Beyster/Kelso Fellowship Proposal

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Background:

In 2007, I conducted a literature review of research on the effects of ESOP and Employee Ownership. The resulting working paper, *Effects of ESOP Adoption and Employee Ownership: Thirty years of Research and Experience* [1], was very well received. It was selected for media presentation at the 2007 Academy of Management; served as the basis for the successful first-ever gathering of major Employee Ownership scholars, professionals and participants in May 2008; and has become the most downloaded paper in the history of the University of Pennsylvania (2,343 full-text downloads as of Dec. 2009!) scholastic commons.

In that review I find overwhelming evidence that employee ownership and greater employee participation in governance benefit individual employee-owners, compelling evidence that it benefits firms, and indications that it benefits society at large; but that large knowledge gaps remain and that some fundamental questions have gone largely unaddressed. These questions include:

- How do we reconcile employee ownership research indicating great gains across the board in productivity, profits and ROI with economic theory and contrary evidence?

Extensive, impressive research indicates that employee ownership lead to major gains in firm productivity and profitability.[2] Yet mainstream economic theory predicts employee ownership leads to underinvestment, inefficient decision making, inadequate supervision, or some combination of these [3] and empirical research published outside the small group of employee ownership researchers – mostly in finance [4-6] – emphasizes problems related to ESOP adoption, for example, *decreased* R&D.[7]

- If employee ownership is so great, why don't we see more of it?

Although the total dollar value of ESOP plans continues to grow, the number of firms with ESOP plans long ago plateaued. We need to better understand empirically the reasons why ESOPs and other forms of employee ownership are or are not adopted or are abandoned.

- Do the social benefits of employee ownership justify special tax treatment? And what of the extant ESOP governance structure that need not provide any additional employee participation? Are any policy changes warranted?

ESOPs are provided special tax treatment because of purported social benefits. Legislation has been passed at least in part due to claims that broad-based ownership can ease workplace tensions, reduce disparities of wealth, and help build a better society. But little empirical research has been conducted to verify or otherwise test these claims.

My plan is to keep these big questions in mind as I pursue manageable research efforts.

Proposed Research

I would use the Beyster fellowship to, first, properly publish my literature review (if it's not already accepted). I would also try to develop for publication a quantitative analysis of the costs and benefits employee ownership tax legislation, a draft of which has already been written and presented to industry groups.[8] I would also like to develop thoughts and empirical research on *innovation* and *resilience* as they relate to employee-ownership.

My primary management research area has been resilience, or the ability to cope with unanticipated dangers.[9] Resilience as such is increasingly recognized as a critical competency in a increasingly dynamic world.[10] I have documented an almost incredible resilience in firms decimated by the 9/11 attacks [11, 12] and an equal *lack* of resilience in the automobile industry [13-15], winning national research awards for articles on both subjects. I have also been teaching a popular course on organizational resilience at Penn since 2003.[16]

No one has studied ESOP resilience or an ability to deal with adversity *per se*, but many studies link employee ownership to firm survival.[17-19] More specifically, French worker cooperatives were found to survive longer than their non-employee owned counterparts under a variety of conditions.[20] US ESOPs were able to improve operating performance even when their stock prices were falling, not only when stock prices were rising, as with matched firms.[21]

I envision writing one paper that theoretically makes the case for the value of resilience and stability. Although enhanced organizational survival rates may seem to be a clear-cut good to the average person, economists and political scientists have traditionally been – and continue to be – dubious. Prevailing theory celebrates "creative destruction," that is permitting organizations to die a timely death, thereby allowing the market to efficiently redistribute human and financial capital.[22-32] The outline of a continuity argument is that people need time to fit into an organization, teams need time to coalesce and organizations take years to develop sustainable models. In contrast, start-ups, for all their vibrancy, are generally inefficient; markets provide only crude mechanisms for reallocating resources; and organizational breakups result in disintegration of intellectual capital and cause disruptions to clients, communities and other stakeholders. In short, the current model of transfer every two or three years results in great social losses; if employee ownership, in fact, allows for resilient, organizations that can withstand adversity and adapt to changing circumstances, they may add a greatly beneficial stability to an all-too-rapidly changing economy and society.

I also envision a literature review and/or meta-analysis of the relationship between employee ownership and stability for individuals, firms, and the communities in which they are located.

At some point down the road, I'd also like to investigate the relationship of employee ownership to innovation, creativity and intellectual capital. Extant research on innovation indicates that after the implementation of an ESOP, R&D intensity *decreases*.[7] But this study is based on data from firms which may have used ESOPs as a possible takeover defense. But for many reasons related to the nature of creativity and innovation, I would expect a strong positive relationship with employee ownership. Some of these include:

- Ability and willingness to pursue long term goals, through incentive alignment and reduced turnover
- Ability and willingness to pursue corporate rather than individual goals, through incentive alignment and internalized corporate values and identity.
- Greater role in decision-making from rank and file employees, i.e., those who have firsthand knowledge of design, production and customer relations

A positive association between employee stock ownership and R&D expenditures was found in Taiwan.[33] A replicative study of US data with additional intervening and outcome variables may further generalize and extend this finding, and potentially rectify the received wisdom on the relationship between corporate governance/ownership structures and creativity/innovation.

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