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Drivers and barriers for employee ownership
– why is the United States in a positive circle while Denmark is not?

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Abstract

Purpose – Drivers and barriers for employee ownership vary between countries because of differences in politics, institutions, and economy. By analyzing this variation the purpose is to answer why employee ownership has developed fast in US and not in Denmark.

Design/methodology/approach – The drivers and barriers for employee ownership are identified from the scientific literature, and the main societal dynamics are identified through the PIE-model covering the dynamics between Politics, Institutional change and the Economy. Politics focuses on different social groups influencing the development of institutions driving or hindering employee ownership in the economy.

Findings – US has followed a self-enforcing circle with broad political support of "shared capitalism" including ESOP-type of employee ownership. In Denmark, the labor movement rejected worker cooperatives as a main strategy and focused on building up the welfare state. Center-right parties favored employee stocks, but the institutional framework never overcame the barriers for employee ownership.

Originality/value – This is the first study to perform an analysis of politics, institutional change and economic development to explain drivers and barriers for employee ownership and to make a comparison between the development of employee ownership in US and Denmark.

Keywords – Employee ownership, shared capitalism, industrial democracy, institutional context for employee ownership, USA, Denmark.

Paper type – Research paper

Introduction

Why are there so few majority employee owned companies in Denmark – a country ranging among the highest in indices for competitiveness and happiness? Why is shared capitalism with employee shares and broad based majority employee ownership much more widespread in USA? To analyze these questions it is necessary to identify the main drivers and barriers for employee ownership and to perform a dynamic analysis of politics, institutional change and the development in the economy. Theories based on alignment of interest and higher motivation of employee predict higher productivity in employee owned firms, and most empirical studies of performance point in this direction (Blinder, 1990; Kruse *et al*.,2010; O'Boyle *et al*.,2016). Still, in Denmark, employee ownership only covers a small fraction compared to traditional capitalist owned enterprises.

The purpose of this article is to relate this variation to different political and economic conditions and different institutions determining the weight of drivers and barriers for employee ownership. How have politics, institutional change and developments in the economy made a positive circle for employee ownership in US breaking the barriers and building a critical mass of broad based majority employee owned enterprises? Why has this not been the case in Denmark?

Methodological remarks

The drivers and barriers for employee ownership relate to about fifty years of theory building and empirical investigations - summarized in Dow (2003, 2018). The main contribution of this study is to connect earlier empirical research into an overall framework for analysis of societal development – the PIE-model. This model for Politics, Institutions and Economy (Mygind, 2007) was developed as the framework for the analysis of the transition in Eastern Europe and the development of emerging markets. The current analysis compares the development in Denmark with very little employee ownership and US with a strong growth of these types of companies during the last forty years. The focus is on companies where a broad group of employee owns the majority of the shares, including all three rights of control, surplus and wealth (capital gains). These rights may not be distributed in parallel, and minority rights and participation in only one or two of the rights may also be interesting because it could be part of a long run path to majority ownership covering all three right. Different models will be compared, but profit-sharing including only the right to profit will be in the periphery while worker-cooperatives and the American ESOP model will be in the core of the analysis.

First, different types of financial participation are defined and the focus for the analysis specified. Then follows a review of the four main barriers for employee ownership and how to overcome these. The following section presents the PIE-model and how the different elements relate to employee ownership. This includes a presentation of how the dynamics between the PIE-elements can form a positive circle for employee ownership. This conceptual framework is applied to US and Denmark by going through the historical background, politics, institutional change, and the economy including the incidence of different types of employee ownership. The dynamics between the elements are emphasized by summarizing the positive circle for US and the negative for Denmark.

Different types of employee financial participation

Employee financial participation is related to the three owner-rights to control, surplus and wealth. Shareholders typically get a share in all three rights. Table 1 gives an overview over the main forms of employee participation in the three owner-rights. The focus is on *majority broad based* employee ownership including the majority of all three rights for the majority of the employees. The distribution among the employee owners should not be more unequal than the distribution of salaries. This allows for some inequality between employees but excludes a situation where few managers own the overwhelming majority.

Worker cooperatives use the democratic one-member-one-vote principle. This is often combined with nominal membership fees meaning that members cannot accumulate individual savings in the company – indicated by limited rights to wealth in the table.

Table 1. Different forms of employee participation in different owner rights

Type **right to:**	**Control**	**Surplus**	**Wealth**
Broad based majority employee ownership	+	+	+
Worker cooperatives – collective ownership	+	+	limited
ESOP Employee Stock Ownership Plans	some limitations	+	+
Minority employee ownership	limited	(+)	(+)
Partnership by minority of employees	(+)	(+)	(+)
Profit sharing	0	(+)	0
Employee representation in company board	(+)	0	0
Economic Democracy – wage earner funds	centralized	shared	shared
Pension funds	often unions	shared	shared

In the American ESOP (Employee Stock Ownership Plans), the shares are owned by an employee trust, often leveraged by loans with collateral in the company. The shares are gradually transferred to the employees through profit-sharing. The employee owners have mandated direct voting rights related to corporate transactions like sale or merger of the company. Often, other voting rights are not executed by the employees, but by a board of trustees without employee control. However, the ESOP trust can be crafted with broader voting rights for the employees, and there is an increasing number of ESOPs controlled by elected employee-representatives (NCEO, 2019).

In some countries *profit-sharing* schemes give the employees the rights to part of the surplus without control rights or rights to capital gains. *Employee representation* in company boards – like in Scandinavia or Germany – mean that employees get some control rights without financial rights to surplus and wealth.

In Scandinavia, there was in the 1970s a debate on *Economic Democracy*. Part of profits or wages should be paid to “wage earners’ funds” and a proportional share of the value would be accumulated on each employee’s accounts, which could be withdrawn after some years or at retirement. Elected employee-representatives or unions should perform the external control. In Sweden, the proposal was partly implemented in 1984, but soon rolled back. Instead, in Scandinavia, union based pension funds developed to be strong institutional investors with diversified share portfolios, though not connecting each employee’s account to their actual workplace.

The current analysis focuses on the three first rows in Table 1. When relevant, the other types are mentioned, because the institutional development of these types also influence the conditions for majority employee owned firms. ESOPs are often combined with different forms of profit sharing

(Kruse *et al*., 2010). Minority employee-owned firms may over time become majority employee-owned; narrow based partnerships may broaden ownership to the majority of employees.

Barriers and drivers for employee ownership

This section presents four main barriers and drivers for employee ownership starting with four main barriers/problems:

<u>Capital problem.</u> The average employee owns relatively little wealth compared to the typical investor and access to capital is limited or more expensive for the average employee and for the combined group of employee owners. The capital problem often means concentration of ownership in the hands of some employees with higher income, wealth and possibly also human capital (Dow, 2003, 2018; Pendleton, 2010; Faigen *et al.,* 2018).

<u>Risk problem:</u> When employees accumulate savings and capital gains in the company and/or take loans based on personal liability they are exposed to financial risk. (Vanek, 1971; Meade, 1972). They may risk a considerable part of their financial wealth combined with the risk of losing their job and firm-specific human capital. Some employees with a certain level of wealth may be able to diversify their risk on top of their employee-shares, so they are not dependent on the economic results of their enterprise to secure a pension on a reasonable level. Furthermore, if the employee ownership wealth, as in the ESOP case, is not based on contributions from the employees, it adds to the wealth, and therefore it is not increasing the risk of the employees (Kruse et al.,2019).

<u>Entry/exit problem of employee-owners</u>: If new-coming employees are not offered or cannot afford to acquire sufficient shares in their company and exiting employee may keep their shares or sell to outsiders the broad based majority employee ownership may degenerate over time. Dow (2003) refers to the "commodification problem" related to the lack of an internal market with specific rules for the transfer of employee shares.

<u>Start-up problem:</u> It is complicated to attract a group of interested and capital-endowed employees ready to invest human and physical capital in upstarting an employee owned company. This is easier for the traditional entrepreneur or a small group burning for a business idea and ready to take some risk for the start-up (often in alliance with outside investors). Therefore, few employee owned companies are started up. Start-ups with a few owning partners may fulfill the definition of majority employee ownership, but when expanding, new employees may not become owners because of the exit/entry problem. There is a "ratchet effect" related to employee ownership: Failing employee owned firms either close or become investor owned; failing investor owned firms close or continue as investor owned with new investors, who only in rare cases include a broad group of employees.

Another problem mentioned by Alchian and Demsetz (1972) is the "free rider problem" of employee owners shirking because their own effort only weighs by a small share in large employee owned firms, but evidence from US (Freeman *et al*., 2010) and from Mondragon (Bradley and Gelb, 1981) shows that increased mutual monitoring among the employees solves the problem.

Dow (2003) refer to the "composition problem": Different groups of employees may have different interests in relation to the company. Some groups have specific human-capital closely attached to the company like lawyers, architects, medical doctors etc. and such groups may have stronger interests in ownership than e.g. the support staff and non-skilled workers. The solution is often partnerships for specific groups of professionals but the partners may make such a small proportion of the employees that the conditions of broad-based employee ownership are not fulfilled.

Theory and practical examples show that the problems of capital, risk, entry/exit of members and start-up can be eliminated or modified by different institutional solutions promoted by the state or by organizations supporting employee ownership:

The capital problem may be solved by specific financial institutions giving loans on preferential terms for starting or taking-over firms by the employees. This may be combined with tax advantages and/or specific saving schemes. The *leveraged* ESOP solves this problem through a loan with collateral in the company.

The solution of the capital problem may trigger the risk problem, which increases with increasing individual wealth accumulated in the company. However, if the employee ownership assets are built on top of e.g. low-risk pension savings and/or a broad based social security system, lack of diversification of the extra assets in their company should not be a major problem.

The exit/entry problem of employee owners is relevant for individual ownership types and may be solved by making loans or other support contingent on open and broad membership like in ESOPs. New-coming employees shall have the option of ownership, preferably with some instruments for accumulating a personal ownership stake over a period like in Mondragon (Whyte and Whyte, 1991). Leaving employees shall withdraw their accumulated capital within a certain period. The problem disappears with collective ownership, which often takes the format of a small nominal membership deposit when entering and recovered when leaving, while the company net-worth is in indivisible reserves. However, this may trigger the classical horizon problem (Ward, 1956; Vanek, 1971).

The start-up problem makes it necessary to have some sort of an incubator-organization to combine entrepreneurial employees and other employees plus capital. This kind of umbrella may also work for employee-takeovers - possibly combined with preferential financing/tax benefits like in the ESOP model. Such takeovers could be more frequent if there are incentives for the current owner to sell the company to the employees as a solution of the succession problem. The government may support employee takeovers considering equality, employment, and competitiveness. As referred to below this has been the case in USA with tax advantages for the selling owner.

When employee owned companies are rare there is little awareness about their potential. Improved information, statutory models, well published positive examples can be expected to be important drivers. There are well-known cluster-effects like Mondragon, Spain or Emilia Romagna, Italy. When reaching the "critical mass" of a considerable number of employee owned firms, the process may get into a self-enforcing circle including consulting networks and easier access to finance.

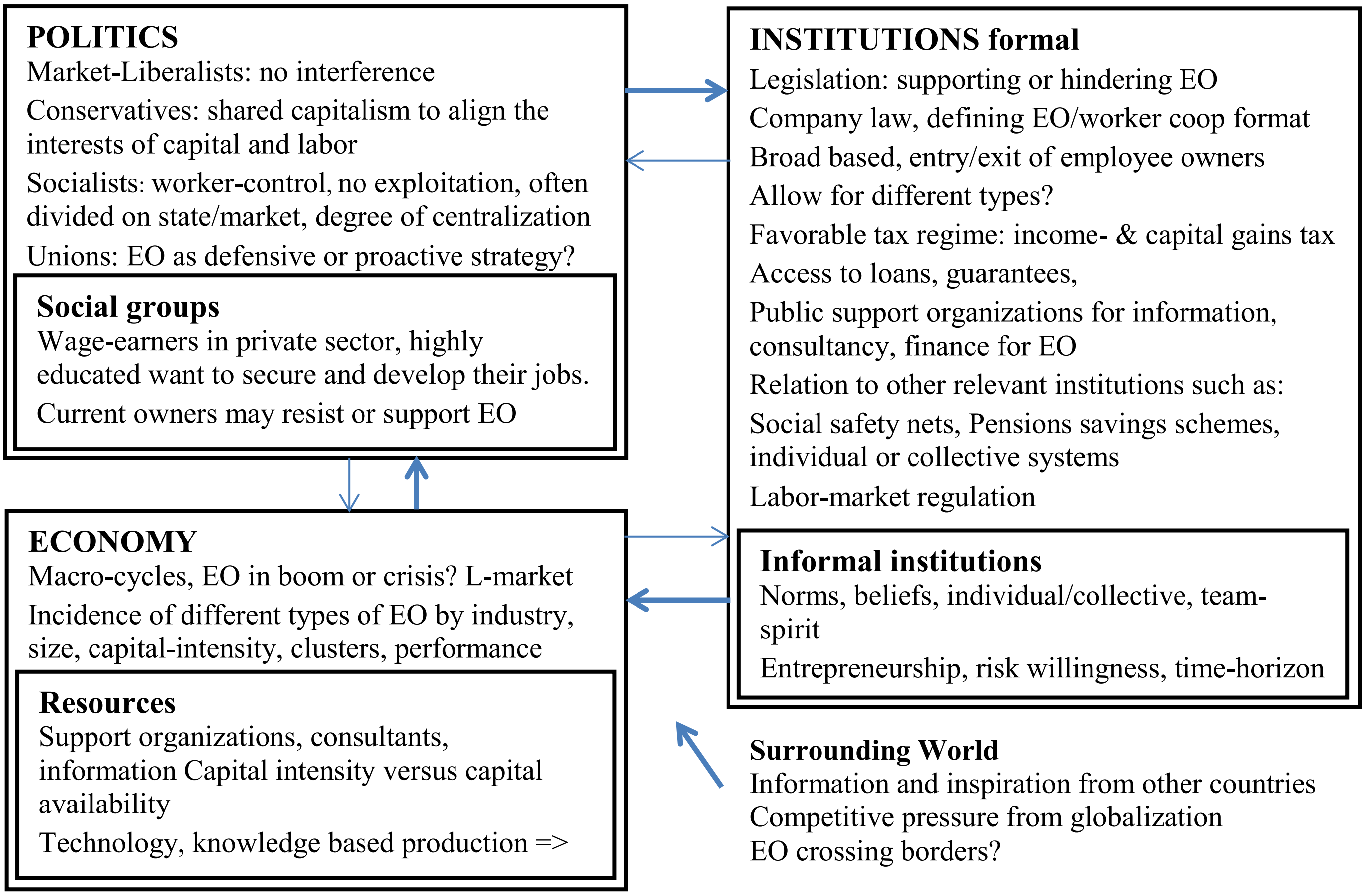
Solving one problem may include a trade-off with other problems. Collective ownership solves the entry-exit problem, but accentuates the capital-problem (and horizon problem). Access to loans ease the capital problem, but may increase the risk problem through higher leverage.

Politics, Institutions, and Economy dynamics related to employee ownership

This section presents the conceptual framework for the analysis of Politics, Institutions and Economy related to the development of employee ownership. The society analysis is structured as a PIE-model – Politics-Institutions-Economy - (Mygind, 2007). The *politics* box includes social groups with different economic and political resources and interests. In the political processes these groups join different organizations like political parties, movements, unions, which make alliances or confront each other. The dominating groups form the government and make the political decisions which determine the development of the formal *institutions*. The institutions form the rules of the game of politics and the economy (North, 1990). The informal institutions related to culture are the unwritten rules of the game, which also have implications for politics and the economy. The *economy* box shows the economic flows on different markets, and the resources created by investments or given by nature. The development in the economy influences social groups and the political process. The PIE-model emphasizes the dynamics between the elements, illustrated by the arrows between the boxes.

In figure 1, the focus for each box is on employee ownership and the arrows summarizes the dynamic links for a possible positive circle of employee ownership.

Figure 1 - PIE-model and the dynamics behind Employee Ownership (EO)



The classical market-liberalists position is: No interference - let the market rule with survival of the fittest - no specific legislation/support for employee ownership, which should develop without state interference. Market liberalists are skeptical of the existence of market failures. If existing, they can be neglected because their costs are outweighed by the cost of state-interference.

Conservatives see the traditional conflict between capital and labor as a problem. They want to align the interests of owners and workers by transforming the employees to small capitalists owning shares in their own companies. They may recognize market failures and find regulation necessary including incentives for employee ownership. Like the promoters of ESOPs in USA, Kelso and Long, they prefer giving employees the financial rights of surplus and wealth without the right of control.

Social liberal center parties accept that market imperfections justify regulation and/or support for employee ownership.

The socialist left and labor-parties like the Scandinavian Social Democrats emphasize redistribution and some state-regulation of the market. They may be split in groups favoring centralized state solutions and groups favoring market based decentralization. This was connected to the ideological split in relation to the Soviet Union. Some socialist groups favored self-management with local democracy, while Soviet friendly Communist Parties backed centralized state solutions and gave only limited support to cooperatives. They considered employee ownership a capitalist element splitting unions and cutting wages leading to self-exploitation. However, during economic crises, employee takeovers were a strategy for saving jobs and such defensive takeovers often included wage cutting. After a period, most of these firms closed down, leaving a bad reputation of employee ownership and further skepticism among unions.

A possible split lies in the modeling of employee ownership. The purist view takes the classical worker cooperative as a model: 100% collectively employee owned with one-vote-per-worker and indivisible reserves. In contrast, a pragmatic view would also support majority owned firm based on individual ownership and accept some inequality among the employees in relation to the ownership rights. The purist model often supported by the radical left may mean that employee ownership only grows strong in small and labor-intensive companies because it does not solve the "capital problem". A center oriented pragmatic view may result in higher incidence of employee owned companies in a wider specter of industries, but may be criticized from the left for being capitalist and only contributing little to more equality.

Social groups with different resources and interests drive politics. The core group interested in employee ownership is employees in the private sector, though some public sector employees may be involved because of privatizations and outsourcing of public services. Employees may have an interest in sharing the three ownership rights. However, if they are satisfied with their current situation perceiving that their interests are well covered by unions and labor party in relation to wages, social security, pensions, job-stability, and participation at the workplace they may not want to change their role as wage-earners. They would not consider employee ownership as an alternative. However, if their jobs are under threat, defensive employee takeovers may be considered an option.

A stronger desire for self-determination and involvement at the workplace may be found among higher educated employees with key-positions in their companies. Professionals like architects, engineers, layers, economists, journalists, may form partnerships, though often with narrow based employee ownership. The technological development as seen within IT-industries may mean that a larger group of employees can be motivated by ownership to develop higher commitment and creativity.

Investors/entrepreneurs are expected to favor investor-owned companies, though there are exceptions, especially when the founders of successful companies are about to retire and sale/hand-over to the employees could be the preferred option of succession.

Interest in motivating, aligning, and bonding employees, especially those difficult to replace makes employee financial participation including minority employee ownership a relevant option for current owners. Therefore, some investors would back proposals supporting employee ownership to increase productivity and innovation through higher motivation of the employees.

There is a strong link - bold arrow - from politics to institutions. Politics is simply the process of changing the institutions including those determining the rules of the game for the start and development of employee ownership. The link in opposite direction illustrate that political institutions set the rules for the political game.

Institutions

Following North (1990), institutions are defined as "the rules of the game" The focus is on *formal* institutions as included in the legislation. Support organizations for employee ownership may also define rules, which works as formal institutions.

Formal rules of special relevance for employee ownership are:

- Company law with provisions for specific types of employee owned companies/worker cooperatives – including e.g. rules for entry/exit of employee owners.
- Supporting tax rules
- Specific opportunities for loans to employee owned companies
- Consultancy, information, training, by supporting organizations
- Labor regulation
- Pension saving schemes

Also *informal* institutions, the unwritten rules related to culture, norms and beliefs might play an important role for the formation of employee owned companies. Formal institutions have different effects depending on the attitudes of the agents in the economy: An individualistic culture may have other effects for collective ownership types than a more collectively oriented culture (Mygind, 1992). Are the employees predominantly collective or more individually minded? Is there in a given area or industry a tradition for employee ownership like in Emilia-Romagna or Mondragon. In the latter case the specific Basque identity as an informal institution probably helped building the Mondragon cooperatives.

Both the formal and the informal institutions set the rules – incentives and constraints – for the agents and organizations acting in the economy. The institutions create the framework for developing employee owned firms illustrated by the bold arrow from institutions to the economy.

Economy

The economic development over the business cycle influences the possibility for establishing and developing employee owned companies. Especially the capital- and labor markets may have strong impact on the possibility for establishing employee ownership.

The economy includes the actual development and incidence of different types of employee owned companies by size, sector, technology, composition of labor-force, wage levels, investment, etc. The resources, including the technological level and the related skills and knowledge of the employees can be expected to influence the development of employee ownership.

Cluster effects may be important when the number of employee owned firms reaches a certain critical mass. A network of consultants, financial institutions, lawyers with special expertise related to employee ownership may develop and make it easier for further expansion.

There is a strong link from the economy to politics – bold arrow. The level of production and income as well as the ups and downs of the business cycle influence social groups and politics. Defensive employee take-overs happen more frequently in economic crises with high unemployment. In boom periods, the workers are in a stronger position and may get a bigger share of value added either as wage increases or as profit sharing or capital gains on employee shares (Ramsay, 1977). The political pressure for employee ownership is also connected to the distribution of income. High profits and increases in wealth of shareowners may induce a political pressure for more equality in income and wealth including a more equal distribution of company assets.

A given society must be seen in relation to the surrounding world illustrated in the right bottom corner of Figure 1. Border crossing flows of goods, information, people and capital influence domestic companies. Hyman and Mason (1995) see the pressure from global competition as a driver for higher productivity through employee share ownership. Information about possible institutions driving employee ownership and the performance effects often come from the surrounding world.

Dynamic PIE-circles

The possible dynamics between the PIE elements can be summarized in a positive and a negative circle following the bold arrows. It is a continuing self-enforcing process - a dynamic circle between PIE elements without a start and an end. Assume that the governing parties in politics have a positive attitude towards employee ownership and implement a supportive change in institutions. Such changes in legislation, company law, tax-advantages, access to finance can help to overcome the earlier mentioned problems and result in establishing more employee owned companies. This means higher incidence in the economy and after some time effects on performance may be seen. Assuming that the results are positive, as indicated by the research, this may spillover into politics with further development of supportive institutions for employee ownership. This will be reflected in the economy where the number of employee owned firms at some point reaches the critical mass with positive cluster-effects of more information, consultancy networks, expert community, research etc.

The negative circle dominates if strong social groups, parties or unions block institutional changes, which could limit the four problems. Lacking institutional changes may mean that only a small group of employee owned companies/worker cooperatives are formed. There will be no positive examples to back political and institutional initiatives and no development of employee ownership.

The development of Employee ownership in USA

Early History

Employee ownership has a long tradition in US. Blasi et al.,(2013) refers to some of the "founders" of the US constitution including Jefferson as promoters of profit-sharing and broad-based property ownership. Kruse, Blasi and Park (2010) cites Gallatin, one of the signers of the US Declaration of Independence, who set up a profit-sharing plan at Pennsylvania Glass Works in 1795, stating "democratic principle upon which this Nation was founded should not be restricted to the political processes but should be applied to the industrial operation" (quoted in US Senate (1939, 72)). The Homestead Act of 1862 promoted by Lincoln was based on the idea of wide distribution of assets. Families should own their own means of production and land-distribution would support greater economic equality (Blasi, Kruse and Freeman, 2018). Clark, one of the founders of the American Economic Association, wrote in 1886 about employee ownership (Blasi and Kruse, 2006). In the start of the 1900s, leading industrialist like Procter of Procter and Gamble and Rockefeller of Standard Oil developed broad-based profit sharing and employee stock ownership, and in 1919 a committee promoting employee ownership in corporations were founded. According to Blasi et al.,(2003) employee shareholding increased steeply during the 1920s covering more than 800,000 employees owning stock worth more than one trillion USD. This was on average 4.5 % in 315 corporations, or an average holding of 1300 USD per employee. However, the Great Depression wiped out this early wave of employee ownership. Most owners lost most of their holdings and the bad memory imposed a barrier for employee ownership for a long period.

The first wave of *worker cooperatives* in US was part of a protest toward the emerging factory system and the introduction of wage-labor for crafts people in 1791 in Philadelphia. The Knights of Labor, the dominant labor organization with nearly 1 million members, formed another wave in 1880-88. Instead of strikes, their members started their own companies, but bad management led to economic failures and the unions turned instead to collective bargaining and gave up worker cooperatives as a strategy (Curl, 2012; Blasi *et al*., 2013).

During the great depression of the 1930s unemployed organized mutual aid groups with cooperative elements. They organized up to half a million members by 1934. As part of Roosevelt's New Deal there was a Self-Help Cooperative Division to support cooperatives and barter associations, which were later substituted by government works programs (Curl, 2012). The Cold War and an anti-socialist reaction in the 1950s led to a decline in cooperative activity, but in the 1960s and 1970s a new wave, especially within alternative food retail, was organized as worker- and/or consumer cooperatives. According to Curl (2012) at its peak in 1979, there were nearly 1000 small worker- and producer cooperatives with 17,000 members, but few remained by 1989.

Politics

In the long history of financial participation and employee ownership in US, you find supporters both among Republicans and Democrats. The main ESOP legislation was passed in 1974 during the Republican Nixon/Ford administration. A conservative law professor and investment banker Louis Kelso developed the ESOP model. Senator Russell Long, a leading Democrat in finance and taxation backed the idea and became the leading force behind the ESOP legislation. Kelso and Long promoted broad based employee ownership as a kind of "people's capitalism". They wanted to spread employee ownership to make workers identify with their company and the capitalist system. They found support from both Republicans and Democrats but met skepticism among leftwing Democrats and some unions.

There were highly published cases in the 1980s and 1990s of companies in economic troubles like Eastern and United Airlines, Weirton Steel, and Hyatt-Clark where ESOPs and profit-sharing were used as instruments for defensive employee take-overs. Most of these deals were negotiated by unions and included wage restraints. These firms eventually closed down and though workplaces were prolonged for several years it gave a negative reputation. The vast majority of ESOPs were successful, but the handful of failures meant, that ESOPs met resistance from some unions and left wing Democrats. According to Blasi and Kruse (2006) there are only few examples where ESOPs were combined with wage restraints. In most cases ESOPs offer employee shares on top of fair market wages, while 401(k) plans are paid from wages. Kruse (1996) found that ESOP adoption was equally likely in union and non-union firms. Unions have conflicting opinions about employee ownership varying from opposition to active participation in the formation of ESOPs.

There have been some cuts in the tax-advantages for ESOPs in later years. Blasi *et al*. (2018) find that the reasons behind these reversals are complex and differed by presidential administration and discussions in Congress. Many of the cuts mostly by Democrats were connected to cutting the state budget deficit.

In May 2019 Bernie Sanders introduced a legislative package to support employee ownership including centers to provide training and technical support and an US Employee Ownership Bank to provide $500 million in low-interest rate loans and other financial assistance to help workers purchase businesses through an ESOP or a worker-owned cooperative (Sanders, 2019). Currently, there are no important dividing lines between Democrats and Republicans on employee ownership in US. According to a 2016-poll, 68% of US-voters support the concept of companies being owned by their employees (NCEO, 2016).

The development of institutions supporting employee ownership in USA

The break-through for employee ownership in US was connected to ERISA (Employee Retirement Income Security Act) of 1974 (Republican Nixon/Ford administration 1969-77). The law defined Employee Stock Ownership Plans, ESOPs, and included substantial tax-advantages as part of the pension system. The ESOP model means that the company can be partly or 100% taken over by an ESOP-trust either by contributions from the company and/or as a leveraged ESOP where the trust finances the takeover through a loan with collateral in the company. There are no contributions from the employees. When the loan is paid back through contributions and/or dividends from the company the value of the corresponding shares are allocated to the employees' individual accounts. The distribution must not be more unequal than the distribution of wages and there is a cap for top employees/managers. The ESOP is broad based including all full-time employees. When employees leave the company the value of their share in the ESOP are paid out (Rosen, 2017).

The Carter administration (Democrat 1977-81) developed the 401(k) defined contribution retirement plans. Unlike ESOPs, 401(k) includes incentives for employees to substitute wages for individual retirement savings. Normally, ESOPs are not substituting other pension plans. According to Rosen (2017) ESOP firms have four times higher probability of having 401(k) pension plan than non-ESOP cases. Thus, ESOPs do not increase risk concentration. Individual employees may allocate a large portion of 401(k) assets in their own company, often pushed by the company through matching free shares. Such KSOPs combining ESOPs and 401(k) are especially used in large listed companies. ESOPs must be broad-based, but there are no legal requirements that employees get voting rights for the board governing the firm. The ESOP is represented by the ESOP-trustees appointed by the company. The trustees can vote the ESOP-shares at the General Assembly including election of board members. Kelso and Long wanted to give the employees financial rights, but not control rights. However, the ESOP can be structured to give the employee owners control right.

Tax incentives was increased during the Reagan presidency (Republican 1981-89): In 1984 tax relief for lenders promoted ESOP with minority shares of 5-20% for public traded corporations. This pushed a steep increase in ESOPs in listed companies (Blasi *et al*., 2018). Corporations paying federal tax could defer capital gains tax when selling more than 30% to an ESOP. Some of these tax advantages have later been rolled back): The G.H.W. Bush administration (Republican, 1989-93) eliminated tax incentives for ESOPs in public traded companies resulting in a decline in incidence. The Clinton administration (Democrat, 1993-2001) cut back incentives for broad-based ESOP while programs for profit-sharing and stock-options for top-five executives were allowed (Internal Revenue Code 162(m)). This was combined with a one million USD cap on executive salary, but according to Blasi et al.,(2013) stock-related pay to top executives still costs 5-10 billion USD per year. The G.W. Bush administration (Republican, 2001-2009) made broad-based stock options to employees less attractive. The Obama administration (Democrat, 2009-17) made deferred profit-sharing plans less attractive. However, in 2018 this tendency was reversed both Republicans and Democrats in Congress passed the *Main Street Employee Ownership Act* (HR 5236) allowing loans to employee-owned companies to be made under the Small Business Administration preferred lender program.

Economy - development and incidence of employee ownership

According to Kruse *et al*.,(2010) US is the world leader in "shared capitalism". 53.4 million or 47% of private workers, are covered by at least one form of financial participation. 38% have profit sharing, 27% gain sharing, and 18% own company stocks.

Since the introduction of 401(k) plans by the Carter administration, individual employee shares have increased in importance compared to ESOPs. According to Blasi and Kruse (2006) 401(k) plans account for more than 60% of employee shares. KSOPs are especially common in large companies with minority employee ownership (Rosen, 2017).

There is much overlap between different schemes. More than 75% of workers who owns employee stocks also have profit sharing or stock options. Stock options are especially prevalent in high-tech firms like Google, Intel and Microsoft and in small innovative firms (Blasi et al., 2018). After going through the existing evidence from a number of representative surveys Kruse, Blasi and Park (2010) conclude that around 1/5 of private employees own stocks in their company.

It is striking, how the ESOP development has followed the changes in legislation confirming the strong link between institutions and incidence of employee ownership. Minority ESOPs in large listed companies appeared especially in the second half of the 1980s after institutional changes in 1984 favored loans to establish such ESOPs. This legislation was rolled back by the Bush administration in the early 1990s, and the expansion of ESOPs in large companies fell back (Blasi *et al*., 2018). The incidence of ESOP in SMEs grew steeply in the 1980s connected to retirement of former owners benefiting from exemptions of capital gain tax for more than 30% ESOP takeovers. This was a main reason for the creation of 1500-2000 majority employee owned SMEs in the following years (Blasi and Kruse, 2006). When the advantages were cut the ESOP takeovers fell.

Tax-advantages for contributions to ESOPs have been a permanent feature from 1974. ESOPs grew fast to 2002 when there were about 8 mill workers employed in companies with ESOPs. The number of active employees continued to increase though with lower growth rates. According to NCEO (2019) based on data from the Department of Labor in 2016 there were 6624 ESOPs holding assets of 1.4 trillion USD, with 14 mill participants of whom 10.6 mill employed in their companies. 565

ESOPs were in public traded companies covering 8.6 mill active employees. Most of these companies have minority employee shares of 5-20%. The remaining more than 6000 companies had two mill actively participating employees with ESOP-assets of 263 billion USD. According to Rosen (2017) 45-55% of these closely held companies have majority (mostly 100%) employee ownership. In most cases the employees do not govern the ESOP trust. In a Survey of 319 ESOPs, NCEO found that in 15% of the ESOPs the employees voted for the board of directors (Rosen, 2017). Scaled up to the whole population it can be estimated that some control are included in about 1000 ESOPs. There is evidence that the positive incentives and productivity effects of ESOP are connected to the development of participation in decision making so there is an incentive for further democratization and the number of majority owned democratic ESOPs are increasing (Blasi, 2017; Rosen, 2017).

Worker cooperatives based on the principle of one-member-one-vote make up a small group of quite small companies. According to Palmer (2019) there were 394 worker coops in 2017. The median number of employees is 9. Estimated total workforce is around 6734. Only a handful of worker-coops exceed 250 workers. The largest is in homecare with 2400 employees (Kaswan, 2017). Many states have specific cooperative statutes and 46% are incorporated as workers cooperatives.

US – ESOPs breaking the barriers for employee ownership

The high and increasing incidence of broad based majority employee owned firms in US can to a high degree be explained by the ESOP model's ability to solve the four main problems of capital, risk, member-entry/exit and start-up/conversion:

The <u>capital problem</u> is solved through the leveraged ESOP, making it possible to finance an employee takeover through a loan with collateral in the future profits of the company. This problem is not solved for worker cooperatives and it is probably a main explanation of their low incidence.

The solution of the <u>risk problem</u> is connected to the fact that the contributions to the ESOP are not deducted from wages or pension contributions. The accumulation of wealth in ESOPs is done on top of the pension contribution e.g. related to 401(k). However, when directly combined with 401(k) savings in KSOPs, there may be a concentration of risk for the individual employee. However, research shows that these savings typically comes on top of pension-savings without KSOPs and seldom goes beyond recommended diversification of assets (Kruse *et al*., 2019).

The <u>entry/exit problem</u> of employee owners is solved through the condition that the ESOP must cover all full-time permanent employees. New-coming employees get an account after entering and exiting employees cash out their part when leaving.

The <u>start-up problem</u> is to a high degree solved through the incentives for conversions. The deference of capital gains tax has given an incentive for owners about to retire to transfer the company to an ESOP. The development of support organizations like NCEO and an extensive network of consultants with expertise in ESOP help such conversions, and may also help starting new firms and create models for democratic ESOPs.

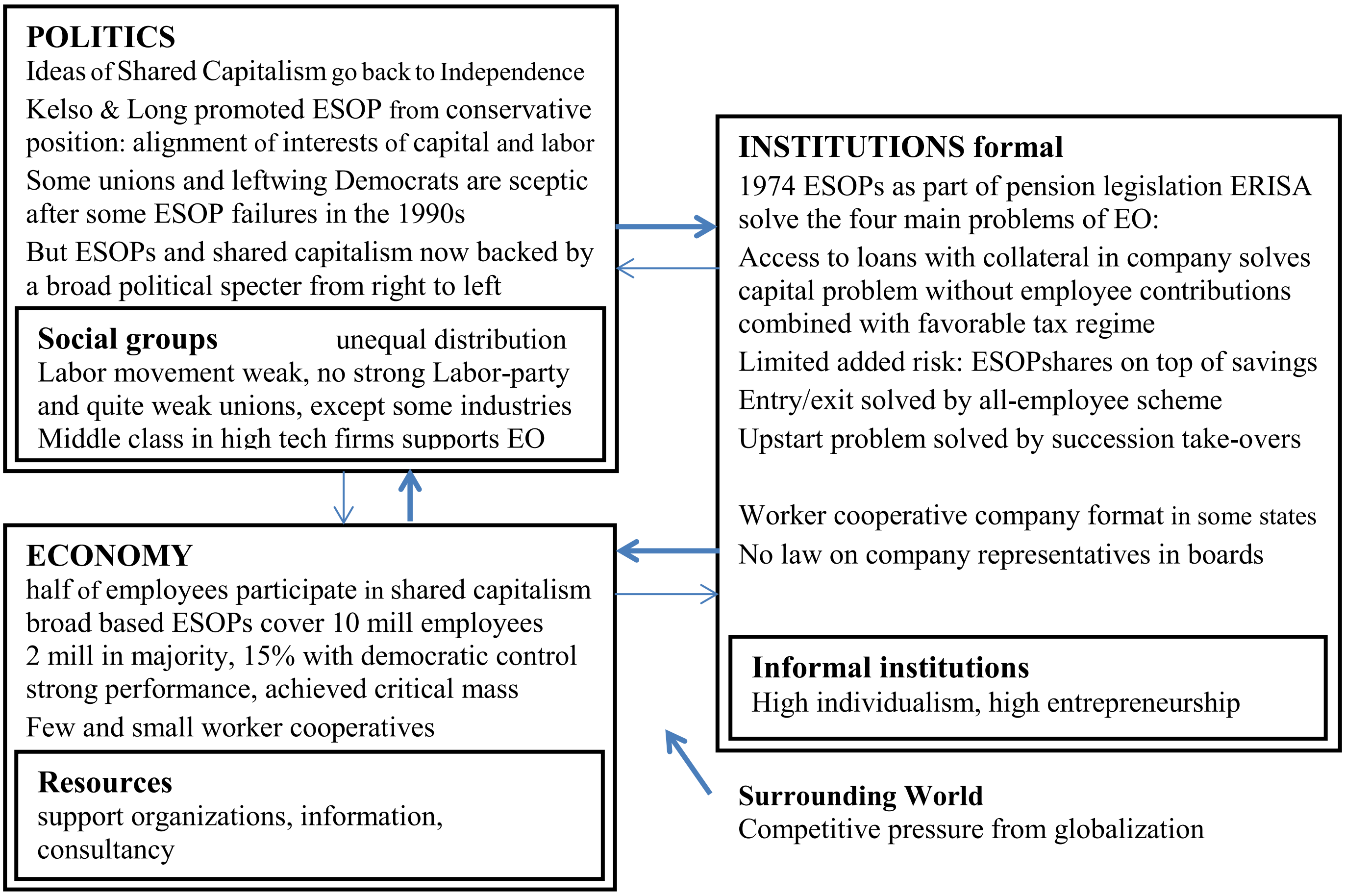
PIE-dynamics – the positive circle of employee ownership in US

The development in politics, institutions and economy and the dynamics between the elements has created a positive circle of employee ownership in US, see Figure 2.

Politics: US never had a strong labor-movement. Only in a few industries, unions have played a strong role. Values of individual freedom have prevailed values of collective solidarity. Widespread property ownership of land and company stocks has been cornerstones for the political parties. The idea of employee ownership goes back to the founders of the constitution and in the 1970s, the conservatives Kelso and Long promoted ESOPs related to ERISA. Left wing Democrats were skeptical toward ESOPs, but the trend has been support from still broader parts of the political specter. The opposition from unions and leftwing Democrats has changed from reluctant acceptance to general acceptance, and recent active support from leftwing Democrat, Bernie Sanders. There have been disagreements about details, but employee ownership has not been an area of conflict between Democrats and Republicans. Especially, in periods when the state budget constraint was considered less important tax-advantages for ESOPs were introduced.

The overall US *institutional system* is characterized by limited state ownership, low regulation and limited redistribution over taxes and social transfers. There is high weight on individual pension savings - an important reason why legislation related to retirement savings, ERISA from 1974, had so strong impact on employee ownership. This was the main institutional change opening up for tax advantaged ESOP, which made it possible for a trust to take over the company on behalf of the employees without wage contributions. In the 1980s business owners got an incentive by exempt/deferral of capital gains tax when selling to an ESOP with at least 30% and often 100% employee ownership.

Figure 2 - PIE-dynamics – the positive circle of employee ownership in US



There is a strong link from these institutional changes to the high number of conversions to ESOPs, especially in the 1980s and 1990s. This is illustrated by the link from the institutional box to the *economy*. Although the growth of ESOPs later has been less impressive, the number of broad based majority ESOPs can be estimated to around 1000 with two million employees. The fast development of minority ESOPs and KSOPs in large listed companies in a period with specific support is another strong indicator of the link between institutional changes and higher incidence in the economy.

There have been examples of negative links in US, like the negative reputation of the Knights of Labor cooperatives in the 1880s; the losses of many employee shareowners after the crisis in 1929; and the failures of some ESOPs in the steel and airline industry in the 1990s. However, overall there has been a *positive self-enforcing circle for employee ownership* in the last 40 years.

The ideas of shared capitalism and employee ownership have been influential in US since the constitution. There have been ups and downs, but the political climate has turned more positive since the 1970s in the two dominant parties including the leftwing Democrats. Also most unions have turned positive. This development in politics has been reflected in institutional changes favoring employee ownership - important for overcoming the barriers. This is reflected in the economy with the increase in different forms of employee participation in general and employee ownership in the ESOP format in particular. The number of broad based majority employee owned companies has reached a critical mass, where it is widespread also among larger companies.

A support structure with NCEO and an extensive network of consulting firms has developed. Several research centers focus on employee ownership, and they have documented the advantages in relation to employee commitment and productivity as well as higher growth in production and employment.

The positive results in the economy make further positive links to politics. More people know about employee ownership, and more have positive experience with employee shares. Voters are positive. Politicians are better informed and there are several examples where they refer to research results when arguing for further political initiatives in favor of employee ownership.

The fact, that the combination of all three ownership rights including control gives the highest productivity effects, have been used to increase the share of employee ownership and over time more employee-owners are getting involved in the governance of the companies. In this way second best solutions of minority employee ownership and ESOPs without employee control rights have been developing in the direction of stronger and more democratic employee ownership.

Denmark

Early history – the labor movement and worker cooperatives

The Danish labor movement goes back to the 1870s with the founding of the first unions and the Party of Social Democrats, SD. During strikes, unions could continue working in worker cooperatives and nine such coops were founded, but closed again during the economic crisis 1877-1882. The labor movement of the 1880s rejected worker coops in favor of the state taking over the means of production. Cooperatives were taken out of the SD 1888 program. The unions grew strong and SD got their first parliament members. In rural areas, the first cooperative dairies and slaughterhouses were established in the 1880s. The farmer related coops developed fast to take the dominant positions in Danish agriculture both on the input and output side. Also consumer coops grew rapidly in rural areas while there were relatively few in the cities. However, bakery coops producing cheap bread for and by workers started to spread and a worker cooperative dairy had great success in Copenhagen. A coop margarine factory started in 1897, but went bankrupt a few years later. In 1902 a worker cooperative brewery and in 1903 a life insurance company was launched (Grelle, 2012).

SD was from start the dominating labor party in Denmark. Within the party there were strong conflicts on the strategy in relation to cooperatives. The result was a cautious acceptance in 1898, though the discussion continued. In spite of reluctance in SD, consumer cooperatives connected to the labor-movement developed quite fast in the first decades of the century including coal-companies and the Workers' National Bank started in 1919. The Federation of Cooperatives was founded in 1922 as the third wing of the labor movement with SD and the unions as the two other and stronger parts. The worker cooperatives in Denmark peaked in the 1930s without making a significant share of production. Some of the largest coops closed down including the brewery and most bakery coops.

However, both the labor dominated city-consumer coops and the rural based coops grew fast and they merged in 1972 to become the biggest retail chain in Denmark. After the war, the reference to cooperatives was removed from the SD program. The focus was to develop the welfare state, not cooperatives. Today, there are only a handful worker coops in Denmark with the strongest incidence in construction.

Politics: centralization strategies dominate the Labor movement – reluctant support for employee ownership from the center-right.

From the 1920s and especially after 1941, the Communist Party, CP, was the strongest party to the left of SD. CP had strong relations to the Soviet Union and supported a centralized model, not worker cooperatives. However, after Soviet troops had crushed the Hungarian rebellion in 1956 the leader plus many members of CP started a new Socialist Party. They criticized the centralized Soviet command economy and from the late 1960s they referred to the "Yugoslav market oriented economy with collective ownership by the employees". At the same time, they were critical toward the one-party rule in Yugoslavia not fulfilling their ideas of "democratic socialism". Another radical left party also supports similar collective forms of employee ownership, but these two parties have only around 10% of the seats in Parliament and no important legislation have been passed in this area.

In the 1960s and 1970s, an idea of large central wage-earner funds under the label of "Economic Democracy" played a strong role in SD's political programs. However, it never became more than an ambitious plan for change of ownership. In Sweden, similar Wage-Earner Funds were implemented in 1984, but met fierce resistance and were privatized in 1992 (Meidner, 1993; Gumbrell-McCormick and Hyman, 2019). In Denmark, these funds never took off, and after some years, the idea disappeared from the agenda. Instead, union related pension funds developed. The obligatory contributions increased over the years and these funds are now the dominant institutional investors in Denmark. For most wage-earners both in the public and private sector these savings make up most of their pension. The contributions are defined in collective agreements between unions and employer associations. The centralized features of the pension funds have some elements in common with the wage earner funds, but although they have started to exercise more active ownership, they are not used as an instrument of wage earner influence in their workplaces.

The center- and center-right in Denmark were successful in making a scapegoat of "Economic Democracy" as a rigid centralized system governed by the top of the unions. Instead, center- and center-right parties promoted broad-based individual share ownership to employees as well as share option schemes mainly directed toward managers. The aim is like in US and UK alignment and motivation of employees, but arguments on shared capitalism are rarely mentioned. There is nearly no debate in Denmark on financial participation. Tax-advantages for employee shares were introduced by center right governments, then withdrawn by center-left, and reintroduced by the center-right. Still, there was very limited political debate about these changes. The center-left considers the tax-advantaged financial participation schemes primarily as a support for the wealthy part of the population and were concerned about distribution and state-budget balancing.

In 2015, a warned closure of a slaughterhouse, one of the main workplaces on a small island, came to the political agenda. The unions wanted to rescue the company, and a special ownership structure backed by new legislation was made with employee investments as an important element. The company is still running, but the model has not been used in other places.

Since a SD government in 1974 introduced changes to the company law, there have been employee board representatives in medium and large stock companies. The center-right was against, but when returning to power in 1982 they did not recall the law, and employee board representation is now part of the broad consensus in Danish politics.

A researcher in natural sciences, a center politician, and a philosopher published in 1978 a book called “Revolt from the Center” (Meyer, Petersen, and Soerensen, 1978) proposing universal basic income, sustainable production and employee ownership, but these ideas had only minor influence on the political debate.

Discussions about ESOPs have never been high on the Danish political agenda. There are some negative myths about employee owned companies. People may refer to a worker cooperative brewery closing in the 1950s or a television factory closing in the 1960s. Both cases happened in sectors with deep restructuring. Besides, the rescue attempt of the television factory was based on “people’s shares”. It was not employee owned. Still, employee ownership got a negative reputation. Recently, the old ghosts have faded and employee ownership is returning to the political agenda.

Institutions related to employee ownership in later years

The “Economic Democracy” proposal dried out the discussion about employee ownership in Denmark. However, for several years there have been tax benefits connected to employee-shares with a maximum 10% of the yearly wage (Lowitzsch and Hashi (2012). These schemes were introduced by the center-right in 1987 and revised 2002. It was slightly noticed when the scheme was abolished in 2012 by the SD led government and reopened in July 2016 after the center right had returned to power. Most of the benefits were used for managers and top-employees. Broad based schemes only cover around 1% in large enterprises and less in SMEs (Torp, 2016).

There is no specific legal format for majority employee ownership/worker cooperatives and no tax-advantages nor financial support. There is no legislation directed towards the formation of ESOPs.

The limited support for employee ownership must be seen in relation to the other institutions related to the Danish welfare state: quite strong social safety nets including high replacement levels of pensions. The universal basic pension is low, but retired persons without other income receive supplementary pensions adding up to the necessary minimum for living. Most wage-earners have additional pension savings in collective pension funds organized by the unions. As a third pillar of the pension system, it is possible to make individual tax-advantaged retirement savings including, but not targeting, employee shares. This system has mainly been used by the highest income groups.

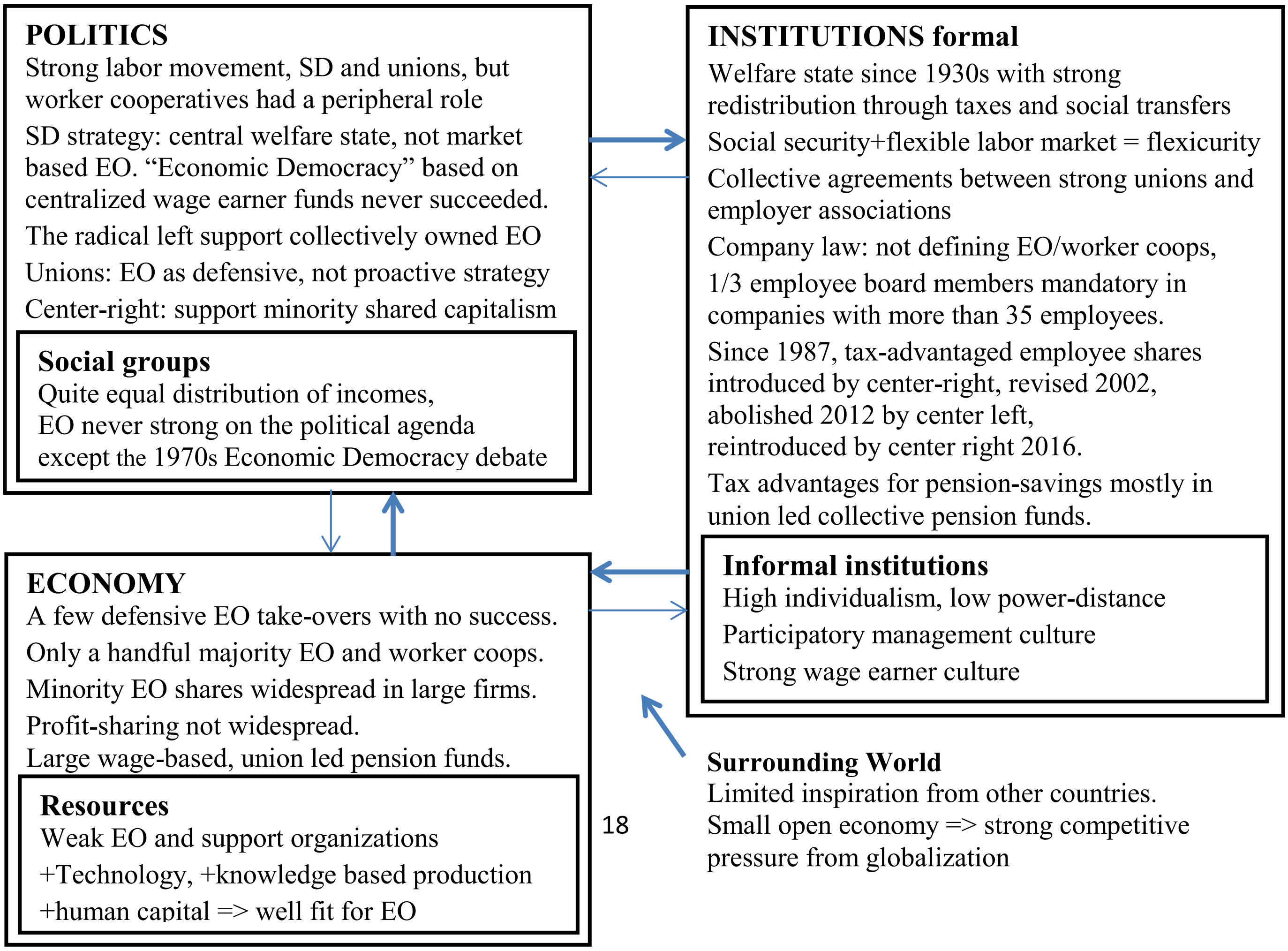
Economy - incidence

According to Mathieu (2018) about half of large listed Danish companies have broad based employee share plans, but it covers only 1.4% of stocks and 6% of the employees in these companies. Employee shares are less prevalent in smaller unlisted companies, which make up the bulk of employment in Denmark so the total share of employee owners is quite low. There are no majority employee owned companies with more than 100 employees. Research in the 1980s uncovered around 20 small majority employee owned companies including a few traditional worker cooperatives. A prominent case was the newspaper "Information" with collective ownership and direct democracy for all employees (Mygind, 1987). Later, an interesting case was "Unimerco", a precision machine tool manufacturer with around 400 employees. It was very successful during the period of employee ownership. In 2011, it was sold to a Japanese company and many employee-owners cashed in several times their yearly income (Berlinske, 29-06-2011).

Like in most developed countries, there are many professional partnerships in Denmark. These 100% employee owned companies are often owned by a narrow group of senior professionals and cannot count as broad based employee ownership, but no precise data exists in this area.

"Kooperationen" an organization with roots back to the worker cooperative movement was recently reorganized and is expected to promote employee ownership. There are no consulting firms with specialized expertise in employee ownership. Employee ownership is a marginal phenomenon in Denmark far from the critical mass achieved in US.

Figure 4 – PIE Dynamics for Denmark – a negative circle for employee ownership



PIE Dynamics in Denmark – a negative circle for employee ownership

There has never been a strong political force in Denmark promoting employee ownership. SD quite early gave up worker cooperatives as a strategy for changing society. When SD became strong enough to form governments in the 1920s and 1930s the strategy was to build the welfare state with strong redistribution over taxes and high social transfers. This was the main agenda also after WW2. CP to the left of SD also emphasized centralized state solutions. A later Socialist Party was inspired by the Yugoslav market socialism based on labor-managed firms. However, no left-parties succeeded in implementing institutions to support employee ownership/worker cooperatives. SD tried in the 1970s to promote a model of centralized "Economic Democracy", but never succeeded. The unions were skeptical toward employee ownership, though in a few cases they have backed defensive employee take-overs. The center right implemented individual employee shares. The intension was motivation, not broad based majority employee ownership. The center-left abolished the law, but later center-right government reintroduced it. Thus, financial participation is a political conflict issue, but the discussion about employee ownership has a low profile on the political agenda.

Minority employee shares especially owned by key employees and managers are widespread in large listed companies and professional partnerships, but there have been no changes in the institutions to develop broad based majority employee ownership. The four main barriers have not been overcome. Therefore, employee ownership only exists in very few, mostly quite small firms. Denmark is far away from reaching the critical mass of employee ownership. There is an organization with roots in worker cooperatives, but no public awareness of the phenomenon, no expert community to support and promote employee ownership. Denmark is in a negative circle with no strong political force promoting employee ownership, no institutional changes to overcome the barriers, no development of employee ownership cases, which could function as role models.

Conclusion

There are striking contrasts between the development of employee ownership in US and Denmark. We identified the main drivers and barriers for employee ownership and used the PIE-model with the dynamics between Politics, Institutional change, and Economy to find the main reasons for these differences. The dynamics can be summarized in a positive self-enforcing circle of employee ownership development in US and a negative circle in Denmark:

In US there has been a long tradition of different kinds of employee financial participation. Profit-sharing goes back to the founders of the constitution and conservatives have seen employee ownership as a way to support capitalism by sharing some of the fruits with workers. Worker coops have a long history, but only for short periods, it has been an important instrument for workers. There were setbacks and worker cooperatives had a mixed reputation. In later years, political parties have converged in their attitude to employee ownership, which is now supported across the political specter. The positive political attitudes have resulted in important institutional changes. The break-through for broad based employee ownership was the introduction of ESOPs in relation to pension savings, ERISA, in 1974. This legislation made it possible to overcome the four basic barriers for employee owned firms: *The capital problem* is solved by tax advantages and by using the company as collateral for loans to the ESOP trust taking over the company. *The risk problem* is of minor importance when ESOP savings are built on top of other pension savings. ESOP statutes solve the *entry/exit problem* by including all employees. New employees become members of the ESOP and exiting employees cash in their savings when leaving. Tax-advantaged transfers from earlier owners have mitigated *the startup problem*. This has been reflected in the US economy with a steep increase in the number of ESOPs - about half with majority employee ownership. There is a clear relation between the institutional changes and the establishment of new ESOPs.

Denmark on the other hand has been stuck in a negative circle where employee ownership has not taken off. The main explanations are: Negative myths about failing worker-coops. The labor movement, unions and SD, have been successful in securing wages and pension savings as well as influence at the workplace, but there is no pressure for the next step to employee ownership. SD tried to develop a centralized version of "Economic Democracy" in the 1970s, but it never made it through Danish politics, and SD has not developed an alternative decentralized strategy for economic and industrial democracy based on employee ownership. The center right has promoted financial participation, but only of the minority type, and even when eligible for all employees it has not spread to broad groups of employees. The parties to the left of SD favor the collective cooperative type of employee ownership. However, worker coops make up only a tiny group of small and labor-intensive companies. This indicates that the capital problem has not been solved.

The ESOP model may have strong potential in Denmark where a main barrier lies in the stigmatized political debate. Shared capitalism with profit-sharing and minority employee shares are promoted by the center-right with no intensions to create models for broad employee take-overs in the format of ESOPs, while the left wants majority take-overs with collective ownership not solving the main problems establishing employee ownership. Shared capitalism has been a political conflict area in Denmark, though not much discussed in the media. In US, shared capitalism is part of a broad specter of financial participation, which opened up also for broad based majority employee ownership. Shared capitalism and economic and industrial democracy are not substitutes, but complimentary. They may be part of a positive circle where the specter of financial participation schemes create the critical mass of experience, information, expert community and supporting organizations. Minority employee ownership may develop to majority employee ownership, and different profit-sharing and stock based schemes may be combined and used as building blocks for ESOPs and new innovative models for broad based majority employee ownership.

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