
BUILDING A WORKFORCE OF OWNERS

"Many compensation programs directed at creating employee ownership have been adopted piecemeal without attention to other plans already in place and have not produced the desired effects."

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Employee ownership has become a key objective in reward system design for many organizations. Despite extensive use of stock-based compensation programs, our firm's consulting experience indicates that employee ownership is not growing as expected.

Employees' ownership of employer stock is low and ownership behaviors are not occurring to the degree desired by managers and shareholders.

Although most managers seek ownership behaviors from employees, the focus continues to be on ownership positions -- how much stock they own. Many employee-owned companies perform poorly and are not providing.

Most discussions of employee ownership start with legal and financial concepts: possession, a bundle of rights and responsibilities; or the organization theory perspective -- resolving the agency problem, aligning employee and shareholder interests. Yet every entrepreneur knows true ownership results in a very different set of behaviors and attitudes, such as a sense of possession, problem-solving initiative, and long-term thinking. It is this entrepreneurial type of ownership managers seek to instill in employees.

Often stock-based compensation programs are implemented for reasons other than to create true employee owners. Financial restructuring, senior management philosophy, or mere fad-following often drive these efforts. Many current compensation design trends are intended to produce employee ownership and the associated attitudes and behaviors, however, either through direct transfer of shares or sharing of the economic benefits of ownership. But, as many organizations have been dissatisfied with the outcome of incentive compensation programs, disappointments with ownership-oriented programs are widespread as one of three outcomes unfolds:

Employees are awarded equity-based forms of compensation, which are quickly converted into cash rather than an ownership position

Employees retain the equity awarded, by choice or by requirement, but the value or potential value is insignificant compared to other forms of compensation and benefits and the employee's overall financial position -- with no feeling of ownership created

Employees have a significant opportunity to share the economic benefits of ownership, but still do not think and act like owner

Why are Employees not Owners?

Since the separation of capital from labor during the industrial revolution, few employees have had a significant ownership position in their employing enterprise. Before embarking on the ambitious effort to convert a workforce of employees into employee-owners, we must realize that several forces work against this:

Economic research indicates individuals are risk averse, loss averse, and tend to "satisfice" (settle for "good enough") rather than maximize -- and taking cash now is safer than long-term stock ownership. The research also suggests that the value of a possession is perceived as greater than what is not possessed -- meaning that an opportunity to purchase stock is often likely to be ignored

Behavioral research tells us employees must see a clear link between effort and performance, performance and reward, and between the form of reward and what they value. These links are very difficult to achieve with equity-based plans, leading to further avoidance of ownership

Common sense leads us to conclude employees already receiving a valuable guaranteed package of salary, insurance, retirement benefits, and paid time off in return for reasonable performance are unlikely to engage in entrepreneurial levels of time commitment, effort, risk taking, and financial investment to achieve a relatively small and uncertain reward.

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In fact, existing compensation programs go a long way in discouraging ownership. The current mix of programs in most organizations produces not shareholders, but the equivalent of bondholders. Through a combination of base salary, benefits, paid time off, and retirement plans with limited or no performance-based pay, employees receive a guaranteed stream of payments, indexed for inflation, with no real upside potential, unrelated to organization performance and a small probability of total loss.

Many compensation programs directed at creating employee ownership have been adopted piecemeal without attention to other plans already in place and have not produced the desired effects. For example:

Employee Stock Ownership Plans. ESOPs have received the most attention in employee ownership discussions, yet they have been used more as a financial transaction tool than as an employee ownership incentive. While some success stories exist, an ESOP alone rarely has the economic significance required to support ownership initiatives.

Executive Stock Ownership Guidelines. Most of these seemingly aggressive guidelines (such as 5 times base salary) pale when compared to stockholdings of executives in entrepreneurial organizations, and require owning only a fraction of what could be accumulated through the company's various compensation programs.

Broad-Based Stock Option Plans. All-employee option plans have been a cornerstone of compensation strategy in the technology sector for many years. As these plans have spread to other industries and to larger companies, they have been viewed as an employee ownership approach. Yet more than 90% of employee options are exercised as soon as vested, with the majority cashed out at exercise. While the reward is a result of stock price increases, most options are liquidated over the 3- or 4-year vesting period. And there is no downside risk when these plans are added-on to the existing compensation structure.

Retirement and Savings Plans. Profit sharing and 401(k) plans frequently offer opportunities to invest retirement funds in company stock, but they are typically add-on plans; and regulatory limits on contributions prevent significant amounts of stock from accumulating in these plans.

Employee Stock Purchase Plans. Elective in nature and limited in the amount available, these programs are a nice add-on for those who wish to invest but are insignificant in the overall reward structure.

Restructuring Compensation Strategy

Without the luxury of beginning with a blank slate -- as start-up companies do -- existing organizations must face the need for a fundamental restructuring of the total compensation and benefits program, supported by changes in organization and management processes, to convert worker inertia into owner momentum.

The first step is recognizing that the current system has attracted and retained non-owners, and most current employees may not want to be owners. Even if interested, few will voluntarily increase the financial risk and uncertainty in their lives for the uncertain promise of future gains.

Changing compensation programs to create ownership behaviors requires both adding new incentives and removing old ones. Incentive does not mean bonus, it means all the reinforcers that create and sustain current behaviors, from sick days to retirement plans to base salary. Every element of the current compensation and benefits program provides an opportunity to reinforce an ownership culture. The movement toward more variable and fewer fixed forms of pay, more equity and less cash, and integrating ownership policy with compensation policy all require a cohesive set of efforts "Changing compensation programs to create ownership behaviors requires both adding new incentives and removing old ones."

In established organizations, creating an ownership culture may call for changes that some will view as drastic. Yet, many shareholders believe companies that do not create economic value and consistently deliver superior returns are in a situation mandating drastic measures.

Seven Requirements for Creating Ownership Through Reward Systems

Consistent Reward Strategy

The entire organization must play by the same set of rules -- from the board of directors to senior management to each employee. A top-down commitment to ownership is critical. And, as organizational boundaries blur along with the concepts of employment, outsiders such as consultants, contractors and vendors may need to be included in equity-based variable pay arrangements.

Integrated Performance Management Program

The overall performance management process -- goal-setting, coaching, performance evaluation, and all forms of reinforcement -- must center on ownership. Clarifying individual performance impact on company results, tying all forms of compensation to results, and linking reward policy to ownership policy -- the performance management process is the glue that holds together all of these pieces of policy and strategy.

Significant Magnitude of Economic Value

The value of ownership compensation must be significant in relation to total compensation and benefits value and to the employee's overall financial position. A \$100 bonus to a \$100,000-a-year employee will not change behavior, just as a stock bonus equal to 3% of salary will not. The potential value of ownership compensation must be substantial in absolute terms as well, considering the basic financial requirements of and lifestyle impact on the employee.

Upside Opportunity and Downside Risk

Ownership involves risk, and few equity-based compensation programs provide for this. For the same reason executive stock options are beginning to be replaced with, and supplemented by, stock purchase requirements, employees must be at risk if the ownership position is to create and support ownership behavior.

Immediate and Durable Ownership

Entrepreneurs are owners from day one, and often continue to be owners past the time their managerial role ends. Ownership as a condition of hire, continuing investment expectations, and portability result in an ownership opportunity with a greater sense of permanence. Company stock needs to be an inherent part of retirement planning and preretirement financial planning, as well as a part of the daily vernacular of the organization.

Proactive and Ongoing Business Education for Employees

Just talking about stock price is not an ownership behavior. Doing something about the stock price is. Employees must understand company goals and strategies, the key drivers of value, and the connection between actions far down in the organization to company goals and share value. Whether or not they have been "empowered", employees who understand the business and have a personal stake in its success will operate more effectively

Proactive and Ongoing Financial Education for Employees

For ownership compensation programs to be well accepted and understood, employees must be schooled in the company philosophy on ownership, key concepts of risk and return, long-term market trends, and the like. Financial planners often give advice contrary to the spirit of employee ownership; employers must provide information and education so employees can see the advantages and understand the risks.

Achieving these seven requirements takes time and effort, yet perhaps less than developing and implementing existing programs and managing the often undesirable resulting behaviors. Viewing a company's current reward and performance management structure in the context of these seven principles will highlight the source of most behaviors exhibited by employees who are not owners.

Employees will not approach their jobs with the level of focus, sense of urgency, and degree of commitment required for success in the increasingly competitive business environment until they have a true owner's perspective. Merely restructuring the reward systems is a necessary but not sufficient step toward creating and sustaining ownership behaviors. Without changing the reward structure, results of leadership and management processes will be short-lasting and remembered as "just another program."

Every organization's reward structure presents dozens of opportunities for revising methods of delivering pay to employees to support new ways of managing -- such as information sharing, increased participation in problem-solving and decision-making, and team-based structures. Pursuing these solutions will enable any organization to prosper as an economically effective and socially desirable employee owned company.

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