ILLUSTRATION: ANTHONY RUSSO

OWNERSHIP Plus INCLUSION

A financial stake in the company isn't enough; employees need to be co-managers. **COREY ROSEN,** author and founder of the National Center for Employee Ownership, talks to Brunswick's **CARLTON WILKINSON.**

As a Senate staff member in the 1970s, Corey Rosen worked on legislation that supported the formation of employee-owned companies and employee stock ownership plans (ESOPs). What he was seeing first hand on Capitol Hill was that many well-intentioned taxpayer-funded social programs either didn't happen or had to cover too many people, making them too expensive to do enough for the neediest beneficiaries.

"Employee ownership was a way that you could use capitalism itself to get there," Rosen says. "It appealed to me because it could actually happen."

He went on to create the National Center for Employee Ownership, a nonprofit that conducts research and acts as a resource for companies involved with and considering ESOPs and other forms of employee ownership. Dr. Rosen—he holds a PhD in political science from Cornell—is the author or co-author of many books and publications, including *Equity: Why Employee Ownership Is Good for Business* (2005) and *Beyond Engagement: How to Make Your Business an Idea Factory* (2019). He stepped down as Executive Director of NCEO in 2010 but remains a full-time volunteer with the organization. He's at work on a new book.

What he uncovered, in those decades of research, is that while employee ownership is a crucial step in creating an advantage for a business, it is not enough. Required in addition is a management structure that includes employee participation in decision making at the work level.

Employee ownership isn't new. The US supermarket chain Publix, which operates primarily in the South, has been employee owned since its founding in the 1930s. In the 1980s, Publix became

one of the first major companies to transition to an ESOP, a structure blessed by new tax laws. Today the chain is not only the largest ESOP in the world, but also one of the largest companies in the US, employing over 225,000 people. Significantly, it also consistently ranks on Fortune's list of "100 Best Companies to Work For."

Employee ownership has gained visibility over the last 50 years, thanks to increased legal recognition and also changes to the tax code that make employee ownership more appealing to private owners. Today, many companies, particularly in the tech industry, offer stock options as part of their employee benefits package, an idea rooted in research (including by NCEO) showing how ownership increases employee motivation. Google is perhaps most notable for using equity compensation to retain much-lauded talent at extraordinary rates. On the NCEO website, Google co-founder Larry Page says, "The significant employee ownership of Google has made us what we are today."

While other publicly traded companies have embraced partial employee ownership, owners of privately held companies found they could transition to majority-owned ESOPs as a way to preserve their legacy as well as to help motivate employees. Selling to an outside buyer carries risk: With no inherent loyalty to the old enterprise, the new owner could implement restructuring or policies that would radically transform the business, leaving workers and existing partners and customers out in the cold. Selling to employees, on the other hand, can help carry the company forward as the old owner intended.

"That was one of the first big changes," Mr. Rosen says, "ESOPs evolved from being an employee benefit plan—and maybe a way to use lower-cost financing to buy capital, with the benefit of that ownership being shared with employees—to being a mechanism for owners of closely held companies allowing them to transition out of ownership. I would say 80% of new ESOPs, or more, are set up for that reason."

Selling to an ESOP also carries large tax advantages for private owners: Under changes to the tax code passed by Congress in 1997, qualifying ESOPs are considered an exception to existing corporation tax structure and exempt from taxes on any income.

"If you become 100% ESOP, you don't pay any tax," Rosen says. "So now a lot of companies looked at that and said, 'Well, gee, this sure makes staying an ESOP a whole lot more attractive.' So now, most ESOPs either are or will be 100% employee owned. That's a really dramatic change from what was the case in the '80s."

It was clear even in the '70s that employee ownership could benefit a business, with Publix as the clearest example. The chain of stores has remained consistently profitable since its founding and continues that trend today. For 2020, it reported $11.8 billion in sales, up nearly 15% over the prior year.

Yet among ESOPs Publix is an outlier: The next largest majority employee-owned company has just under 30,000 employees—still big, but a fraction of Publix's size. Only 3% of ESOPs are publicly traded, with the ESOP holding a minority stake. Meanwhile other public companies offer similar ownership-based incentives including stock options, equity grants and discounts on company shares.

Companies in the top 100 list of majority-owned ESOPs frequently show outstanding growth and financial results, including Gore-Tex maker WL Gore, railroad supplier Amsted Industries, and Houchens Industries, operators of IGA, Piggly Wiggly and Food Giant food markets. Early research in fact showed that ESOPs could be more successful than traditionally owned companies, by a significant margin. But that research also showed that, on its own, the ESOP structure was not a recipe for such success, Rosen said. The secret ingredient was employee participation in management.

> "DEMOCRATS LOOK AT THIS AND SAY, 'IT'S MORE FAIR. IT'S MORE EQUITABLE.' AND THEN REPUBLICANS SAY, 'IT'S MORE CAPITALIST.'"

"In the '80s, the thinking was, 'If you set up one of these ESOPs, they're great benefit plans, they'll help employees retire securely and that should be enough to really motivate them and get them to behave differently as employees.' And that didn't happen," Rosen says. "So then people said, 'Well, it must be because we're not explaining it to them well enough. We need to communicate that.' And it still didn't happen."

As one of its first large research projects, the NCEO investigated what could make employee ownership more salient to employees, what could make those companies more or less financially successful, and what the links might be between those two things.

"What we found was really, really clear," Rosen says. "The companies that performed well combined significant annual contributions to their ownership plans plus a very high-involvement culture where more employees could make more decisions about more things. These are employee teams, self-managing teams, ad hoc committees, open-book management, all of that kind of stuff, which was very much in its infancy at the time—1986. Subsequent research over and over again confirmed that that was true."

Employee ownership coupled with clear, open pathways to participation in business management turned out to be a powerful combination, producing a return on investment 3.9% higher, on average, than a company's competition. That advantage vanished in companies without significant employee involvement in management.

TEPID RESPONSE

Business executives, board members and owners remained unconvinced, and experimented with implementing only pieces of the idea. Along with stock options, employee engagement became a hot topic. Problem-solving groups evolved and teams of various kinds.

Some companies tried giving employees "a sense of ownership." In *Beyond Engagement*, Rosen jokes, "I'd like to take these people to lunch—let them pick the spot, soak up the atmosphere, suggest

what to eat, and smell the aromas, but not actually get to eat," he writes. "After all, a sense of lunch should suffice."

He also takes issue with companies reserving rewards of ownership for "a few key people," noting that anyone in the business can prove to be a key person on any given day. Speaking to a class of graduate students at Stanford Business School in 2008, he hammered that point home: "To the customer, the company is the person who answers the phone."

While the list of ESOPs seems to grow only incrementally each year, if at all, what is perhaps more significant is that the average size of ESOP companies has grown, with many now employing 10,000 to 20,000 workers.

That list also includes some of the most innovative companies with regard to management structure. Materials science company WL Gore, famous for the development of the athletic fabric Gore-Tex, is one example. The business has no management hierarchy. Each of its more than 10,000 employees is free to develop a new idea as long as it has support from other employees. Consultation is required only for ideas that might damage the company. The company founders also limited the number of people at any one facility, assuming that each employee needed to have the opportunity to get to know his colleagues in order to make connections that could act to foster new ideas, and that such incentive would decline if the number of co-workers at any one site grew too large. They currently have 40 facilities spread across 23 countries.

Successes launched from Gore's employee-led projects include Gore-Tex, of course, as well as intravenous-bag filters used throughout the medical industry, and cables used by NASA in the 1969 Moon landing and the "sky crane" that lowered Perseverance to the surface of Mars earlier this year. In the mid-'90s, Gore associates experimenting to create better animatronics cables for Disney began toying with guitar strings as a way to prototype their ideas. Members of a project team, including a guitar player, decided on their own to branch off to investigate whether their cable expertise could produce a better type of guitar string. That brand, Elixir strings, is now gaining popularity on the market, where the company touts its exceptional tone and durability.

Of course, ESOPs can fail and critics often point to those failures as evidence that the structure is too risky. But research from several different sources shows that the opposite is actually the case: fewer than 0.5% fail to repay the loan used to set up the ESOP, compared to 19.4% for non-ESOP business loans. ESOPs also have 25% higher job growth over a 10-year period and employee owners were one-fourth as likely to be laid off during a recession as employees of non-ESOP companies. Moreover, Rosen finds that behind most ESOP failures is a lack of follow-through regarding measures to support both the ESOP and employee inclusion in management decisions.

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"Any company can fail because it's in a rotten market, or its business environment changes, or you're a restaurant and there's a pandemic," Rosen says. "Nobody's bullet proof, no matter what sort of organizational structure you have. Others fail just because management makes bad strategic decisions—it happens. But where employee ownership fails to do what it should be doing mostly has to do with not creating these kinds of cultures."

POLITICAL SUPPORT

Other strategies for employee representation in management have gained the spotlight recently. Senator Elizabeth Warren's proposed Accountable Capitalism Act calls for 40% of the board of directors to be elected by employees. Called co-determination, the plan is similar to corporate governance structures used in Germany.

Senator Warren promoted the idea during her presidential campaign in 2019. "That will make a difference when a corporation decides, 'gee, we could save a nickel by moving a job to Mexico,' when there are people on the board in the boardroom saying, 'no, do you know what that does to our company? Do you know what that does to our community, what it does to our workers?'"

But the idea of employee board seats may resonate less than its supporters hope, Rosen says.

"I get it," he concedes. "But our research indicates that the employees don't care that much about it. People of certain political views care a lot about it. But we haven't found that when employees have representation on a board in an ESOP company it does anything different."

Importantly, employee ownership is "a completely bipartisan idea," Rosen says. While neither party has made it priority, "it has no significant opposition. Democrats look at this and say, 'It's more fair. It's more equitable.' And then Republicans say, 'It's more capitalist.'"

As he did in the 1970s, Rosen sees employee ownership as a way to right the wrongs of our capitalist economy through capitalism itself. Company experience in the marketplace, backed by research by NCEO and others, demonstrates that such benefits are achievable and can actually increase productivity and profits while boosting employee quality of life.

"The biggest issue that people are facing right now is not whether they've got two representatives on the board of directors. The biggest issue is the enormous amount of wealth insecurity and the perception that the economy is essentially unfair. Those two things are really eating away at our society—and not just ours.

"Employee ownership is one of the things that actually works, that's been proven to work, that's practical, that's bipartisan. So let's do that." ◆

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