships Project, 2005) 91. For a substantially revised and abbreviated version of this paper, see K Anderson and I Ramsay, 'From the Picketline to the Boardroom: Union Shareholder Activism in Australia' (2006) 24 *Company and Securities Law Journal* 279. See also K Anderson et al, 'Union Shareholder Activism in the Context of Declining Labour Law Protection: Four Case Studies' (2007) 15 *Corporate Governance: An International Review* 45.

[138] See, eg, M Jensen and W Meckling, 'Rights and Production Functions: An Application to Labor-Managed Firms and Codetermination' (1979) 52 *Journal of Business* 469, who argue that employee equity holdings create an entrenched workforce with corporate governance power. See also O Faleye, V Mehrota and R Morck, 'When Labor has a Voice in Corporate Governance' (Working Paper 11254, National Bureau of Economic Research, March 2005).

[139] See H Hansmann, 'When does Worker Ownership Work? ESOPs, Law Firms, Codetermination and Economic Democracy' (1990) 99 *The Yale Law Journal* 1749, 1755–6. Hansmann concedes that the effectiveness of market selection should not be exaggerated: at 1756.

[140] Ibid 1756.

include improved worker productivity, lower monitoring costs, 'worker lock-in'; and employee satisfaction that may arise from participation in the process of collective decision-making. Among the major costs of employee ownership are the costs of raising capital; risk-bearing and costs associated with collective worker governance. From his analysis of existing evidence on which companies succeed, Hansmann suggests that collective governance costs are high when the workforce exhibits any substantial degree of heterogeneity, as there is greater potential for conflicts of interest among the worker-owners. He also suggests that decision-making would be inefficient where workers share voting control with non-worker investors of capital.[141]

Turning his attention to ESOPs, Hansmann observes that ESOPs in the US generally provide for participation in earnings but not in control. He notes:

> ESOPs are quite paradoxical when viewed in terms of conventional perspectives on worker ownership. The common view seems to be that worker participation in corporate governance is highly desirable but that the risk and the high cost of capital that workers face if they participate in ownership of a firm that is at all capital-intensive are serious liabilities. By these criteria, one would expect worker ownership to be structured to maximise workers' participation in control but to minimize their contributions of capital. ESOPs, however, have just the opposite character.[142]

Drawing upon his original presumption that the most efficient forms of worker participation would survive, Hansmann questions why there is not more worker control in companies with ESOPs. He finds that the fact that workers do not participate in corporate governance strongly suggests that those responsible for structuring ESOPs believe that the benefits of worker ownership are outweighed by the costs. Hansmann concedes that the creation of ESOPs without voting rights might be explained in part by the determination of management to maximise their autonomy. He tentatively concludes, however, that there is 'considerable circumstantial evidence' to suggest that direct worker participation in the control of enterprises with a heterogeneous workforce is too costly. While Hansmann is careful to acknowledge that a range of factors beyond the 'market' may explain why ESOPs have evolved in the way they have, his work still appears to downplay the important roles played by the legal regulation of ESOPs, including taxation issues, and by enduring political, economic and industrial structures and institutions.[143]

In the US context, Faleye, Mehrotra and Morck have sought to empirically examine the effects of labour ownership and control on corporate governance.[144] They argue that their findings demonstrate that 'publicly-traded firms whose employees have a greater voice in corporate governance deviate more from value maximization, spend less on new capital, take fewer risks, grow more slowly, create fewer new jobs, and exhibit lower labor and total factor productivity.'[145] They conclude that their findings

[141] Ibid 1812.
[142] Ibid 1799.
[143] Similarly, Hirsch has described Hansmann's conclusions as 'unsatisfying', and criticised Hansmann for comparing worker-owned firms to an ideal version of the investor-owned firm that simply doesn't exist in reality: J Hirsch, 'Labor Law Obstacles to the Collective Negotation and Implementation of Employee Stock Ownership Plans: A Response to Henry Hansmann and Other "Survivalists"' (1998) 67 *Fordham Law Review* 957, 979–80.
[144] Faleye, Mehrotra and Morck, above n 139.
[145] Ibid 3.

‘cast a serious doubt on the simple premise that labor equity participation causes a convergence of interest between workers and shareholders.’[146]

How employee share ownership influences corporate governance in practice, however, appears limited. Parkinson has observed, ‘the object [of ESOPs] has been… to achieve financial participation rather than participation in decision-making’.[147] Similarly, Pendleton has observed that it is ‘doubtful’ whether one of the key attractions of employee share schemes –their capacity to provide employees with additional ‘voice’ – actually provides this.[148] Pendleton explains:

> Employee shareholders do not usually have any special status, and the main vehicle to exert influence is the conventional one of the Annual General Meeting. In this forum employee shareholders are treated as individual shareholders (rather than as a collective entity) and, since AGMs tend to be dominated by company directors and institutional shareholders, it is not easy for employees to express their views and interests.[149]

Commentators have reached similar conclusions in the US context. Rosen has observed that ESO has not led to increased impact of employees in corporate decision-making.[150] For Jacoby, writing on corporate governance and labour in the United States, only a few companies, particularly those with substantial employee share ownership, have created mechanisms that enable employee views to be communicated to senior management and to the board, including through formal representation systems and board seats for employee or union representatives.[151] He emphasises that ‘the vast majority of employee owners have no governance mechanisms available to express their unique interests as both owners and employees.’[152] He notes that the extent to which employee voice may be facilitated in US companies is impeded by a number of factors, including labour law (in particular, it is unlawful for employers to play a role in establishing representative bodies) and the legal presumption that boards represent the interests of shareholders.[153]

Pendleton has recently argued that, while ESOPs provide a solution to problems posed to employer-employee relations in the context of the development of shareholder value and the reliance on market-based forms of regulation in the US and the UK, this is not done through facilitating employee involvement in corporate governance. Rather, it is done by providing some protection for workers’ financial and economic interests through indicating some level of commitment by the firm to the employees that is otherwise absent. For Pendleton, this use of ESOPs explains why financial participation is more prevalent in the US and the UK than in European

[146] Ibid 28.
[147] J Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (1993) 423.
[148] Pendleton, ‘Stakeholders as Shareholders: The Role of Employee Share Ownership’, above n 130, 174–5.
[149] Ibid 175.
[150] Cited in L Baddon et al, *People’s Capitalism: A Critical Analysis of Profit-Sharing and Employee Share Ownership* (1989) 26.
[151] Jacoby, above n 135, 47.
[152] Ibid 53.
[153] J Blasi and D Kruse, *The New Owners: The Mass Emergence of Employee Ownership in Public Companies and what it means to American Business* (1991) 245.

economies (such as Germany) where other forms of institution exists to articulate and balance the competing interests of labour and capital.[154]

Authors concerned with facilitating increased employee participation in corporate governance through employee share ownership have proffered a range of potential solutions. Both Pendleton and Michie and Oughton have suggested that the use of trust structures to administer ESOPs may enable employees to take a more proactive role in corporate governance as trustees may canvass employee opinion and vote employee shares as a block.[155] Michie and Oughton go further in considering how this could be done. First, they note that the tax incentives for ESOPs could be restructured so they encourage employee shareholders to actively participate in trusts that provide a collective voice. Schemes would only be eligible for tax concessions if they are designed and operated in a manner that was open and democratic. Secondly, the authors note that such schemes are only likely to endure if there is a body established to develop and monitor such approaches to ESO.[156] Pendleton also suggests that non-executive directors could be appointed to the board with a remit to represent employee interests.[157]

Jacoby identifies a number of potential means through which to 'link' ownership by employees to governance. First, employee owners should be given board representation as 'this is consistent with their heavy investments – financial and human capital – in the employing company.' Second, trustees of pensions and ESOP plans should be legally permitted to give weight to the special concerns of employee owners. Third, policy makers should encourage the adoption of other innovative mechanisms for bringing employee concerns to a company's strategic decision makers. Finally, Jacoby argues that more should be done to promote the use of stock options among general employees, as this may translate into a corresponding role in governance.[158]

Despite offering a number of ways in which employee share ownership could be restructured so as to contribute to better corporate governance, Pendleton concedes that such measures are unlikely to be adopted voluntarily, particularly in the context of an Anglo-Saxon corporate governance model. If policy makers seek to mandate such participative schemes, many firms will simply be deterred from adopting ESOPs.[159]

A critical issue bearing on the extent to which ESO translates into greater worker influence is whether ESOPs confer voting rights on employees or merely financial distribution rights. In the US, employee shareholders in publicly held ESOP firms

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[154] Pendleton, 'Employee Share Ownership, Employment Relationships and Corporate Governance', above n 36, 75.
[155] Michie and Oughton, 'Employee Share-Ownership Trusts and Corporate Governance', above n 135, 7; Pendleton, 'Stakeholders as Shareholders: The Role of Employee Share Ownership' , above n 130, 175.
[156] See Michie and Oughton, 'Employee Share-Ownership Trusts and Corporate Governance', above n 135, 8.
[157] Pendleton, 'Stakeholders as Shareholders: The Role of Employee Share Ownership', above n 130, 175.
[158] Jacoby, above n 135, 53–4.
[159] Pendleton, 'Stakeholders as Shareholders: The Role of Employee Share Ownership', above n 130, 175.

must be able to vote their shares and can direct trustees on how to vote, whereas employee shareholders in privately owned ESOP companies are not required to have voting shares.[160] Most ESOPs do not confer voting rights on employee shareholders or assign voting rights to a trustee.[161] Yet this may be contrary to motivations for implementing ESO schemes, such as to transfer capital ownership and control to employees.[162]

6 COMPARATIVE APPROACHES

While there are comparative studies of employee share ownership, these are generally limited to Europe or to Europe and the US. [163] In Europe, a number of reports have contrasted the incidence and nature of ESO, and the regulatory frameworks in EU Member States.[164] Aitken and Wood appear to be the only authors who have sought to compare the experience of ESO in the US and UK with that in Australia.[165] Their analysis, however, is very broad and also now out-dated.

Gospel and Pendleton have offered an explanation for the higher incidence of ESOPs in the UK and USA in comparison with European countries in the context of their discussion of the impact of differing financial structures and corporate governance practices on labour management practices. They observe that ESO 'appears to reflect a need for bonding mechanisms in contexts where financial calculation is especially important, and where the capacity to generate commitment via employee voice is limited.'[166] Two recent analytical papers have compared the incidence and development of employee share ownership in the EU and the US and sought to account for the variations. In 2003, Blasi et al contrasted ESO in the two locations and offered suggestions for policy makers in both jurisdictions.[167] In 2005, Bagchi sought to explain why employee ownership varies across institutional environments.[168] He examines the development of employee share ownership in the United States, Germany and Sweden. Bagchi's thesis is that the institutional background – in particular the existing corporate and labour law frameworks – in the context of which employee share ownership is developed significantly determines its course.

[160] McHugh, Cutcher-Gershenfeld and Bridge, 'Examining Structure and Process in ESOP Firms' , above n 63, 278. For an interesting brief discussion of the history behind the current US policy – in particular on whether ESOPs should be structured so as to facilitate control not just ownership, see Bagchi, above n 17, 17–18.
[161] Hirsch, above n 144, 960 and N Mygind and C Rock, 'Financial Participation and the Democratization of Work' (1993) 14 *Economic and Industrial Democracy* 163, 170–1.
[162] See D D'Art, *Economic Democracy and Financial Participation: A Comparative Study* (1992) 115.
[163] See, eg, J K Thompson, 'Promotion of Employee Ownership through Public Policy: The British Example' (1993) 27 *Journal of Economic Issues* 825 and R W Clark, 'Employee Stock Ownership Plans (ESOPs): An International Comparison and Analysis' (1998) 24 *Managerial Finance* 19.
[164] See, eg, A Pendleton and E Poutsma, 'Financial Participation: The Role of Governments and Social Partners' (European Foundation for the Improvement of Living and Working Conditions, Dublin, 2004).
[165] Aitken and Wood, above n 6.
[166] H Gospel and A Pendleton, 'Finance, Corporate Governance and the Management of Labour: A Conceptual and Comparative Analysis' (2003) 41 *British Journal of Industrial Relations* 557, 570.
[167] J Blasi et al, 'An Assessment of Employee Ownership in the United States with Implications for the EU' (2003) 14 *International Journal of Human Resource Management* 893.
[168] Bagchi, above n 17.

7 CONCLUSION

The subject of employee share ownership is a diffuse and complex one. In Australia, despite broad and sustained public policy interest in ESO, literature on the subject remains limited. The breadth and depth of the literature from the UK and the US, however, provides valuable guidance on potential avenues for research on the Australian experience of employee share ownership.