

in brief...

## Shared capitalism: does it work?

Employee share ownership and other forms of 'shared capitalism' are large and growing. **Alex Bryson** and **Richard Freeman** ask whether it leads to better performance.

Shared capitalism – in which firms reward employees on the basis of the performance of their enterprise or workplace – has traditionally been viewed as a niche part of the economy. Famous names – John Lewis in the UK, Mondragon in Spain and, at one point, the US company United Airlines – might operate in this way, but they are thought to be unusual organisations.

Our analysis shows that in the UK, the United States and elsewhere in the advanced countries, shared capitalist arrangements have increased way beyond niche status. Today, more employees have a bigger financial stake in their firms than ever before.

In the United States, 44% of employees have part of their pay linked to company performance, either through ownership, stock options, profit-sharing or gain-sharing. In the UK, one fifth of private sector workplaces have share ownership schemes covering one third of employees.

Some of the growth in share ownership in the UK over the past quarter century is attributable to tax privileges for firms that pay staff with ownership stakes. But some of the growth is also part of a movement towards giving employees more effective incentives through collective forms of pay.

Despite the United Airlines bankruptcy, overall employee ownership in the United States has not fallen. And in the UK, an increasing number of firms, some with very different ownership models, have joined the Employee Ownership Association, which represents the growing co-owned sector.

Is this any good for the economy? The narrowest view of worker behaviour says it can't be. Workers will 'free-ride' on the backs of others instead of trying harder because of the financial incentive. And under UK tax law, employees have to hold onto shares for three years before they benefit from the tax breaks: shares can go down as well as up.

What's more, worker effort and activity is only one factor influencing a company's performance. And aside from top executives, few employees have sizeable holdings that give them both a large financial stake and an influence on decision-making.

But share ownership and other forms of shared capitalism are large and growing. So do they really lead to better performance?

Isolating the effects of share ownership on performance through economic analysis is tricky. Firms do not choose the schemes randomly. Share capitalist companies may be those that have identified benefits in sharing the rewards of good performance with their employees, while other firms may have chosen to be 'lean and mean' because that pays off for them. In addition, many believe that firms with share schemes have more sophisticated managements and it is the leadership that really matters, not the scheme.

But two recent studies find that shared capitalism works for UK firms beyond the fabled John Lewis. The first, commissioned by HM Treasury, is the largest study of share ownership ever undertaken in the UK.

Linking administrative data from HM Revenue and Customs records to company performance data, the Treasury study finds that 'on average, across the whole sample, the effect of tax-advantaged share schemes is significant and increases productivity by 2.5% in the long run'. The analysis also finds that 'there are further benefits to be gained from operating several types of schemes'. And schemes chosen by firms without tax advantages tend to pay off more than those with tax breaks (Oxera, 2007).

Our research, which analyses data from the 2004 Workplace Employment Relations Survey, finds positive effects of share ownership on workplace productivity, with the effects being much more pronounced when shared capitalist schemes are deployed in combination. Share ownership has the clearest positive association with productivity, but its impact is largest when combined with other forms of shared capitalist pay.

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Image: www.flickr.com/photos/timcaynes

## Shared capitalism works in the UK outside John Lewis – and it works in the United States and many other economies too

Our findings mirror results from the United States in the 2000s. Researchers at the National Bureau of Economic Research (NBER) have surveyed tens of thousands of workers about what makes shared capitalism work more or less effectively. They find that shared capitalism improves outcomes both for companies and their staff. For example, owning company stock strongly predicts both a culture of innovation and a willingness to engage in innovative activity (Kruse et al, forthcoming).

We have learned a lot about shared capitalist schemes as a result of this research but much remains to be understood. Firms often change the specific schemes they use. The schemes also appear to have larger positive effects in some sectors and firms than in others (though there is almost no evidence of any negative effects).

Neither we nor the authors of the Treasury-sponsored study feel sufficiently confident in the magnitudes of the estimated effects to assess whether the tax privileges given to shared capitalist arrangements are socially optimal. And neither we nor the NBER researchers feel sufficiently confident that we have identified the right mix of schemes and other policies that guarantees success with shared capitalism.

But taken together, the growth of shared capitalist forms of pay and the research evidence that it pays off for both firms and employees give a picture that diverges greatly from the old view that this is just a small niche within capitalism. Shared capitalism works in the UK outside John Lewis. And it works in the United States and many other economies too.

Given the fundamental problem of ‘free-riding’ that shared capitalism must surmount to succeed, how do firms and workers manage to produce positive economic outcomes? There are two ways firms overcome this incentive problem: through workers monitoring other workers (see Kruse et al); and through the creation of corporate culture that inculcates workers with a team orientation.

This article summarises ‘How Does Shared Capitalism Affect Economic Performance in the UK?’ by Alex Bryson and Richard Freeman, CEP Discussion Paper No. 885 (<http://cep.lse.ac.uk/pubs/download/dp0885.pdf>).

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### Further reading

Douglas Kruse, Richard Freeman and Joseph Blasi (forthcoming) *Shared Capitalism at Work: Employee Ownership, Profit and Gain Sharing, and Broad-based Stock Options*, University of Chicago Press.

Oxera (2007) ‘Tax-advantaged Employee Share Schemes: Analysis of Productivity Effects’, HM Revenue and Customs Research Report No. 33.