

ARE EMPLOYEE SHARE OWNERSHIP PROGRAMS REALLY IMPROVING ORGANISATIONAL PERFORMANCE?

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Abstract

This paper examines the findings on employee share ownership programs' (ESOP) influence on organisational performance among Australian firms. The ESOP anticipated benefits that lead to superior organizational performance measured by traditional key accounting ratios are primarily based on a research conducted in the USA. Since there is no evidence of a similar research conducted in Australia, a quantitative study explored links between employee share ownership participation and organizational performance among Australian firms. The findings are opposed to the common understanding among academics and business people today that ESOP significantly contribute to an improved organisational performance.

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INTRODUCTION

ESOP are emerging as means of improving organizational performance among Australian firms. Despite the anticipated benefits very little research in this respect exists in Australia. Literature emerging from the USA indicates that employee ownership is linked to superior organizational performance, as measured by traditional key accounting ratios. In contrast, traditional management literature opposes the participative approach represented by ESOP and disclaims potential benefits by citing inefficiencies in motivating employees and reduced managerial authority.

This paper explores possible links between the existence of significant employee share ownership and organizational performance. As we develop our framework, we explain the methodology used to measure organisational performance by a number of financial performance indicators. Further, we discuss the research findings and develop some insight into the effectiveness of ESOP on influencing financial performance, thus bringing this issue into the Australian business arena. The paper ends with concluding remarks and further research interests.

LITERATURE REVIEW

ESOP as a part of a participative management strategy that aims to enhance productivity and competitive performance of organisations have been a matter of an increasing interest among scholars for last two decades.

Fiore (1990, 6) defines ESOP as an employee "contribution plan designed to invest primarily in the stock of the company providing benefits to both the sponsoring corporation and the participating employees". Blasi, Conte and Kruse (1996) state that ESOP are unique reward systems. Such systems endeavour to motivate employees, increase participation, and enhance productivity to improve organizational competitive advantage. In other words, ESOP tie employee income and wealth to company performance. ESOP also decrease employee-management conflicts and encourage employee effort, cooperation, and information sharing (Blasi, et al, 1996).

Many research projects establish that ESOP are effective in improving profitability, share price and other financial measures by creating increased motivation, participation and commitment of employees owners (Anderson, 1995; Allen and Helms, 2002; Blasi et al 1996; Brown, Fakhfakh, and Sessions, 1999; Fiore, 1990; Godfrey 2000; Park and Moon, 1995; Sesil, Kruse and Blasi, 2001; Wilson and Peel 1991; Smith, Lazarus and Kalkstein 1990). Other research suggests that there is no significant link between organizational performance and ESOP or non-ESOP firms (Sesil et al, 2001). Although more rare, some studies did find a negative or negligible impact of ESOP on performance conflicts (Blair and Kruse, 1999). Consequently, there is still considerable debate as to whether the increased participation and motivation possibly resulting from ESOP translate into increased organizational performance. Furthermore, the applicability and relevance of the findings of foreign research on Australian organization has yet to be established.

In Australia an interest to apply ESOP came with the changes of legislation in 1974 in favour of bipartisan government. Since that time there has been a continuing increase in the number of ESOP within Australia's corporate community. According to the Australian Government publication *Shared Endeavours* the employee ownership is still at an early developmental stage in Australia. In 1997 there were in excess of 500,000 shares owned via ESOP, with that number having grown considerably since (Shared Endeavours, 2000, 17). Shared Endeavours further argues that the use of ESOP is not merely to provide a bonus to employees, but rather an important element in increasing organizational profitability.

Our research into the impact of ESOP upon organizational performance was focused on the relative financial benefits of ESOP. Analysis was conducted upon various accounting ratios, as administered in previous studies from the USA including Kruse, Freeman, Blasi, Buchele, Scharf, Rodgers and Mackin (2003), Allen and Helms (2002), Blasi et al (1996), Park and Moon (1995), Iqbal, Hamid and Tin (2000), Conte and Svejnar (1990) and Bhargava (1994). In developing this paper we addressed the following research question:

“Do Australian firms with higher employee share ownership plan participation rates exhibit improved financial performance as measured by common accounting ratios?”

METHODOLOGY

In answering the research question we achieved the objectives of determining the impact of ESOP on key performance indicators including profitability, liquidity, gearing ratios, investor ratios and share analysis.

In this study we have adopted a deductive research design with the objective of revealing relationships between the variables of interest. Such approach enables concepts to be measured quantitatively and allows for generalizations over a population (Saunders, Lewis and Thornhill, 2003). Furthermore, this study is exploratory in nature. Hence, we used quantitative analysis of secondary data to probe for connections between our two key variables, ESOP participation levels and accounting ratios.

Organizational performance can be measured in a variety of ways, including financial and non-financial performance measures. This study focused solely on financial measures as a means of evaluating organizational performance. Allen and Helms (2002) state that many researchers utilize financial measures such as profit, return on investment, and share price as an effective technique for measuring organizational performance. Financial performance indicators, especially profitability ratios and share analysis, are “important in determining how an organization compares with industry competitors when assessing firm performance” (Walker and Ruekert, 1987, 15).

Annual reports of companies listed on the Australian Stock Exchange were analysed to identify share holdings in ESOP within each organization. Gaps in data were overcome by manual collection, directly from organizations. The resulting data set was used as the basis for statistical analysis. A comprehensive review of 507 annual reports and the electronic resource DatAnalysis from the 2001-2002 financial year was conducted to gather the required data. The 2001-2002 accounting period was selected because at the time of data collection annual reports for the 2002-2003 financial year had not been released.

This analysis resulted in 71 organizations that had disclosed their employee share holdings, from which 60 contained complete and useable data. The sample of 60 organizations was then divided into two groups based on the relative ESOP participation of individual firms and inputted into the SPSS statistical program for comprehensive data analysis. This relatively small sample size of 30 for each group is due to the restrictive size of the Australian economy and limited number of organizations in Australia that disclose details of ESOP.

ESOP participation levels were manually calculated according to figures relating to employee ownership found in annual reports, the electronic resource DatAnalysis and contact with specific organizations. The number of shares allocated to employee share plans was divided by the total shareholdings of the respective organizations. The resultant ratio is used as a basis for classifying the companies into two groups: Group 1 is low ESOP participation organizations and Group 2 is high ESOP participation firms.

Data analysis for the variables was conducted according to the natural data distribution. The variables were not transformed using logarithms. The variables that were normally distributed

were analysed using Independent Samples T testing. The remaining variables that were not normally distributed were analysed using a non-parametric statistical technique, the Mann-Whitney U test. Testing for both techniques was conducted at a 95% significance level. Koosis (1996) states that research conducted at this level was considered to be statistically significant for establishing relationships between variables. This type of hypothesis testing is a standard method for comparing two data sets, and is often used in academic research (Albright, Winston and Zappe, 1999).

RESEARCH FINDINGS

We have conducted statistical analysis and a review of the descriptive statistics for all the variables of interest. On the basis of the findings we either accept or reject the null hypotheses established for achieving our research objectives (See Table 1).

In the Table 1 the under-score next to the variables indicates the group number. The subscript number 1 represents low ESOP participation and the number 2 represents high ESOP participation among firms. The null hypothesis for each variable indicates that both groups have equal means, while the alternative hypothesis indicates that group 1 has higher mean.

Table 1: Null Hypothesis

Profitability Ratio	Liquidity Ratio	Gearing Ratio	Investors Ratio	Share Related Ratios
$\mu ROA_1 = \mu ROA_2$	$\mu CURRENT_1 = \mu CURRENT_2$	$\mu D/E_1 = \mu D/E_2$	$\mu PER_1 = \mu PER_2$	$\mu BV/SHARE_1 = \mu BV/SHARE_2$
$\mu ROE_1 = \mu ROE_2$	$\mu QUICK_1 = \mu QUICK_2$		$\mu DIV_1 = \mu DIV_2$	$\mu YEPRICE_1 = \mu YEPRICE_2$
$\mu EPS_1 = \mu EPS_2$			$\mu YIELD_1 = \mu YIELD_2$	$\mu PRICECASHFLOW_1 = \mu PRICECASHFLOW_2$
			$\mu GROSSYIELD_1 = \mu GROSSYIELD_2$	

where: μ = a sample mean of group; variables are: ROA = return on assets, ROE = return on equity, EPS = earnings per share, CURRENT = current ratio, QUICK = quick ratio, D/E = dept to equity ratio, PER = prices to earning ratios, DIV = dividend, YIELD = dividend yield, GROSSYIELD = gross divided yield, BV/SHARE = book value per share, YEPRICE = year ending share price, PRICECASHFLOW = price to gross cash flow.

In summary we can classify the following variables into two categories; those exhibiting significant differences in mean between the two groups, thus rejecting the null hypothesis, and variables that show no significant relationship between ESOP participation levels, which accept the null hypothesis. Table 2 summarizes the variables that show significant statistical difference between the mean.

Table 2: Significant Differences between Groups
(Reject Null Hypothesis)

Category	Variables
<i>Profitability Ratios</i>	ROE, ROA, EPS
<i>Investor Ratios</i>	PER, DIV, YIELD, GROSS YIELD
<i>Share Price Analysis</i>	BV/SHARE, YE PRICE, PRICE/CASHFLOW

Table 3 summarizes the variables that show no significant statistical difference between the mean.

Table 3: No Significant Differences between Groups
(Accept Null Hypothesis)

Category	Variables
<i>Liquidity Ratios</i>	QUICK, CURRENT
<i>Gearing Ratio</i>	D/E
<i>Share Price Analysis</i>	Cash per Share, PRICE/BV

Despite the mixed results, statistical findings show that there are differences for key performance indicators among the two groups. In general, low ESOP firms exhibit stronger financial performance based on profitability, investor and share related ratios, while there was no significant differences noted between the two groups for liquidity and gearing related ratios. However, these results suggest that lower ESOP participation in firms can positively influence organizational performance when compared to firms with high ESOP participation.

The overall results for the profitability analysis indicate that higher ESOP rates do not translate into higher profitability, thus, dispelling existing theory that regards employee participation initiatives as benchmark for sustaining improvements in organizational performance. The findings do show that ESOP is more effective in smaller amounts. It is possible that organizations with lower employee-owned firms utilize ESOP as a component of a larger organizational strategy that is more practical in realizing the theoretical benefits identified.

The findings for investor ratios are consequential in determining the extent for which ESOP align employee and organizational objectives. If it is assumed that the higher share owned firms will experience greater benefits because employees are more deeply involved with and share greater associations with company performance it should exhibit superior performance in relation to the identified investor ratios. This is because it is through ordinary shares that employees will receive the intrinsic benefits associated with employee ownership. However, results indicated that this was not necessarily the true for this study.

It is apparent that our findings for Australian firms across most ratios dispute the arguments that suggest that high ESOP participation has a positive correlation with organizational performance. The results contrast the common view that higher ESOP participation aligns employee and management objectives. The study indicates that lower ESOP correlates to higher performance on many levels including profitability, share price and investor ratios. The results of these key performance indicators suggest that ESOP are a not sufficient motivational force to influence employee behaviour. Consequently, there is concern in regards to reward benefit at an employee level. The results seem to suggest that the theoretical benefits noted by previous research are not evident. Furthermore, although no clear causal relationship is established that ESOP underlie individual employee behaviour, it is apparent that at an organizational level lower ESOP participation results in superior financial performance for Australian firms.

CONCLUSIONS

This research considered the organizational performance benefits that ESOP have upon Australian firms. We found that firms with lower ESOP participation rates have better organizational performance across many financial areas. This group of organizations exhibits higher profitability and superior share related performance. Our project's findings obviously contradicts existing literature by proposing that high ESOP participation may not be effective at motivating employees because they do not align organizational and employee objectives, thus resulting in little to no improvement in performance. The fact the majority of positive findings are from the USA suggests that Australian organizations respond less favourably to ESOP participation incentives. It is apparent that at lower levels ESOP are linked to highly efficient and financially successful firms, thus implying that employee ownership can play a role in but not entirely influence organizational

performance. Establishing reasons for these differences is beyond the scope of the research. However, findings are embedded with traditional economic and management theory.

The research contributes to the existing literature by suggesting that ESOP participation levels are important in realizing superior organizational performance. The trend towards increased employee ownership makes the findings of particular importance to organizations seeking to improve their performance. Since consensus on the apparent benefits has not been achieved from previous research based in the USA, this study helps bridge the gap with the aid of statistical evidence implying that high ESOP participation may not provide the evidence of improved corporate performance.

This study recommends further research that is broader in scope, possibly incorporating firms without share ownership that will further contribute to the ESOP/organizational performance paradigm. Finally, in-depth qualitative research is necessary to establish reasoning behind the rise of ESOP in Australian business and the links to motivation, participation and rewards at an employee level.

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