ESOP Basics

Creating an Ownership Culture

Overview

The backbone of the American economy is the small family-owned business. The responsibility of running such a business on one's own involves a great deal of both stress and time. Often, the owner has no one to trust to take care of the company while going on a much needed vacation. Not only is their time for relaxation severely limited, but they also have to shoulder all of the responsibilities of the firm. The obvious solution is to share responsibility, but it is hard to pay competent employees enough to retain them and employees rarely feel the same sense of responsibility that owners have. Sharing ownership with employees offers the opportunity to involve the workforce in the business with the same sense of responsibility that an owner has.

Sharing ownership through an Employee Stock Ownership Plan (see "When Employee Ownership Makes Sense" in the Family Business Journal [Winter, 1998]) is one of the necessary ingredients to establish a successful ownership culture. However, employee-ownership by itself will not increase employee motivation and performance.

This is the conclusion of the U.S. General Accounting Office (GAO) which compared ESOP companies with traditionally owned firms. The GAO's study found that the combination of employee ownership and employee participation yields substantial improvement in firm performance. It is precisely this type of genuine employee partnership which can lead your employees to take on some of the responsibility.

According to a U.S. Department of Labor (DOL) study, the high performance workplace provides workers with "incentives, information, skills, and responsibility to make decisions essential for innovation, quality improvement, and rapid response to change." Further, the DOL suggests, high-performance workplaces exist in companies which integrate their business, human resource, and technology strategies and share the following common characteristics:

- Give workers a stake in the performance of the organization through employee ownership and gainsharing;
- Create employment security strategies that recognize the value of workers to long-term economic performance;
- Push responsibility down to front-line employees, often by organizing work into self-managing teams;
- Provide workers with the information necessary to exercise a high level of autonomy and discretion;
- Build worker-management relations on trust, mutual interest, and cooperation;
- Focus on satisfying customers, not simply shareholders; on improving quality, not simply reducing costs; and on building organizations that adapt easily to market change;
- Encourage workers to learn new skills through skill-based pay and pay-for-performance compensation systems;
- Invest in training and retraining to develop workers as critical business assets, rather than treating them as costs to be minimized; and
- Provide workers with safe and supportive work environments.

Though the high-performance workplace concept is cited as an optimal solution, the Department of Labor estimates that currently only 4 percent of U.S. businesses qualify as high-performance workplaces. Interestingly, 25 percent of employee-owned firms in the U.S. have these high-performance characteristics. Overall, employee-owned firms are more likely than traditional firms to provide sufficient incentives, information, skills, and responsibility to their work forces.

Ownership + Participation + Information + Training = Higher Performance

Studies in the States of Ohio and Washington reinforce the federal government's findings. The Ohio Employee Ownership Center (OEOC) at Kent State University surveyed 167 Ohio ESOP companies and found that employee-ownership coupled with participation, education and information leads to higher financial performance. Equally important, a study in the State of Washington showed that companies which reward employee participation with stock ownership outperform those which only reward participation with profit sharing.

The transformation of workers into owners requires cultivating a genuine sense of ownership where the employees take the responsibility of ownership seriously and their actions contribute to the company's success. This process obviously does not occur overnight. Developing an ownership culture among your employees means seeing that they get what you already have: equity, a say in how things get done, information and training. Employees need to understand company financial reports and develop their decision making, communication and problem solving skills.

Ownership

Equity makes a big difference. Consider the difference between renting and owning a home. Unlike a person who rents, the home owner has equity in his or her investment and therefore will have an incentive to increase the value of that investment. After all, how many renters do you know that paint the outside of their residence? Just like a homeowner, an employee-owner has a greater incentive to drive the value of stock in his or her company. This could result in reducing scrap, generating creative ideas on how to improve a process, and producing better quality products. This ownership could be in the form of stock options, a cooperative or an Employee Stock Ownership Plan (ESOP). Although rewards like profit-sharing and bonuses are great supplementary incentives, they do not provide employees with an ownership stake.

When employees have an ownership interest in their company and are valued for their input, their jobs become more meaningful. Satisfied employees as well as satisfied customers stay with the company longer! As mentioned earlier, ownership is just the first step in creating a successful ownership culture. The remaining ingredients are participation, training and information.

Participation

Motivated employee-owners need the opportunity to express their ideas for improving the business to management. Effective communication requires that managers listen, appreciate dissent and tolerate opposition. Likewise, supervisors need to lead rather than order, assist rather than discipline, and teach rather than threaten. It is the responsibility of employees to make suggestions without confrontation, learn basic business concepts, and work cooperatively with others. Open channels for input should be maintained throughout the company. To initiate increased levels of participation, you might consider creating problem solving teams or shop floor committees.

Whether your company is employee-owned or not, the goal of participation is maximum feasible employee involvement in all areas of company decision-making, from the shop floor to the boardroom. It is through participation on decision making bodies that your employees can truly accept greater responsibility.

Information

An owner needs access to financial and other strategic information to make sound business decisions. Responsible employees also need access to company information like financial reports, scrap rates, customer satisfaction indicators, and on-time delivery records. Of course information is only useful if it is communicated effectively. This information can be in the form of regularly published newsletters, annual or quarterly meetings to review business issues, and company financial statements. Part of this communication process requires that the receiver to be able to understand the information presented. This requires a long-term commitment to education and training.

Training

U.S. firms generally spend much less on training and education for employees than their competitors in Japan, Germany, Sweden, and other advanced countries. Most of what U.S. corporations spend goes for management training. The American Society for Training and Development confirmed that two-thirds of corporate training monies go into training for those who already have college degrees. If you want to create a successful ownership culture at your firm, just informing employees is not enough. They also need to understand the information they receive in order to be informed and involved owners. Opening your books to employees is meaningless unless your employees understand how to read financial reports. Meetings to improve quality lead nowhere if the participants lack effective meeting skills.

Education is a process of learning, and coordinating an effective training program requires a long term commitment. Training non-managerial employees in problem-solving and group process techniques helps make employee participation programs work successfully.

Getting Started

It is relatively inexpensive and highly cost effective to undertake some combination of employee participation, training, open-book management, and financial incentives to increase company competitiveness. However, family business owners who are seriously considering the establishment of an ownership culture to increase performance may want to begin by examining their own personal philosophical beliefs. They might also want to discuss the challenges and potential rewards with other business owners who have implemented policies to foster an environment that allows employees to think and act like owners.