Shared Capitalism: What is it and What Does it Do?

Alex Bryson (UCL – a.bryson@ucl.ac.uk) and Richard Freeman (NBER and Harvard)

We all know that people respond to incentives. Economics 101 teaches that workers put forth greater effort when these efforts are rewarded financially, and top talent tends to gravitate toward jobs and firms where rewards are geared to performance.

For the most part, however, the research that's led us to these conclusions has focused on performance incentives for individual workers, such as piece rates, merit pay, individual commissions, or bonuses.

Today's reality is different. Since the mid-2000s, broad-based shared capitalist programs – in other words, programs where firms offer profit-sharing and employee ownership to non-managers as well as managers -- have spread to cover more employees than traditional forms of individual performance-based pay in Europe and the United States. The research has taken time to catch up. But we're finally starting to get a better picture of the impact these incentive programs have on rewarding all workers for the good performance of firms or teams -- and which systems work in retaining talent and improving firm performance.

First, a bit of history. Until the latter part of the 20th Century firms were organised in a top-down hierarchical fashion using production techniques that broke down job tasks into their smallest components in what came to be known as a Taylorist, or Fordist, method of production. Under these conditions it made sense for firms to pay piece-rates to incentivise workers: Why link financial incentives to groups, teams, or organizational performance when production wasn't set up in that way and if it risked enticing workers to "free-ride" on the efforts of more industrious co-workers? But that began to change in the 1980s, most notably with the success of Japanese manufacturing multinationals like Nissan, who brought in new systems characterised by team production in which workers had some autonomy to organize the pace, order and timing of tasks. These systems called for group incentives: If it was the collective performance of workers that improved productivity, it started making more sense to reward teams of workers since it was the outcome of their collective performance that managers were monitoring.

Something else was also going on at the same time: Many firms, especially blue chip firms, wanted their workers to share in the company's prosperity through profit sharing or co-ownership. They saw it as part of "stakeholder capitalism", in which corporations responded to the interests of all their stakeholders, including workers. Government support for such ideas quickly followed: In France, profit sharing is compulsory for the largest firms. In other countries, including the U.K. and the U.S., tax breaks have helped support profit-sharing and share ownership schemes. For instance, individuals who become part of all-employee share ownership plans (ESOPs) are given tax breaks to own their company's stock. The introduction of ESOPs also changed the equation by giving employees a financial stake in their firm that came with voting rights and opportunities to participate in company governance.

All of this progress doesn't answer some key questions, however: Does shared capitalism actually work? And more specifically, does it boost productivity? To help answer this question, the National Bureau of Economic Research undertook a huge program of research with companies using such schemes to try to understand why firms adopted these practices, what they expected from them, and what they got. The conclusion from this body of work, together with similar work conducted in the UK and elsewhere, is that such schemes can and do work, often when combined with supportive management practices. This research found that three of the most prevailing concerns about the efficacy of team incentives were more myth than reality.

The first is the aforementioned "free-rider" problem. This turns out not to be such a big deal, primarily because participants tend to informally monitor their co-workers, enforcing reasonable levels of effort among the group. The second is the "line of sight" problem that arises when worker pay is linked to organizational performance: Why would workers focus closely on their tasks when the minutiae of what they do may seem like it would have little impact on the overall output of a much larger firm? Although this sounds like a reasonable objection in principle, it doesn't seem to be important in practice. Study after study shows those workers belonging to ESOPs and group-based pay schemes tend to identify more strongly with the firm than those on standard fixed pay contracts, and they tend to work harder as a result..

The third is workers' concerns about fluctuations in their earnings due to events that may have nothing to do with their effort, like the case of a substantial shock in the demand for a good or service. Although this seems like a reasonable concern, studies do not find much of an association between risk aversion and the propensity of workers to enter into share capitalism.

In addition to debunking these myths, research also points to some important motivations behind why group incentives work. For example, some forms of share capitalism are viewed more as gift-exchanges between the worker and the firm. In other words, the company offers something for free, such as shares, in anticipation of worker reciprocation in the form of additional effort. These feelings of reciprocity are often linked to perceptions of fairness and justice underpinning the contractual exchange between labour and rewards, and they can generate organizational commitment and loyalty in a way that a simple bonus or raise cannot.

Our own recent research also indicates that share capitalism can improve job satisfaction. This is the case even controlling for the additional income a worker can derive from group incentive plans. This suggests that workers derive value from sharing ownership in their firm over and above the value they get from making additional money. We show the effect is partly related to the warm glow employees feel in response to the "gift" of free or discounted shares, and partly due to the effect ESOPs have in dampening the negative wellbeing effects of what we typically think of as "bad" aspects of job quality. Importantly, individual performance-related pay plans do not have this positive wellbeing effect: they can incentivise through income, but they don't affect worker wellbeing in the same way as shared capitalism programs.

While we're learning a lot more about how group incentive programs work, there is still a lot we don't know. For example, we don't know whether it's simply that "good" firms and "good" workers participate in shared capitalism, leaving open the possibility that they may not increase productivity everywhere. But hopefully, as our society seeks to build better ways to incentivize employees, economists and policy-makers alike will spend more time and energy experimenting with shared capitalist incentive systems to further our understanding of what works and why.

References/further reading

Blasi, J. R., Freeman, R. B., Mackin, C. and Kruse, D. L. (2008) “Creating a Bigger Pie? The Effects of Employee Ownership, Profit Sharing, and Stock Options on Workplace Performance”, NBER Working Paper No. 14230 THIS IS ONE OF TWO PAPERS FOR THE LINK IN PARA 7 ON ‘STUDY AFTER STUDY’

Bryson, A., Clark, A. E., Freeman, R.B., and Green, C. P. (2016) "Share Capitalism and Worker Wellbeing", *Labour Economics,* 42: 151-158 THIS IS THE LINK FOR ‘OUR OWN RESEARCH’ IN PARA 10

Bryson, A. and Freeman, R. B. (2010) 'To join or not to join? Factors influencing employee share plan membership in a multinational corporation', in T. Kato (ed.) *Advances in the Economic Analysis of Participatory & Labor-Managed Firms, Volume 11*, pp.1-22, Emerald Group Publishing Limited THIS IS THE STUDY FOR THE LINK ON RISK TAKING IN PARA 8 WHICH SAYS ‘STUDIES DO NOT FIND MUCH OF AN ASSOCIATION’

Bryson, A. and Freeman, R. B. (2014) "Employee Stock Purchase Plans: Gift or Incentive?", IZA Discussion Paper No. 8537 THIS IS THE LINK FOR GIFT EXCHANGE IN PARA 9

Bryson, A., Freeman, R.B., Lucifora, C., Pellizzari, M. and Perotin, V. (2013). "Paying for performance: incentive pay schemes and employees’ financial participation" in T. Boeri, C. Lucifora and K. J. Murphy (eds.) *Executive Remuneration and Employee Performance-related Pay: A Transatlantic Perspective*, Oxford University Press Oxford: Oxford University Press THIS IS THE REF FOR THE LINK ON EUROPE AND THE US IN PARA 3

Freeman, R. B., Kruse, D. and Blasi, J. (2008) “Worker Responses to Shirking Under Shared Capitalism”, NBER Working Paper No. 14227 THIS IS THE REF FOR THE LINK ON FREE-RIDING IN PARA 7

Klein, K. J. (1987) “Employee stock ownership and employee attitudes: A test of three models”, Journal of Applied Psychology, 72, 2: 319-332 THIS IS ONE OF THE TWO PAPERS FOR THE LINK ON PARA 7 FOR ‘STUDY AFTER STUDY’

Kruse, D., Freeman, R.B. and Blasi, J. (2010) *Shared Capitalism at Work: Employee Ownership, Profit and Gain Sharing, and Broad-based Stock Options*, Chicago: University of Chicago Press THIS IS THE LINK FOR PARA 6 ON SCHEMES THAT WORK