Expanding Employee Ownership as a Path to Increase Canada's Competitiveness and Grow the Middle Class

Submission to the House of Commons Standing Committee on Finance
for its Pre-Budget Consultations in Advance of the 2019 Budget

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Recommendations

Among many recommendations that could follow from the considerations in the body of this submission, key ones could include:

Recommendation 1: that the government study the progress of employee ownership in the US, UK and other countries, and consult with knowledgeable researchers and practitioners in this field, both in these countries and in Canada, including the ESOP Association Canada [8] and the Canadian Worker Co-operative Federation [9], with a view to developing appropriate incentives and support for broad-based employee ownership in Canada;

Recommendation 2: that the government work with partners to establish Employee Ownership Centres in each province or region in Canada with the purpose of providing training and technical support for programs promoting employee ownership, drawing on the experience of such centres in several US states, e.g. [10];

Recommendation 3: that the government review how federal agencies generally, such as the Business Development Bank of Canada and the regional development agencies, can best serve the specific needs of employee-owned companies and companies that might be interested in adopting employee ownership.

Introduction

Canada faces two significant economic challenges in the 21st century. One of these challenges, on which the Committee is specifically seeking submissions, is how to ensure Canada's competitiveness in an increasingly competitive global economy. Another significant challenge for Canada and other advanced economies is their recent trend of growing economic inequality, and the "hollowing out" of the middle class, leaving an increasingly stark division between the affluent and those who are struggling to provide for themselves and their families. It is the thesis of this submission that policies to expand employee ownership could make a significant contribution to addressing both these challenges.

Employee Ownership: Canada Compared with Other Advanced Economies

Among advanced economies most similar to Canada, both the United States of America (US) and the United Kingdom of Great Britain and Northern Ireland (UK) have significant and growing levels of employee ownership in their companies. This is probably to a substantial degree because both countries have specific policies to encourage employee ownership, in particular, Employee Share Ownership Plans (ESOPs) in the US and various schemes, including Shareholder Incentive Plans (SIPs) and Employee Ownership Trusts (EOTs), in the UK. In addition to tax incentives, such programs provide a standard legal and administrative framework that can facilitate establishment of the programs. ESOPs and EOTs are required to be broad-based employee ownership plans, rather than ownership restricted only to managers and a few others; this provides general incentives to increase productivity and competitiveness while also helping to reduce economic inequality.

In the US, there are over 7,000 companies that are owned wholly or in part by their employees, and among these an estimated 1,600 to 4,400 are majority employee-owned [1]. The largest 100 majority employee-owned companies in the US range in size from 188,000 employees (Publix Supermarkets in the south-eastern US) down to 1,250 employees [2]. One of the promoters of employee-owned companies in the US summarizes their benefits as follows: "Research shows that when employees own the company, they make higher wages, have about double the retirement savings, and are one-fourth as likely to be laid off. Their companies are more likely to be environmental stewards, and they don't export their jobs overseas. With employee ownership, a lot of the things that we worry about in the economy are on their way to being solved..." [1, 7]. A certification and labelling program for employee-owned companies ("CertifiedEO") has also recently been launched in the US [3].

In the UK, the 50 largest employee-owned companies had combined sales of £22.7 billion in 2017. They range in size from the John Lewis Partnership (a retailer) with 91,000 employees down to 350 employees [4].

Employee-owned companies are consistently highly rated both by their customers for the quality of their products and services and by their employees as places to work. They are also in the top ranks in terms of levels and growth of productivity. In 2017, the UK 50 largest employee-owned companies achieved an aggregate productivity growth of 6.2% year-on-year [4].

Worker co-operatives are a special type of employee-owned company that are democratically governed by their members, usually on the basis of one member-one vote or sometimes on the basis of "patronage", i.e. the amount of work contributed by each member. In small worker co-operatives the members might elect managers directly, while in larger worker co-operatives they might elect a Board to appoint the managers.

The Mondragon Corporation is a renowned federation of worker co-operatives in the Basque region of Spain . It has grown from a co-operative of 5 workers that started producing kerosene stoves in 1955, and now has about 75,000 members producing a range of products and services. It also has its own bank (*Caja Laboral*), university and high-tech research and development centre (*Ikerlan*). Worker co-operatives also constitute a significant part of the economy in parts of Italy, particularly Emilia-Romagna which is one of the most prosperous regions in Italy.

Countries in northern Europe, notably Germany and in Scandinavia, practise various forms of "codetermination", where employees elect anywhere from one-third (for medium-sized companies) to almost one-half (for larger companies) of the governing boards. France has both codetermination for large companies, and a significant network of worker co-operatives ("Scops" - Sociétés Coopératives).

According to documentation from the US Conference Board, while firms in northern Europe have faced the same challenges of globalization and technological advance as US firms, "they have steadily raised wages for decades by about 1 percent annually in real terms, leapfrogging flat US wages in the process" [5].

In Canada, the overall situation is unclear, but it appears that, while there might be some notable instances of employee ownership and participation, it is on a smaller scale or less visible than in these other countries. If so, this might be partly due to the relative lack of specific incentives and support for employee ownership in Canada. Quebec might be a partial exception with its *Chantier de l'économie sociale* [6].

Correcting Misconceptions about Employee Ownership

There are some common misconceptions about employee ownership that could be holding back its development in Canada and elsewhere. Many of these misconceptions are discussed in recent reviews, e.g. [7]. Here, there is space to highlight only two:

<u>Employee Ownership and Investment Portfolio Diversification</u>: Even among accomplished economists who might not be knowledgeable specifically about employee ownership there can be a view that it is too risky for employees to invest in their own companies, especially considering that their jobs and incomes are already at risk there, but they should invest instead in a diversified portfolio of securities in other industries such that the returns from these and their jobs are not highly correlated, and overall risk is minimized.

However, this neglects at least three important factors. Firstly, employee ownership can be funded by specific tax incentives and prospective increases in productivity that derive from employee ownership, which are not obtained in its absence. The US ESOP program provides tax incentives for companies to set up employee benefit trusts whereby employees receive grants of stock over and above competitive pay and other benefits [7]. Secondly, even where employees invest their own savings, studies by authors including the economist Harry Markowitz, who won the 1990 "Nobel Prize" in Economics for his pioneering work on portfolio theory, indicate that an employee could invest about 9% of her total wealth in her company's stock "with only a modest loss in utility due to risk" while "10 or even 15% would not be imprudent" [7]. Thirdly, risks of job loss (hence income loss) in employee-owned firms are less than in most other firms [7].

<u>Employee Ownership and Unions</u>: Some managers appear to take a view that, in the case of employee-owned companies, unions are redundant at best, or counter-productive at worst. However, there is nothing inherent in employee ownership that restricts freedom of association or the right of employees to form unions and engage in collective bargaining. Even in a business that is wholly owned by its employees, unions could also have a key role in protecting the rights of employees both as a group and in terms of the rights (and possible grievances) of individual employees. Unions also offer another path for employee-owners to provide input into management that is supplementary to the path they are accorded as owners.

The "Silver Tsunami" and the Millennial Generation

There are two demographic reasons why an interest in employee ownership is especially timely now.

Firstly, an increasing number of owners of small and medium-sized businesses who are of the "baby boom" generation are now reaching retirement age, the so-called "silver tsunami". They have a number of options, but one of the most attractive could be to sell their businesses to their employees if appropriate financial arrangements can be structured. Selling their businesses to the majority of their employees would help ensure that jobs and a continuing legacy stay in their communities.

Secondly, at the other end of the working population age distribution, many in the "Millennial Generation" are entering the workforce facing increasingly precarious work arrangements, and often have little emotional or behavioural commitment to their transitory work. It is not clear whether such precarious work helps to prepare them for more productive work in the future, or just captures them indefinitely in low wage-low productivity traps. Further research is needed.

Final Thoughts: Employee Ownership and Entrepreneurship

In an increasingly competitive global economy, the economic prospects of Canada in the long run depend on the entrepreneurship of Canadians and their capacity to develop new businesses and realize new opportunities. If one believes that entrepreneurs are "lone wolves" who are only born not made, one can only hope that biological science will soon identify the specific entrepreneurial genes and splice them into our DNA at birth if not earlier. If, on the other hand, one believes that entrepreneurs are at least as much made by their education and life/work experience, employee ownership could have an important role in increasing entrepreneurship and improving Canada's economic prospects.

By giving employees a stake in the success and excellence of their companies, rather than just earning a paycheque, employee ownership can encourage employees to see and develop new ideas to increase productivity. Of course this depends not just on employee ownership *per se*, but also on developing an "ownership culture" within the company. This can also lead beyond just increasing productivity in existing operations to the conception and development of new products and services, and even whole new product lines. These new products or product lines can then be developed and produced by new divisions in the company or by spin-off companies, filling new market niches. This is historically how much economic development has progressed.

More broadly, if one thinks of a business as "producing" not just goods and services but also people who are both competent in their fields and alert to new possibilities and opportunities, employee ownership can contribute significantly to this latter "product". It can thereby help to develop a more entrepreneurial economy and society in which everyone is a potential entrepreneur and is recognized and encouraged as such.

Policies to expand employee ownership deserve serious consideration as a way to ensure Canada's competitiveness in the 21st century.

References

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