

New Research Confirms that Employee Ownership Benefits Companies

While many researchers have asked whether employee-owned businesses in the U.S. can be as profitable as traditionally-owned ones, doubters—especially academic economists—have continued to express skepticism. But a recent study¹ by an economics doctoral student at the City University of New York provides strong evidence that *majority employee-owned businesses have a significant advantage over comparable traditionally-owned businesses in sales per employee*, a reasonably good indicator of efficiency and profitability. His figure for the average advantage, \$44,500, would mean that a typical employee-owned 200-employee firm could be expected to have nearly a \$9 million annual sales edge over its non-employee-owned “twin.”

The research

The investigation was conducted by doctoral student (now Ph.D.) Brent Kramer, of New York City, with supervision by (among others) Professors Douglas Kruse and Joseph Blasi of Rutgers University (N.J.), two of the premier experts on employee ownership in the U.S. The ESOP Association (TEA) provided Kramer with a list of its employee-owned member firms, together with the information TEA had about their number of employees, and the share of firm value that the ESOP trusts hold for each firm. Kramer’s study covered all of the TEA member firms with 100 or more employees and 50% or more employee ownership, plus another 81 smaller majority employee-owned firms which returned survey questionnaires sent out by TEA about their employee participation practices, a total of 328 firms.² Comparing the TEA list of firms to another organization’s proprietary list of employee-owned firms, Kramer expressed

¹ *Employee ownership and participation effects on firm outcomes*, by Brent Kramer, City University of New York, 2008.

² Some firms had to be dropped because data was unavailable; 328 is the total after all exclusions.

confidence that, at least among small and medium-size firms (employment of 400 or less), the TEA list is fairly representative of all employee-owned firms in the U.S., and his results can be generalized for firms of these sizes. He cautions, however, that the study did not include enough very large firms (employment of 4,000 or more) to be able to generalize these results to very large firms.

Using a database available to subscribing college libraries,³ Kramer recorded Dun and Bradstreet's estimates for these firms' number of employees and annual sales, enabling him to compute sales per employee. He also used this database to find traditionally-owned firms that closely or exactly matched each employee-owned firm in size (employment) and primary industry. Sometimes he found one matching traditionally-owned firm (TOF) for an employee-owned firm (EOF), and sometimes as many as 40, even narrowing his search to just the same region of the country as the EOF. He recorded these matching firms' employment and sales data, and computed *their* sales per employee, using an average when there was more than one match.

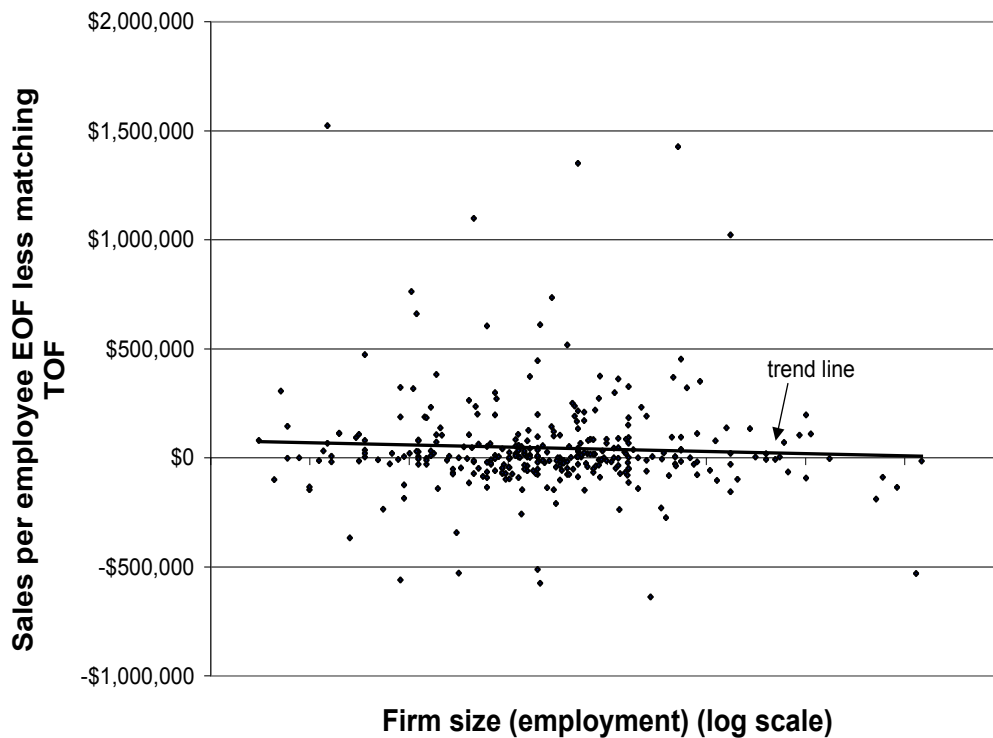
Kramer was then able to calculate the "EO advantage," the EOF's sales per employee minus its matching TOF's sales per employee. Using standard statistical methods, he found that the average advantage in this panel of firms, \$44,500, was large enough that it is 99.97% certain that, among *all* majority-owned EOFs and matching TOFs in the U.S., EOFs have (on average) a sales per employee edge over their matching TOFs. Using a ratio instead of a difference method to compare EOFs and their matches, he concluded that the average sales per employee advantage, expressed as a percent, was 8.8%.⁴

³ The D&B \$Million Database

⁴ This can be generalized with a confidence level of 97.3%

Size makes a difference

Many of the factors that make employee ownership effective might be weaker as firms get larger. Larger firms make it harder for employees to communicate easily, both among line employees and between line employees and management, and it may also be harder for a “culture” of ownership to develop or be maintained as firms grow. For this reason, Kramer looked at whether the employee ownership advantage decreased for larger firms. A “scatter-plot” of the employee ownership advantage by firm size gives us a preview of his results.



While we can see that the advantages vary greatly, a mathematically calculated “trend line” (a line that best predicts the data) does slope downward. Kramer’s statistical analysis shows that, for his sample of firms, for each increase of 100 employees, the average sales per employee advantage for EOFs decreases by about \$2,250. This is large enough that we are 97.3% confident

that (on average, among all EOFs and matching TOFs) the employee ownership effect weakens as firms grow larger.

Does employee participation matter?

Why does employee ownership matter? Could it be that employee owners try harder? Come up with more suggestions about improved production methods or marketing strategies? Whatever the reasons—and there are probably many—it makes sense that the degree of effective non-management employee participation and power at work should affect the size of the employee ownership advantage. In other words, given two groups of similar-sized EOFs, we might expect that the group that allows non-management employee-owners greater latitude in various dimensions of their work would have a greater employee ownership advantage.

TEA sent managers of over 600 of its member firms a survey questionnaire designed by Kramer to try to measure the degree of non-management employee participation and power at work, and about 22% of these were completed and returned. Kramer's analysis of the survey responses as a whole did not show any participation effect. But when he looked just at the questions that asked about non-management employee input into innovation in work processes, new products, and marketing, results were indeed as predicted. For firms of the same size, higher "innovation" scores (using these three measures) increased⁵ the employee-owned advantage in sales per employee, and this increase can be generalized (with over 98% confidence) to all U.S. firms.

⁵ A change in any one of these three answers, for example, from "Workers have no influence at all" to "Workers may make suggestions" increases the predicted sales per employee advantage by nearly \$16,000.

Conclusion

While this study discovered nothing really new, it confirmed much of what we already knew (or suspected) about majority employee ownership through ESOPs. While employee ownership is of value in itself, allowing people to “work for themselves,” it is also valuable to the firm. And society as a whole gains, since higher efficiency leads to more goods and services being available from the same human and material resources. Especially when combined with empowerment of line workers to suggest innovations, and especially (though not exclusively) in smaller firms, majority employee-owned firms have higher average sales per employee than seen in matching, traditionally-owned firms.

