

Every Employee an Owner. Really.

- [Corey Rosen](#)
- [John Case](#)
- [Martin Staubus](#)

New accounting rules will soon require companies to place on their income statements, rather than in footnotes, the cost of stock options they issue to employees. Option plans will thus be subject to the same shareholder scrutiny as all other equity compensation programs. Shareholders have learned to be wary of the dilutive effects of equity grants and their potential for abuse by senior managers, so it's possible that executives will respond to the reforms by reducing the number of employees who are eligible to receive equity. In fact, surveys of human resource professionals suggest that almost half of companies with broad-based options programs will limit participation in them at lower levels of the organization. Kodak, Aetna, and Time Warner have already done so.

The Impact of Expensing Options

READ MORE

But companies that reserve equity compensation for executives and leave the rest of the workforce out of ownership plans are bound to suffer in the long run. Top managers aren't the only ones who make a difference to a business. Study after study proves that broad-based ownership, when done right, leads to higher productivity, lower workforce turnover, better recruits, and bigger profits.

"Done right" is the key. United Airlines created an employee stock ownership plan (one of several types of broad-based equity plans available to companies) in 1994, but the ESOP was doomed from its inception. It was adopted under duress, rejected by a major segment of the workforce, and soon opposed by new management. The company declared bankruptcy in 2002.

Management must encourage workers to "own" their responsibilities once it has allowed them to own, literally and legally, their employer's equity.

Getting broad-based ownership right isn't a matter of choosing one type of equity plan over another (see the sidebar "The Varieties of Employee Ownership"). As far as we can tell, the form of participation, whether it be options, a 401(k) plan, an ESOP, or a restricted stock plan, is unimportant in comparison with four factors: A significant percentage of the workforce—generally, most of the full-time people—must hold equity; employees must





think the amounts they hold can significantly improve their financial prospects; managerial practices and policies must reinforce the plan; and employees must feel a true sense of company ownership. In essence, management must encourage rank-and-file workers to “own” their responsibilities once it has allowed them to own, literally and legally, their employer’s equity.

The Varieties of Employee Ownership

READ MORE

The four factors add up to an ownership culture in which employees’ interests are aligned with the company’s. The result is a workforce that is loyal, cooperative, and willing to go above and beyond to help make the organization successful. In the following pages, we’ll examine the factors and explain how to achieve an ownership culture. We’ll also look at United’s ESOP and explore the examples of two widely differing firms, one a California R&D contractor, the other a Rust Belt forge shop, that have achieved excellence in implementing broad-based employee ownership.

Owning a Piece of the Action

In 2004, close to 11,500 U.S. companies had ESOPs involving a total of nearly 10 million workers. An additional 4,000 companies sponsored different types of broad-based stock option programs covering an estimated 10 million employees. Thanks to these and other programs, roughly 23 million individuals, or about 39% of people working for stock corporations, owned stock, or options to buy stock, in their employers. A few thousand companies are wholly or majority owned by their employees. This group includes multibillion-dollar corporations such as the Publix supermarket chain as well as a host of small and midsize companies.

Rutgers University’s Douglas Kruse and Joseph Blasi, the preeminent scholars in the field of employee ownership, examined 105 publicly traded companies that provided stock options to at least 75% of their employees. In the three years following the implementation of their options plans, the companies improved productivity 17% and return on assets 2.3% per year, on average. Moreover, the grants made by these companies didn’t exact a price from the employees: Wages were about 7% higher than in comparable companies that did not distribute options widely.

In 2002 congressional testimony on Section 401(k) reform, Kruse summarized the results of some 30 studies, his own and many others, that looked at the financial results of companies in which a significant percentage of employees had equity stakes of various kinds. Most of the studies found that these companies did better than other firms. Some found that employee ownership made no difference, but none found that it hurt performance.





A 2003 study by Sibson Consulting (one that Kruse did not cite) found that, dollar for dollar, sharing ownership is the most effective way to lure employees to a new company or keep them at their current jobs. Other studies have shown that companies with substantial employee ownership are more likely than others to offer diversified retirement plans (in addition to the equity compensation), so employee-owners usually don't need to fret that their holdings are unduly concentrated in the stock of a single company—namely, their employer.

The Wrong Way

Employee ownership is not, however, a magic bullet. Some economists have long regarded it with skepticism, arguing, for example, that employees of all but the smallest organizations can rarely see a link between their efforts and the company's results; hence, ownership has little effect on business performance (see the sidebar "When Does Employee Ownership Make the Most Sense?"). They also point to the "free rider" problem: Even if employees as a group have an incentive to work harder and smarter, some individuals will be tempted to slack off and let others carry the burden. They suggest that employees don't value ownership as much as it costs a company to provide it. And if employee owners are in the majority and actually control the company, economists argue, workers will favor higher wages and other short-term benefits at the expense of investment in future growth and profitability.

When Does Employee Ownership Make the Most Sense?

READ MORE

The experience of United Airlines and the high-profile failures of certain other companies' employee-ownership programs have lent credibility to these views. But in reality, United failed because it defied almost all of the precepts of productive employee ownership.

At United, unionized pilots, unionized mechanics, and nonunion employees were given 55% of the company's shares through an ESOP in return for wage concessions. The experiment began in a rosy glow of collaboration. Task groups of employees from all over the company began attacking workplace problems and figuring out how to cut costs. Employees took on new responsibilities: "Everyone from gate agents to mechanics gained new authority to address customer complaints without consulting their supervisors," the *Chicago Tribune* reported in a 2003 retrospective. Even pilots got into the act, "checking wind conditions and other data to determine the most fuel-efficient routes."

The cooperative attitude brought results. By the end of 1995, the ESOP's first full year, grievances had fallen by 74% and sick time by 17%. Revenue per employee, a key measure of productivity in the airline industry, was up 10%. Surveys showed that employees enjoyed working at the "new" United. In 1995, the company's stock outperformed the





Standard & Poor's 500 index by 67%, and shareholder value increased by more than \$4 billion.

Five years later, however, the task groups were long gone; in fact, the company disbanded them just a year after establishing them. Gone, too, was the cooperative attitude. In the summer of 2000, pilots seeking a new wage deal staged a drastic slowdown. They refused to fly overtime, making it impossible for the airline to keep to its schedule. They taxied at a crawl. They flew low to burn more fuel. Shortly before takeoff, one pilot “walked off a full 747, claiming nerves,” according to a postmortem by *New York Times* writer Roger Lowenstein. On-time performance, which had reached 81% the year the ESOP was put in place, dropped to an industry-worst 61% for the year (it was at 40% during the summer). Passenger traffic plunged.

The tale of how the ESOP's high hopes and promise were shattered is long and involved. But any account would surely highlight at least three elements.

Divisive Beginnings.

The 1994 deal was controversial from the start. The Air Line Pilots Association and the International Association of Machinists gave up some \$4.8 billion in prospective wages and benefits in return for equity. (This was unusual; fewer than 2% of stock ownership plans involve givebacks.) Meanwhile, United's other major unionized group, the flight attendants, refused to join the buyout on the grounds that members couldn't afford to make such large concessions. “You can't eat stock” would become a catchphrase for those who opposed the whole deal.

Fading Support.

Changing any large, entrenched organization requires constant effort, and no such effort was forthcoming. The pilots' union, still riven with disagreement over the givebacks, voted out the leaders who had supported the ESOP only a few weeks after it was implemented. The union's new leaders had little interest in employee ownership. The machinists, never too excited about the scheme, became increasingly distracted by a challenge from a rival union. Within the company's executive ranks, says Chris Mackin, an employee-ownership consultant who worked with United at the time, “a cluster of ‘old guard’ management officials who openly criticized the original move to employee ownership began to gain strength.”

A Flawed Structure.

Not only were the flight attendants on the outside looking in, but workers who were part of the ESOP would get stock for only five years. People who joined the company after that period would get none at all. Soon the ESOP wasn't anyone's priority. In 1999 and 2000, with the ESOP flagging and contract negotiations coming up, the pilots' union was in no





mood for compromise. Then James Goodwin, the new CEO, announced that he had negotiated a merger with US Airways, a move that jeopardized the United pilots' seniority. That's when the infuriated pilots mounted their slowdown. (The proposed merger was subsequently nixed by the Justice Department on antitrust grounds.)

When United went bankrupt, a few commentators were quick to place the blame squarely on employee ownership. That made about as much sense as blaming US Airways' bankruptcy on investor ownership. But employee ownership certainly didn't save United. Both the union leadership and management, for different reasons, viewed employee ownership as a negotiating ploy rather than as a commitment to cultural change.

Success Stories

United's example notwithstanding, a wide variety of companies have recorded exceptional business performance with the help of employee-ownership programs reinforced by management policies. We visited dozens of such companies and spoke one-on-one with a broad cross section of people at each, from CEOs and other senior executives to frontline workers. Examining the particulars of company experiences seemed to us an important way to learn why some companies do very well with employee ownership while a few crash and burn.

Science Applications International Corporation (SAIC), a research and development contractor based in San Diego, employs about 45,000 people at its state-of-the-art facilities. Last year, it reported revenues of \$6.7 billion, making it perhaps the largest employee-owned firm (and among the largest privately held companies) in the world. J. Robert Beyster, the physicist who founded SAIC in 1969 and until recently served as its chairman and chief executive officer, was passionately committed from the beginning to sharing ownership. Not surprisingly, many respected scientists scrambled to sign on when he offered equity in a growing company.

The firm has set up a unique infrastructure devoted to getting stock into employees' hands and to ensuring that people understand what it means to be owners. SAIC staff members, many of whom have PhDs or master's degrees, can buy shares outright, either for cash or through a payroll deduction. A program that adds a certain number of shares to those purchased by first-time buyers encourages employees to give ownership a try. A large percentage of workers are awarded stock as part of their compensation packages or bonuses. And every employee is included in SAIC's retirement plan, which awards a quantity of shares every year based on an individual's pay. An internal market, operated four times a year by a licensed, wholly owned broker, allows employees to buy or sell shares at a price set each quarter by the board of directors. (If there is an imbalance between buyers and sellers at a given price, the company typically steps in to make up the difference.) Meanwhile, an internal Certified Employee Owner training program offers courses in the company's financials and other aspects of stock ownership. At last report, nearly 17,000 employees had completed the course.





Scot Forge is a very different kind of employee-owned enterprise. At five locations in America's heartland, the company turns metal and other material into various shapes for use in industrial machinery. Its plants are hot and noisy. Its 500 workers are mostly high-school and community-college graduates. Unlike SAIC's employees, Scot Forge's workers can own stock only through the company's ESOP, and they can cash out only when they retire or leave the company.

But in important respects, SAIC and Scot Forge are similar. Both have recorded steady and at times exceptional revenue and earnings growth and today are highly profitable. SAIC officers share and discuss the firm's financial performance with employees in quarterly "town meetings" broadcast over the Web; Scot Forge's executives hold monthly all-hands lunch meetings in every plant to review sales, profits, and other aspects of the business. Like SAIC, Scot Forge makes a point of reminding people of their ownership stake at every opportunity. An elected ESOP council offers training programs and serves as a sounding board for employee shareholders. Many of SAIC's employees—about 3,000, according to one informed estimate—have accumulated at least \$1 million worth of stock each. Scot Forge isn't quite in that league, but the company's performance has enabled many blue-collar workers to accumulate retirement accounts of \$750,000 or more. Its worker-shareholders also receive dividend and profit-sharing payments. A 15-year employee can expect to receive an additional six weeks' worth of pay, on average, from these sources every year.

Employee-owners are trusted to do what is best for the company. They know which numbers to watch, and they watch them.

The employee-ownership plans at both SAIC and Scot Forge incorporate the four factors that add up to an ownership culture. At both companies, every employee with a year or so of service holds equity, and employees can accumulate a comfortable nest egg over a period of years. Management's sharing of financial information reinforces workers' sense of ownership. So does the fact that employees are expected to accept the responsibilities of ownership—and do. At Scot Forge, for example, employees will arrange to work weekends to finish an urgent job without any prompting from management. Workers with this kind of ownership attitude are trusted to do what is best for the company. They know which numbers to watch, and they watch them. They internalize their responsibilities and feel they have an obligation not only to management but to one another. Finally, they expect to make decisions that will boost the bottom line.

What Ownership Means

A culture of ownership is common at companies with ESOPs, but it's still not typical of other employee-owned companies, even though granting stock options has been commonplace since the 1990s (ESOPs have been around since the 1970s). Many employees remain puzzled by the offer of equity. They wonder, Is it just one more benefit? Will we become owners in the sense that we can work whenever we feel like it? It's easy for a





company to dispel some of the more misguided notions, but it's harder to communicate exactly what ownership means and to instill a sense of true ownership. The companies that have been the most successful at implementing employee-ownership plans follow these precepts:

Believe in what you propose.

Senior management must want equity ownership to work and must devote the necessary resources to sustaining it over time. This commitment doesn't have to exist at a company's birth, as was the case at SAIC. Most of the companies we studied made a transition from conventional ownership to substantial employee ownership. But all had or found a CEO and a team of senior managers who believed in the idea and worked hard to make it a reality. Few of those companies reaped the rewards right away; most found that employee ownership began to "take" only after a year or two, as people gradually began to understand it.

Communicate the meaning of ownership.

Signs reminding employees of their ownership are everywhere at SAIC, Scot Forge, and other successful implementers—on banners, on bulletin boards, on company stationery, and on Web sites. The chief executives of those companies manage to work the subject of employee ownership into their speeches, as well as into informal talks inside the company.

Share profit-and-loss information.

Like any other business owners, employees of companies with broad-based ownership plans should be entitled to see all information about the company that doesn't run afoul of privacy restrictions or SEC regulations. Leaders at successful employee-ownership firms continually educate workers about the company's financials, explaining where profits come from and how they affect the value of the stock. Every employee-ownership exemplar makes a point of conducting some kind of business-literacy training program and sharing financial information with employees. The contrast with United, which did virtually nothing on this score after the first year, is striking.

Make it worthwhile financially.

The switch to employee ownership has a built-in advantage that other change initiatives lack, namely the financial rewards the new system can offer. We have never seen a stingy equity-compensation program that had much effect on employees' attitudes or behavior. At United, the pilots and mechanics did own a significant stake in the airline, and the stake grew in the early years as the stock price increased. But they had given up substantial amounts in wages to get that stake, and they had no chance to earn additional stock over time. Many might have been better off financially had the deal never gone through. At SAIC and Scot Forge, by contrast, people's shareholdings increase every year of their tenure,





creating many millionaires and near millionaires. Millionaires or not, the participants have enough to *feel* like owners.

Turn your owners into decision makers.

That is, give them a say in how they do their jobs and in how things might be improved. If workers aren't given the prerogatives of ownership, their equity stake will make little difference. The cluster of practices known as "participatory management"—self-managing teams, ad hoc task forces, quality circles, and so on—are common at successful employee-ownership companies. For example, workers at Whole Foods Market are responsible for hiring people into their work groups. Because profit-sharing bonuses are based on team performance, a recent article noted, employees don't want "buddies on their teams," they want *workers*—people who will "make them some money." Some years ago, a Honeoye, New York, company called Stone Construction Equipment was manufacturing and selling roughly \$20 million worth of machinery a year. Today the employee-owned company's sales are well more than twice that, yet the head count has stayed at just over 200. Its competitors have folded or moved their manufacturing to Mexico. The reason for Stone's success is the company's lean-manufacturing system, which depends on employees' extensive participation in decisions about how to meet constantly shifting production goals. According to CEO Lynne Woodworth, the system is so demanding that it can work only if employees have, in effect, an owner's commitment to the enterprise. • • •

Companies seeking to implement successful employee-equity plans needn't go as far as SAIC or Scot Forge did. But they certainly must make a serious commitment to the concept of employee ownership. That requirement helps explain why, despite broad-based equity's record of superior business performance, more companies haven't yet jumped on the bandwagon. Creating an ownership culture is an ambitious and time-consuming process. Many CEOs these days don't stay with one company long enough. Those who do are often more concerned with rapid growth through mergers and acquisitions (or rapid cost cutting through layoffs) than with organic growth through organizational development.

CEOs who offer their employees only a modest amount of stock ownership without making any of the other commitments are not necessarily throwing money away. Equity is certainly a nice benefit. Like any nice benefit, it may help attract and keep good employees, and it does seem to engender modest increases in performance. But a plan that gives meaningful and growing amounts of stock to employees within a culture of ownership can profoundly transform attitudes and behavior—and, in turn, financial results.

A version of this article appeared in the [June 2005](#) issue of *Harvard Business Review*.

