

THE COCO COMPANY AS AN ANTIDOTE TO PRIVATE EQUITY

Could I just start this week's column by saying that, if there are any private equity players out there who are thinking of making a bid for me, I would of course be prepared to consider any serious offers. True, the Stern property portfolio may not look all that impressive and there remains the question of the family stake. But frankly, knowing some of the people involved as I do, I am pretty sure that for the right price they could all be shaken loose. Enough about me. Next Monday evening in the House of Commons a short pamphlet* is being published which describes an approach to business that is about as far removed from the world of private equity as it is possible to get. The UK's Employee Ownership Association is promoting what it calls the "CoCo" company: co-owned and, almost as important, "co-created" (more on that later). An antidote to private equity, based on the widest possible distribution of share ownership, might find a receptive audience just at the moment. After all, we are living through a time in which Michael Gordon, chief investment officer of Fidelity International, can confess in a letter to this newspaper that he is "struggling to make sense" of the private equity craze. (He understands enough about it, though, to observe that "Employees are a little further down the pecking order" in the private equity world.) The principle behind the employee ownership of businesses is simple. It is to "induce employees to think and act like owners, making decisions that increase corporate value", in the words of Wharton's Martin Conyon and Harvard's Richard Freeman. How startling an idea is that in reality? Top executives have been enjoying the benefits of share options for many years. The theory is that these share options help align managers' interests with those of other existing shareholders. Well, as an employee, you could not be any more aligned if you were also a shareholder yourself. Employee ownership is already more widespread, and more successful, than you might imagine. The National Center for Employee Ownership in the US has over 3,000 corporate members. Perhaps its best-known is the technology firm Science Applications International Corporation, or SAIC, founded by Robert Beyster in 1969, and now a 44,000 employee business with sales of around \$7.8bn. Dr Beyster chose at the outset not to keep a tight grip on the company equity, but to offer stock ownership as a way of rewarding (and holding on to) staff. His Beyster Institute at the University of California in San Diego continues to spread the gospel. His own account of the SAIC years - "The SAIC solution" (Wiley) - will be published at the end of next month. Employee ownership is not merely an Anglo-Saxon phenomenon. In Spain the Mondragon network of employee-owned businesses had sales of almost E12bn (J8bn) in 2005. Smaller co-operatives are a familiar presence all over Europe. So employee ownership is already well-established. But does it work? There is some evidence to suggest it does. In the UK in recent years, the Employee Ownership Index (EOI) has outperformed the FTSE All-Share. An investment of J100 in the EOI in 1992 would have been worth J349 at the end of June 2003. The same amount invested in the FTSE All-Share would have been worth J161. Looking at the performance of US businesses with employee stock ownership plans (ESOPs) reveals a similar story. But crucially, as Richard Reeves, author of the new paper on "CoCo" companies points out, the ESOP businesses that do best "are those which also have robust forms of consultation and employee involvement." In other words, "the greatest benefits seem to flow when co-ownership is combined with real opportunities for co-creation." Hence "CoCo". What

are the characteristics of a CoCo enterprise? Supporters say that levels of engagement (or “organisational citizenship”) among employees are higher. Staff show more initiative. Information and ideas spread more quickly, which is good for innovation and creativity. Reeves is quite evangelical on the subject. CoCo companies are, he says, “vehicles for meeting the productivity challenge but also for generating happiness... a wellbeing creator as well as a wealth creator.” But, in the context of today’s stampede towards private equity ownership he concedes that the employee-owned model may have a limited appeal for some: “The transition to co-ownership may damage the bank balances of precisely those few individuals with the power to bring it about.” Britain’s best known employee-owned business is the highly successful John Lewis Partnership (65,000 staff, sales up 11 per cent at £6bn and profits up 25 per cent). They have just opened a branch of their attractive supermarket chain Waitrose in Balham, in south London – where I lived happily for many years before being expelled in the economic process known as gentrification. Almost opposite stands a smart branch of Sainsbury’s, the UK supermarket group being stalked by a private equity consortium mulling an £11bn-plus bid. For the time being the Sainsbury’s branch is doing good business. But should the venerable PLC fall into private equity ownership in the next few weeks, I have little doubt that Balham’s shoppers will soon be favouring the employee-owned side of the street.

* CoCo Companies - “Work, Happiness and Employee Ownership” by Richard Reeves, www.employeeownership.co.uk stefan.stern@ft.com Read and post comments online at www.ft.com/stern