

# ESOP

EMPLOYEE STOCK OWNERSHIP PLAN

## The Bosses Dream



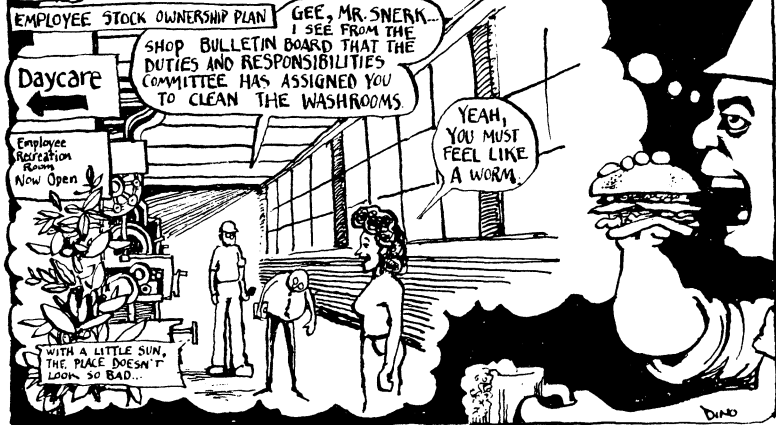
# ESOP The Workers' Dream

EMPLOYEE STOCK OWNERSHIP PLAN

Daycare

Employee Recreation Room Now Open

WITH A LITTLE SUN, THE PLACE DOESN'T LOOK SO BAD...



# 6

## Who Will Benefit from ESOPs?

■ *Joyce Rothschild-Whitt*

In the past decade, the number of worker-owned firms or ESOPs (Employee Stock Ownership Plans) has been growing geometrically. The national law granting tax incentives to ESOPs was passed in 1975, and since then several other pieces of legislation promoting employee ownership have passed at the federal level and in eight state legislatures. As a result of the technical assistance and industrial revenue bonds that some states now provide for ESOP development, and as a result of demonstrable tax, productivity, labor relations and even marketing advantages, business has taken note of the ESOP option. Several thousand ESOPs have started and scores of reports on employee ownership have appeared in the popular press and in business and trade publications.

Although the most widely discussed worker-ownership cases have emerged in response to the threat of a plant shutdown, the National Center for Employee Ownership finds that, in fact, only 18.5% have arisen as buy-outs of endangered companies. Indeed, most ESOPs have been developed in brand-new companies because of their financial, marketing and productivity advantages, or they have been used as a means of selling an established and viable company to its employees, sometimes as part of an estate

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plan as the owner of a privately-held firm approaches retirement. Again, the law provides attractive tax incentives for doing so.<sup>1</sup>

The first wave of ESOP development (1975-80) was mainly initiated by business, but there is evidence that a second wave is now underway, post-1980, eliciting substantial worker and union involvement. This paper will show that ESOPs are not all alike, that in fact, the ESOP is a flexible instrument with the potential to move in several different, if not contradictory, directions.

Some people argue that ESOPs, and other forms of worker ownership, are inherently cooptive devices meant to undermine worker solidarity. Others argue that worker ownership inherently confers worker control. I will argue that the future form that ESOPs take, and who they will come to benefit, is not set in concrete. While it is true that existing ESOPs often serve managerial interests, ESOPs can be made to serve the needs of workers and communities, too. *The outcome will depend upon what actions workers, unions and communities take.*

### **Union Views of ESOPs**

Two surveys tell the story of how union views toward ESOPs are changing. The first survey, conducted in 1977, asked national union leaders for a general assessment of employee ownership. Three-quarters of those surveyed were "basically negative." Three years later, however, a survey of trade union leaders found only 29% negative to employee ownership. Moreover, there was a marked difference between those international officers whose locals had some experience with employee ownership and those who had not. Virtually none of the respondents who had observed worker ownership in one or more of their locals expressed disapproval,<sup>2</sup> suggesting that as trade unionists acquire more experience with worker ownership, their attitudes are getting more positive.

I believe that trade unionists' increasingly favorable (or decidedly less negative) view of worker ownership reflects objective changes taking place in the types of ESOPs being created.

In the early days of employee ownership (the 1970s), the union position could best be described as ambivalent. Worker ownership was not the unions' issue. It was not conceived, designed or even anticipated by the unions. It was conceived by conservatives who believed that broadened ownership could revitalize or stabilize capitalism, and was translated into a set of legal tax advantages designed to make business stop and take note.

But in the late 1970s as industrial shutdowns spread, particularly in unionized firms, worker ownership quickly won the support

of many local managements and local unions. Under the cloud of threatened job loss, issues of job security naturally move to the fore, and workers' ownership had *prima facie* appeal to workers who would otherwise lose their jobs. After the appropriate feasibility studies indicated that an operation could be viable if reorganized under the terms of an ESOP, we witnessed numerous cases where local management and working people worked cooperatively to mobilize the necessary financial and community support to "save" the plant. This process, at least for the time being, brought management and labor together in a unified cause, but what did it do for workers and unions?

In the mid-1970s, international union leaders had some difficulty formulating a stance on worker ownership. On the one hand, it would be unseemly for union leaders to oppose an effort that stood a chance of preserving jobs. On the other hand, they had at least four good reasons to suspect the whole idea. First, some trade unionists recalled that unions had supported the formation of worker cooperatives in the nineteenth century without much success. Second, national union leaders feared locals that survived by way of an ESOP would be forced to take substantial pay reductions, which could undermine the wages and benefits generally prevailing in an industry. Third, ESOPs had sometimes entailed the dropping of hard-won pension plans. The substitution of ESOP stock in a possibly shaky employer for a more diversified set of pension investments struck many trade unionists, quite justifiably, as risky. Beyond these concerns, trade union leaders worried that the union might have no place in an employee-owned firm. This was expressed in the often repeated statement, "you can't bargain with yourself."

Ironically, as economic conditions set the stage for the explosive development of employee ownership, unions were caught without a policy and without any in-depth information on the subject. The national unions could not help but be concerned about job preservation, but the apparent contradiction between collective bargaining and worker ownership left them so immobilized that they were generally of little help to local unions in formulating ESOPs. This left the initiative in the hands of local managers, who were soon followed by local workers and community leaders. The fact of management initiative then became another reason for suspicion by the international unions. The notion that the traditional adversarial relationship might be suspended in favor of cooperation understandably brought fears that management would use this as an opportunity for productivity speed-up, without sharing the productivity gains with the workers.

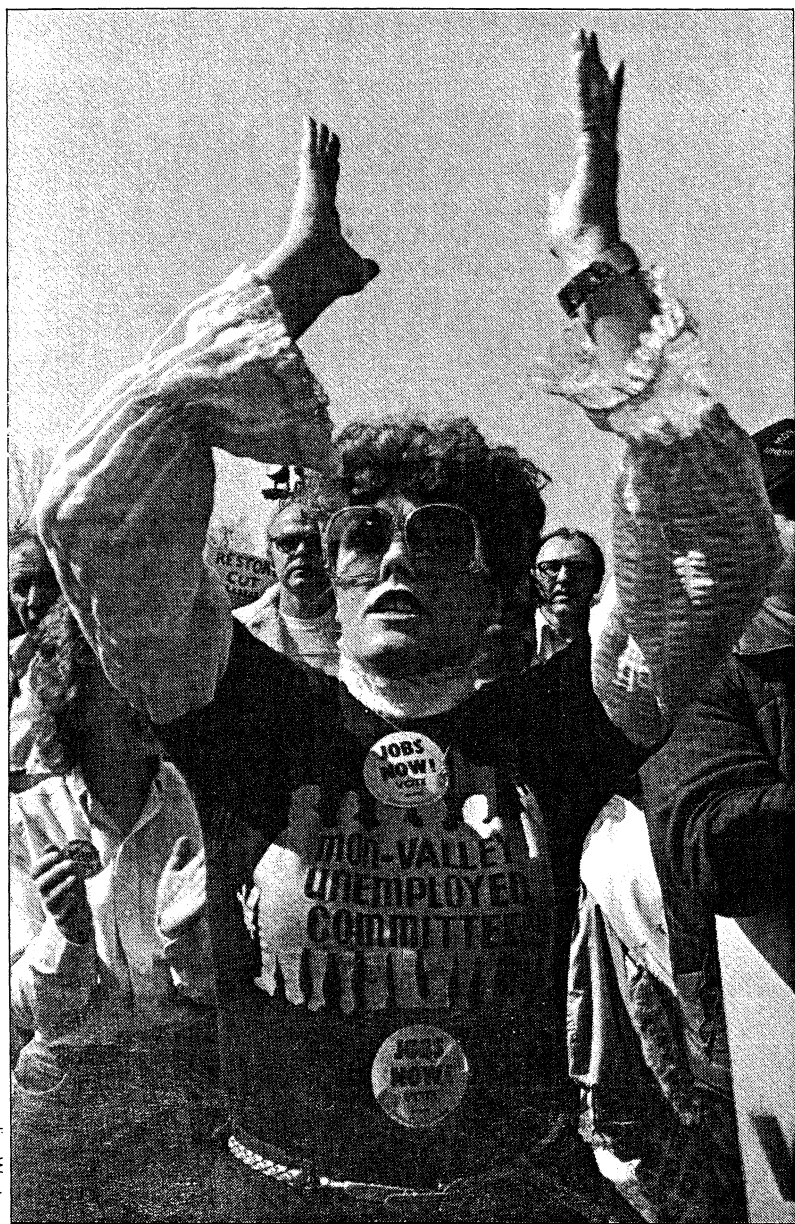
Indeed, most of the ESOP cases initiated by owners and managers in the 1970s did not extend formal voting rights to workers, much less democratic participation. Studies found that in management-initiated cases, managers were ordinarily so preoccupied with legal, financial and technical concerns that they failed to consider what social and organizational changes the new ownership structure might imply.<sup>3</sup> A recent survey by the National Center for Employee Ownership estimates that perhaps 50% of the majority worker-owned firms provide for full voting rights, but that refers only to voting one's stock, which is nearly always unequally distributed.<sup>4</sup> An earlier survey of 299 manager-initiated ESOPs established in 1975-76 found that in only 3% of the cases were the ESOP trustees selected by the employees, and only 21% of the companies gave the ESOP participants full voting rights. When managers were asked why they had instituted the ESOP, 51% said they wanted to improve productivity, 35% wanted to finance company growth, and 8% admitted to wanting to avoid unionization.<sup>5</sup>

### **So What's Changed?**

Since 1980, precisely *because* unions have become more actively involved in the worker ownership issue, we have seen very different types of cases develop. These recent cases provide a signal of what unions and workers can hope to gain from ESOPs.

There are at least two ways in which the ESOP form of ownership can be used to advance worker and community interests. It can be used to enhance the material well-being and job security of the worker, and where ESOPs are used as an alternative to shutdowns, this spares the community the devastating "multiplier effect" wherein several jobs may be lost in the community for each job lost in the actual shutdown. Second, ESOPs can be used to extend the sphere of worker influence in the workplace, and this should make the content of pricing and product decisions more responsive to public need.

To illustrate, consider the new bargaining strategy used successfully at several of the airlines. It started with Pan Am. On the brink of financial collapse, Pan Am claimed it needed wage reductions in order to survive. The claim was credible, but the union leaders countered by demanding stock in exchange. Ultimately the workers negotiated a 12% voting interest in Pan Am, receiving \$3 worth of stock for every \$9 sacrificed in pay. Now that Pan Am is solvent again, the stock is worth \$5, so the employees have made back nearly two-thirds of their original pay cut. And Dick Phenneger, who led the union bargaining effort,



Jim West

reports that the employees are using their 12% interest in Pan Am to influence corporate policy. Inspired by the Pan Am example, employees at Western Airlines insisted on stock in return for a pay cut they would have had to take anyway. They won an 18% share of the company, with full voting rights. Similarly, employees at Eastern got a 25% ESOP. The extent to which this strategy has spread throughout the airline industry in less than two years is indicative of its potential.

The UAW has been the first major national union to suggest worker ownership in its contract talks. Arising again in a time of crisis, the Chrysler Loan Guarantee Act provided Chrysler employees with 15-20% of the total company stock. The UAW made the argument to Congress that if the government is going to make loans to private corporations, the cost to the taxpayers is more justified if the benefits of the loan are spread more broadly to the workers rather than concentrating only on the investors. Over 1981-82, \$81 million worth of Chrysler stock was allocated to the employees. Because of Chrysler's comeback, that stock quadrupled in value, and now holds a valuation of approximately \$350 million, the total value of the sizable concessions that the workers made.<sup>6</sup> In addition, Doug Fraser, former president of the UAW, was put on the board at Chrysler.

Since there is no reason to believe that contract concessions in the auto or airline industry would have been any smaller had the workers *not* gotten stock in return, the unions' insistence that companies match any wage concessions with stock has been a plus for workers and a very important new bargaining strategy.

The other way in which unions are just beginning to use ESOPs to further worker interests is in recent attempts to establish "democratic ESOPs." The pioneering case of this kind, and one that has received a great deal of attention in both union and business circles, is Rath Packing Co. in Waterloo, Iowa. After a long corporate decline and substantial worker sacrifices in wages during the 1970s, the company asked the workers to take even deeper cuts in 1979. The union leaders, representing the United Food and Commercial Workers, refused, unless a transfer of ownership and change in management could be gotten in return. This case differs from many others in that it was the local union that took the initiative.

After extensive negotiations, a complex plan was worked out whereby the workers would have \$20 per week deducted from their pay in return for 60% of the Rath stock, with 50-50 profit sharing between the company and the workers. What makes this plan the first of its kind is the provision that workers elect their

Board members on a one worker-one vote basis, not on the basis of number of shares owned. Final approval of the ESOP came in December of 1980, and subsequently union and management worked together to effect major changes in labor-management relations, from the shop floor to the boardroom. With the assistance of researchers from Cornell University "action-research teams" were set up in many departments, and after training in group process and problem-solving skills, many of these teams made impressive productivity improvements, without which the company could not have survived. Groups have been involved in everything from strategic planning, to the types of new machines that should be bought, to safety issues. Arising out of a truly desperate situation (where employee ownership would *not* ordinarily be counselled), the involvement of the workers in the ownership and decision making at Rath is credited with substantial productivity gains.

Recently, however, Rath has suffered severe financial strains (including filing for bankruptcy), and in this context, labor-management relations have deteriorated, grievances have gone up, and the action research teams have been suspended. Union leaders blame ineffectual labor representatives on the board and inadequate worker education for worker ownership, but still maintain that the democratic ESOP plan was "perfect." (See interview with Gene Redmon and Chuck Mueller elsewhere in this issue of *Labor Research Review*.) To me this case underscores the importance of considering the market before going into an ESOP or any other business. At Rath wage cuts, productivity gains, an intense and cooperative desire to succeed, and a well-designed ESOP forestalled but could not block a basic market failure.

Following the lead at Rath in setting up a democratic ESOP, UAW Local 726 organized a \$53 million buy-out of a bearing plant from GM. The 100% worker-owned company, now called Hyatt Clark Industries, was established in October 1981. Workers put up \$100 each to hire an outside consultant to do a feasibility study. Based on the results of the study, the workers agreed to a 100% ESOP, with a 30% reduction in wages, about half of which is expected to be made up through a profit-sharing plan. What makes this plan unusual is that the shares are *not* allocated differentially according to wages. Everyone gets an equal share of stock, and therefore, an equal voting right (although they cannot vote the stock until 1990). The initial board has three union representatives, but over time (recall that ESOPs only gradually transfer ownership) workers will elect the whole Board. Although the International UAW took a neutral or indifferent stance in this case, they did learn from



it and in the 1984 cases involving UAW members (Atlas Chain and Seymour Specialty Wire) the International UAW actively fostered worker ownership.

The brand new "O & O" stores in Philadelphia (so named because they are worker-owned and operated) represent yet another unprecedented scheme for democratic worker ownership. In this case, when A & P announced that they would shut down many of their stores in Philadelphia, the United Food and Commercial Workers representing 2000 members who would have lost their jobs, actively put together and ultimately ratified a collective bargaining agreement whereby A & P will contribute 1% of gross sales at its Super Fresh stores to a union-controlled trust to be used to finance worker cooperatives. The union has options on a number of A & P properties and is determining which would be most viable, and it has rights-of-first-refusal on the leases of remaining stores should the company decide to sell or franchise them in the future. In October 1982, the union opened up the first couple of stores. They are set up as worker cooperatives with ownership as a condition of employment, one worker—one vote, and full participation in policy and planning. Although workers must make an investment of \$5,000 in the coop (these are not ESOPs), worker interest in joining is very high, and sales are reportedly good.

Finally, in the most ambitious example to date, the heads of 13 unions representing the employees of Conrail are acting in concert to put together a proposal for a worker buy-out of Conrail. Last year the government announced that it would sell Conrail by the end of 1984. Whether or not the union-sponsored bid is accepted, at least partial employee ownership seems likely, making Conrail the largest case of its kind, with some 40,000 employees. It is the first case where the heads of national unions have initiated a bid to buy a company that is not failing.

All four of these cases, started between 1980 and 1984, contrast sharply with the sorts of cases we saw in the 1970s. They were initiated and actively organized by local unions, not by management. The internationals assisted or took a neutral stance, in contrast to a case like South Bend Lathe in the mid-1970s, where the International was hostile to the conditions of the ESOP and the local's role in it. These four recent cases were union-sponsored, and as a result, the worker-ownership brought with it worker voice in company affairs, access to information so that workers could oversee their investment, formal positions on the Board, and democratic voting rights.

### **The Future is Made, Not Predicted**

The idea of worker ownership has attracted diverse constituencies in the U.S., including politicians from the left along with those from the right, owners and managers along with workers, church and community leaders. Like many important social inventions in their early stages of development, worker ownership could develop in a number of different directions in the U.S., depending upon which of its constituencies manages to shape the issue.

There can be little question that worker ownership carries the potential to benefit workers and their organizations. Recall that the transfer of ownership in the ESOP is gradual. As the principal on the loan is repaid, the shares are allocated to the employees. It would not be unusual, for example, for it to take 18 years for 51% of the stock to be released in this fashion and 25 years for 100% of the stock to be allocated. In studies in which I participated at Cornell University, we found that workers in the 1970s tended to go into ESOPs with vague expectations of more say and more respect in the firm and that management tended to go in thinking it would give them a more motivated or compliant workforce. Without either side making specific plans to accommodate these rather inchoate expectations, hopes got dashed and industrial relations deteriorated. Nevertheless, as the ESOP mechanism distributes stock slowly, workers have a long time before they become majority owners. Over time workers may well recognize that ownership and voting rights provide a legal foundation upon which they can mobilize for greater information, greater voice, and more socially useful products.

Management and small business owners were quick to grasp ESOPs, as were workers who were facing job loss. The unions took a few more years, but they too seem to be coming around to worker ownership—not out of some *a priori* ideological commitment, but out of the practical opportunities it offers for job preservation, for getting shares of stock in return for concessions that would be exacted anyway, and for advancing democratic control of the workplace. The outcomes for the individual worker-owned firms and the outcomes for this movement as a whole depend to a great extent on who stays involved in bringing the changes about.

If workers and their union representatives continue to take the initiative in planning and developing ESOPs, as they did in the four post-1980 cases discussed in this article, we can expect to see more majority worker-owned firms, with more worker control on

the shop floor, more access to corporate information, and more avenues for worker and community voices at higher levels, including the Board room. Following the example of Rath Packing, we will see the development of more "democratic ESOPs," utilizing the cooperative principle of "one worker—one vote."

On the other hand, if management continues to dominate the planning of ESOPs, we can expect to see more ESOPs with minority worker ownership stakes and without any special avenues for worker participation. In this case, the ESOP will come to be seen by all concerned as a simple supplement to wages like a profit-sharing plan or a pension, signifying no essential alteration in the social relations of production. The future of worker ownership will be determined by those constituencies who remain actively involved. ♦

<sup>1</sup> For a description of how ESOPs work as a legal mechanism for the gradual transfer of stock to employees, the specific kinds of tax advantages contained in the ESOP law, and why ESOPs have been attractive to business as a means of debt finance as well as deferred compensation, see the article by Rothschild-Whitt in *Research in Social Movement, Conflict and Change*, Vol 6, JAI Press, 1984.

<sup>2</sup> The 1977 survey was conducted by Robert Stern and Ray Ann O'Brien at Cornell University, and reports on responses from 49 international union presidents or research directors. The 1980 survey was conducted by Joseph Blasi, Doug Kruse and Eric Asard at Harvard University, and received responses from 42 union officers.

<sup>3</sup> A number of studies of such cases were conducted through the New Systems of Work & Participation Program at Cornell University.

<sup>4</sup> Reported in the March 1983 newsletter of the National Center for Employee Ownership.

<sup>5</sup> This survey by Thomas Marsh and Dale McAllister is reported in *Employee Ownership*, Vol. 1, No. 3, December 1981, pp. 5-6.

<sup>6</sup> Stock prices quoted are as of November 2, 1984.