Ohio's Employee-Owned Network: Helping Employee-Owned Companies to Help Themselves?

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Can a support organization enhance the development and performance of an employee-owned sector in a market economy? That is the question this paper will address. While there is testimonial evidence that support organizations matter, empirical evidence is sparse. Small Spanish cooperatives, the *Sociedades Laborales,* have attested that their provincial support organizations are important to their success. An early research effort in the U.S. suggested that employee owned companies were more numerous and more long-lived in states with support agencies (Winther 1997). This finding notwithstanding, of eight state support organizations, only one remains as a freestanding institution solely focused on promoting, supporting and researching employee ownership. That is the Ohio Employee Ownership Center, which houses Ohio's Employee-Owned Network, whose impact is the focus of this paper.

The Ohio Employee Ownership Center (OEOC) was founded in 1987 as part of Ohio's commitment to economic development. Based at Kent State University over the past 17 years, it has grown into a multifaceted support organization with a staff of nine, administering and managing a variety of programs to assist in the creation of new employee-owned companies and participatory management in established ones. In the U.S., employee ownership is typically structured as an Employee Stock Ownership Plan or ESOP, a pension plan where the assets are invested in employer stock. Employee involvement in the management of the company is not legally required, and employees of most ESOP companies have little or no involvement. Most OEOC clients are ESOPs, but the Center has also assisted a few companies exploring workers' cooperatives or direct stock ownership.

Over the years, the OEOC has assisted 463 employee and company groups, employing more than 84,000,[1] exploring in each case whether employee ownership makes sense for that company; it has helped employees buy part or all of 69 of these companies, retaining or stabilizing 13,654 jobs. The result has been that employees have created more than $300 million in employee equity. These companies continue to create in excess of $20 million in new employee equity annually, in addition to cashing out retiring employees.

History and Membership of the Network

In terms of participation and longevity, the OEOC considers Ohio's Employee-Owned Network to be one of its most successful endeavors. The Network today is an association of 61 employee-owned companies providing a variety of training and organizational development services to improve business performance. Network members reflect Ohio's economy in that many members are manufacturers. Some of the companies assisted by the OEOC later became Network members, but most members of the Network did not receive any special technical assistance to establish their ESOPs. Recent additions to Network services include a purchasing cooperative (developed in

[1] Ohio has a population of about 11 million and a workforce of about 5.5 million. It is significantly more dependent on manufacturing than the United States as a whole, particularly in steel and automotive industries.

2003), and a revolving loan fund able to provide loans for expansion on favorable terms (OEOC assumed administration in 2004).

The Network was created in 1989 when a dozen employee-owned companies asked the OEOC to create a process for inter-company collaboration. It is staffed by the OEOC, but its members set its direction and training curriculum. Training and education for employee participation have been the chief focus of the Network. At the heart of the curriculum is a series of leadership development programs emphasizing effective participatory management. Topics regularly covered include training for nonmanagement board members, basic business education and basic ESOP education for rank-and-file employees, training for front-line and midlevel supervisors, basic training for fiduciary oversight of the ESOP trust, updates on ESOP law for plan administrators, and effective management of committees and meetings. The curriculum offers training and education for every employee-owner, from the CEO to the rank-and-file worker. There are occasionally new topics in the annual curriculum as member companies encounter new challenges and look to the Network for assistance. Over the years, long-time member companies have sent many employees for Network training.

Typically, training sessions involve employees from a variety of companies, and feedback from Network members indicates that the opportunity to exchange ideas with other employee-owners is especially valuable. As a consequence, time for free discussion and interaction is regularly included in training and education programs. The Network also offers an annual retreat for Chief Executive Officers, and there is some friendly socializing among companies' leadership that is organized through the Network.

The Network's training curriculum is funded in part with state employee ownership assistance funds. The Ohio Employee Ownership Assistance Program was first enacted in 1988, and reauthorized in 1994 and 2000 by unanimous vote of the Ohio legislature. It has received strong support from Ohio governors of both major political parties. For example, Governor Taft's message to the 17th Annual Ohio Employee Ownership Conference in April 2003 noted, "Employee ownership and cooperative enterprises save jobs and companies, anchor capital, benefit local economies, create new wealth for employee owners and improve the lives of their families. As an economic development strategy, employee-owned companies are a positive influence to improve job security that also benefits the communities where they operate. Employee-owned companies also increase productivity and efficiency by enhancing employee motivation. They make Ohio's economy stronger." (Quoted in *Owners at Work* Winter 2004)

Karen Conrad, Manager of the Office of Small Business in Ohio's Department of Development explained, "the OEOC encourages the development of cooperative, high performance workplace practices in employee-owned companies through training and organizational development. The OEOC is part of a statewide network of training organizations that work with clients to provide labor-management cooperation programming. The Ohio Labor-Management Cooperation Program (OLMCP) grantees provide workplace assessments; help in the establishment of high-performance work systems and offer assistance in improving labor and management cooperation.

The program grantees provide cost-effective training and consultation to both private and public Ohio companies and organizations. This has a significant impact on Ohio's industrial competitiveness. This proven effort helps to retain jobs and encourages expansion in Ohio." (Quoted in *Owners at Work* 15:2, Winter 2004)

Because Network companies produce a variety of products and services, opportunities for cooperation through reciprocal purchases are limited. However, the Network's purchasing cooperative pools members' buying power, offering lower prices for business services such as package delivery, office supplies and insurance.

The impact of a diffuse and disaggregated set of activities such as those created by the Network is difficult to assess. One difficulty is that Network members are self-selected for their interest in improving management and performance through employee involvement, and so they may be more likely to prosper than other firms. A second problem is that the percentage of a company's employees that have participated in training is not precisely known. What is more, learning tends to gradually extinguish, leading to the expectation that the impact of Network training programs will diminish over time. Nor is it possible to connect acknowledged benefits like the exchange of views among employees to any definite economic impact.

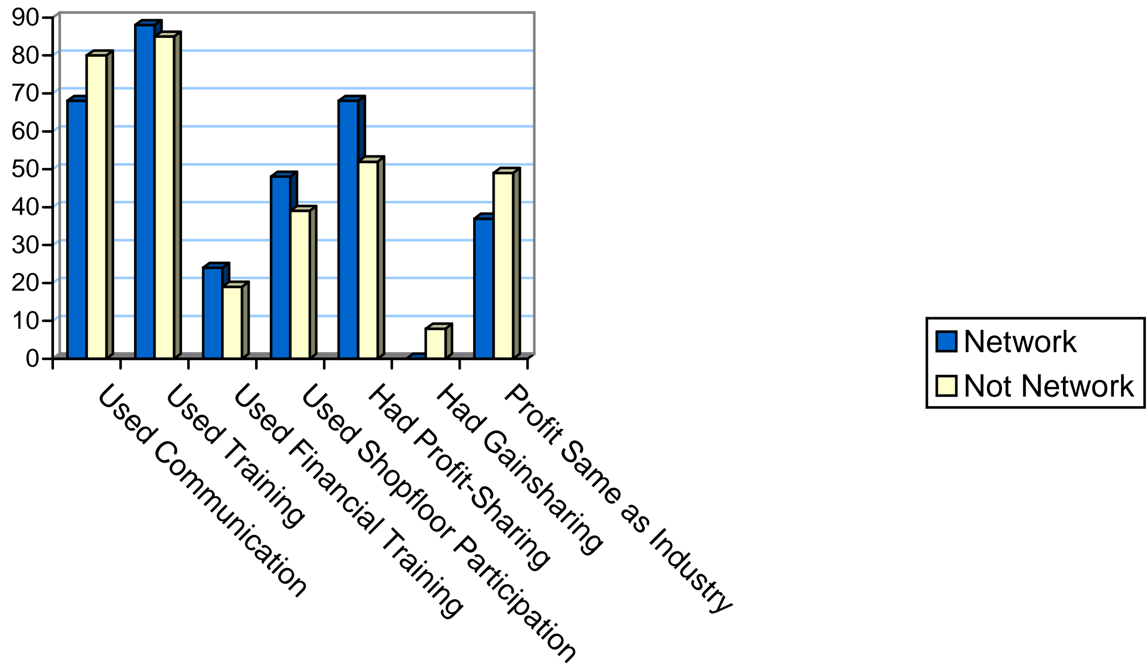
Early research on employee involvement, support organizations and the Network

There is some research supporting the hypothesis that training for employee involvement has a lasting impact in the presence of employee ownership. A U.S. Congress General Accounting Office study of companies with Employee Stock Ownership Plans (ESOPs) found that **only ESOP companies with employee involvement enjoyed better performance** than conventional firms (1987). The diffuse impact of employee involvement has been measured in a study finding that employees who engage in cross-functional problem solving teams subsequently become more productive in their individual work stations (Jones 2003).

An early comparison of Network companies with other employee-owned companies was done with data from a 1993-94 survey of 167 Ohio companies. (Companies that were members of the Network before the survey was taken were classified as Network members.)

It is possible that the Network members were inclined to participative employee involvement even before they established ESOPs and became employee-owned, but if there was a favorable attitude, the future Network members did not practice participation more than others. Before they became employee-owned, they reported management styles, operational performance and profits much like companies that did not become Network members, as shown in Figure 1.

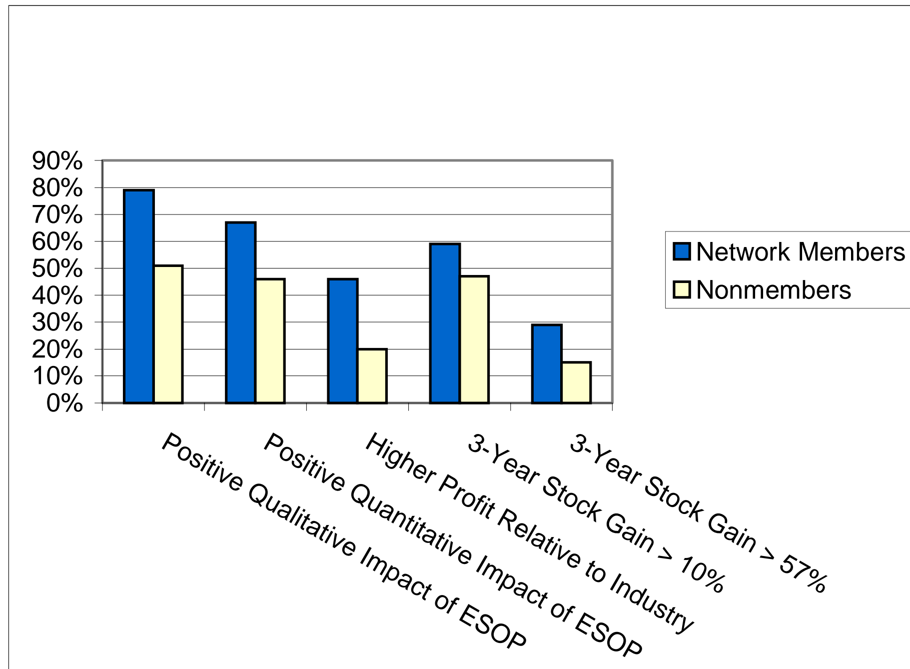
Figure 1. Network vs. Non-network Members before ESOP was Established (1993-94 data, n = 167).



Note for Figure 1: In general, companies were not much engaged in participatory management and employee involvement before they created their ESOPs. Therefore, a low threshold was set in creating the comparisons in this figure. If a company used any communication, any training, any financial training, or had any shopfloor participation (such as quality circles, self-managing groups, labor-management cooperation, or the like), they were classified as using it. Likewise, any profit sharing or gain sharing was classified as having the activity. The profit variable was measured by asking companies to compare themselves to their industry. They could respond as being worse than industry, the same, or better. On this variable, Network companies resembled other companies, and so the response of "profits same as industry" was chosen as representative of the item.

After becoming ESOPs, however, the Network members surpassed other ESOP companies in the study. They reported markedly more communication, training and participation and superior performance in operations and profits (Logue and Yates, p. 168 and *Owners at Work* Winter 2000-2001). As shown in Figure 2 below, Network members reported better operational performance after establishing their ESOP than did nonmembers, whether that performance was gauged by easily quantified measures like absenteeism or productivity or by qualitative measures like employee attitudes or labor-management cooperation. Network members were more than twice as likely as nonmembers to report improved profits compared to other firms in their industry, and they were more than twice as likely to report substantial gains in stock values.

Figure 2. Network Members and Nonmembers: Performance Comparisons after the ESOP was established



Source: *Owners at Work* 12(2), Winter 2000-2001

Note for Figure 2: The **quantitative impact index** reports on the impact of the ESOP on easily measured (quantitative) aspects of firm performance, including absenteeism, on-the-job performance, employee turnover, product quality, productivity, customer service, profitability and production costs. For each item, respondents could choose from a range of five answers, the worst being "strong negative impact" and the best being "strong positive impact." The index simply summed their responses, with "strong" responses weighted twice as heavily as "weak" responses. Therefore, a company reporting many strong positive impacts received twice as many points as a company reporting the same number of weak positive impacts. A score of zero meant "no change." On this index, there were ten cases where more than 25 percent of the data for quantitative impact was missing. These cases were counted as missing on the index. For cases with less missing data, missing scores were replaced with the value meaning "no impact," (which was the most common response on most of the items). On the variable asking about the impact of a company's ESOP on labor-management relations, five companies with missing data were non-union, and had probably skipped the question because they did not have unions. For these five companies, the missing score was replaced with the mean score for the question (.576 rounded to 1 "weak positive impact"). In Figure 2, any positive impact is represented.

The **qualitative impact index** was created similarly to the quantitative index, with greater weight placed on "strong" responses. It summarized questions on less measurable aspects of the firm's performance: manager-worker communication, worker job satisfaction, motivation, working conditions, employee participation, labor management relations and employee attitudes generally. Missing values on the index were addressed in the same manner as the quantitative index: cases where more than 25 percent of the data was missing were counted as missing on the index. Cases with 25 percent or less missing data received an average score of "no change" or "weak positive impact" on the missing items. In Figure 2, any positive impact is represented.

"Relative profit" was based on the firm's report of how it was doing before the ESOP, compared to other firms in the industry, and how it fared after the ESOP. Three values were possible: worse relative to the industry, the same relative to the industry and better relative to the industry. Change in a firm's profit position relative to other firms in its industry was calculated from the two variables. Lacking access

to financial records, we believe that this is a better, more objective measure of firm performance than a simple report of improved profitability, because it is a calculated datum that also controls for changing economic factors in the firm's business sector. In addition, it was separated from the battery of performance questions used for the quantitative and qualitative indices, and is less subject to response bias.

New Research Findings

A new dataset developed from Internal Revenue Service Form 5500 pension reports allows for further investigation of the impact of Network membership on company performance in the years 1993-2001. Because filing is required by law, the Form 5500 data is the most complete set of data on ESOPs, including numerous small closely-held firms. Form 5500 reports on the value of pension plans held in ESOP trusts and the amounts paid out to participants. It is an indicator of the amount of wealth accruing to employee owners through their pension plans.

The data were taken from compact disks developed by Larkspur Data Resources, a private firm that processes IRS data and combines it with a search utility for answering queries. In past years, companies with ESOPs were required to file Form 5500 annually if they had more than 100 employees, while smaller plans were required to file every three years. The triennial data reports were simply repeated in annual editions of the Larkspur disks. Therefore, to avoid duplication, the data below were drawn from three disks at least four years apart. With a few noted exceptions for missing data, data was taken from CDs dated 1993/94, 1999 and 2003. The range of plan reporting dates for each CD is shown in Table 1. Overall, reporting dates of the plans covered the period from 1993 to 2001.

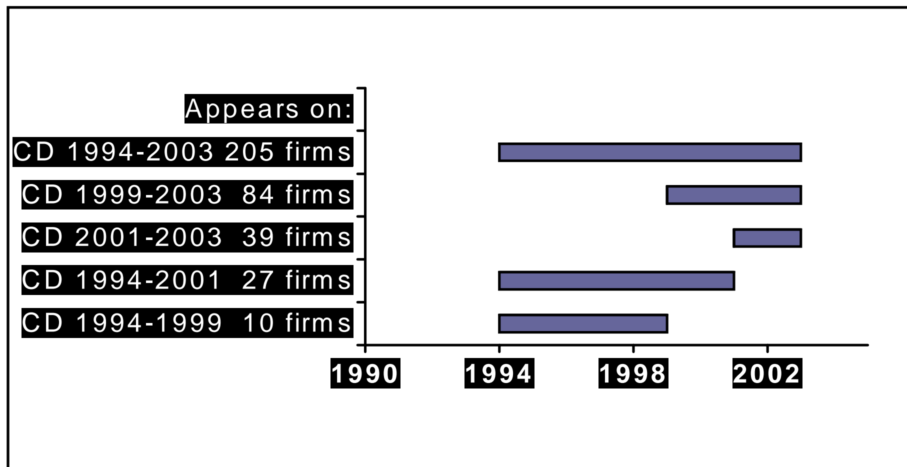
In this paper the focus will be on Ohio companies reporting stock bonus plans, leveraged ESOPs and unleveraged ESOPs. Companies known to have terminated the plan and those that reported no assets were eliminated from the analysis. Network members with out-of-state headquarters were also excluded.

A Special Case: The Ohio-based multinational firm, Procter and Gamble, presented special problems in the analysis. Now 30% employee-owned, this huge firm reports wealth accrual and employee payouts that overwhelm the reports of all other Ohio ESOPs. Such an enormous firm has the resources to do its own training and education, and its involvement with the Network has been limited to one year of membership. However, it could be argued that, because pension reports are not itemized by individual facilities or locations, Procter and Gamble could serve as a surrogate for all the multinational companies with employees in Ohio but headquarters elsewhere. However, it is an exceptionally old plan. Because of its size and its age, its results are reported separately in Tables 2 and 3 below.

Turnover in Plans: During the period under study, some ESOP plans were created and some were terminated. As shown in Figure 3 and in Table 1, a core of 205 companies existed throughout the reporting period. Of these, 42 (or 22%) were Network members, while the percentage of Network members in the entire group of 528 distinct plans was

8%, hinting that Network members may have longer-lived ESOPs than other companies. The number of short-lived ESOPs was surprising. In part, this may be due to data entry errors, filing errors, or opportunistic use of the ESOP law by family owned firms.

Figure 3. ESOP Lifelines 1993-2001
(from Larkspur IRS Form 5500 CDs 1993, 1999, 2001, 2003)



Despite the confusion of many firms starting and ending their ESOPs within the period under study, the data in Table 1 suggest that the number of employee-owned companies and the number of employee owners has increased by 37% in Ohio over the period under study. Nationally, the number of ESOPs and stock bonus plans increased by 21% in the same period. In the same period, the number of Network members approximately doubled.

Table 1. Number of ESOPs and Stock Bonus Plans appearing in various CD Years (Larkspur Data Resources Pension Master) Total number of distinct plans is 528.

CD year (and range of reporting years)	CD93-94 (1993-1994)	CD1999 (1995-1998)	CD2003 (1997-2001)
1994-2003	205	205	205
1994-2001	27	27	
1994-1999	10	10	
1999-2003		84	84
1999-2001		4	
2001-2003			39
only 1994	55		
only 1999		26	
only 2001			
only 2003			78
Total	297	356	406
% with data on only one CD	19%	7%	19%

Network Members compared to Others: Table 2 below characterizes companies in terms of the length of Network membership, date of establishment, total employees and total participants. In terms of when the ESOP was established, Network members do not much differ from other members. In terms of employment, Network members employ only about one percent of all employees in ESOP firms in Ohio, and 3.2% of participants.

Table 2. Characteristics of companies by Network Membership

	Never a member	Member for less than 3 years in 1989-2003 period	Network Member 3-5 years	Network Member 6-15 years	Network Member Heavily Indebted	Network Member (1 year only) Procter and Gamble
Distribution of Network Membership among nonterminated Ohio ESOPS	461 85.2% of 542 firms	19 3.5% of firms	15 2.8% of firms	41 7.6% of firms	4	1
Median date established	1988	1988	1991	1987	1997	1944
Total Employees circa 2000 (source is CD2003). P&G data is from CD2001 (plan year 1999)	726,203 85.5%	2713 0.3%	1073 0.1%	4023 .5%	575 0.1%	114,771 13.5% of all
Active Participants 2003*	348,090 87.1%	3609 0.9%	2249 0.6%	6571 1.6%	327 0.1%	39,023 9.8%

*Participants can outnumber employees because retirees are counted as participants along with current employees.

By law, pension plan assets are evaluated annually using stock market prices for public companies and professional valuations for closely held ones. Profitable companies have higher stock prices and higher valuations. Firm performance is reflected in the changing value of plans, combined with the amounts paid out to participants. Debt payoffs and purchases of additional stock can also increase plan value, but ESOP companies cannot pay off debt and purchase additional stock unless they have profits to do so. Table 3 below offers a minimum estimate of the wealth created by ESOP and stock bonus companies in Ohio. The actual amount paid to participants is probably larger (because only three CDs were used), but there is no reason to believe that the relative differences among categories would change very much. Where missing data was encountered for Procter and Gamble on the 2003 CD, the missing information was approximated from CD2001.

How did the pension plans of Network companies perform, compared to other companies? Table 3 shows the obscuring effect of Procter and Gamble, but even so, Network companies had 1% of the employees and 3.2% of participants, but 4.4% of the gains in net assets, and 2.5% of the total payments to participants. Network members created 3.4% of the total wealth. Of the Network members, the best performers are the

long-term members, who have 0.5% of the employees, who created 2.4% of the total wealth (more on this later in the paper). Because the Procter and Gamble plan is older than most other plans, it has a larger share of retirees than most, and reports a larger share (64%) of payouts than other plans.

Also separately reported in Table 3 are companies with heavy debt. These are isolated because one company's large debt obscured the positive performance of many small Network companies. Debt typically arises in recently established ESOPs that borrow money to purchase company stock and repay the loan out of company profits. Interestingly, all the companies reporting debt are Network members. It is not known if all other ESOPs are actually debt free or if they are simply not including debt in their plan valuations.

Table 3. Wealth Creation Network and non-Network Members Compared

	Never a member	Member for less than 3 years in 1989-2003 period	Network Member 3-5 years	Network Member 6-15 years	Member Heavily Indebted	Member Procter and Gamble
Net Assets of plans in 2003	$13,907,533,228 56% n = 330	$108,883,235 0.4% n = 18	$41,687,479 0.2% n = 12	$376,162,377 1.5% n = 39	($37,654,088) -0.2% n = 3	$10,421,889,370 42% n = 1
Median Plan Value per participant in 2003	$18, 416 n=328	$22,655 n = 18	$12,906 n = 12	$31,987 n = 39	-$38,077 n = 4	$267,070 n=1
Median Gain in Value/Participant annualized by number of years plan is reported in LDR data	$1,252 n = 283	$1,186 n = 17	$1,031 n = 11	$1,608 n = 40	-$20,487 n = 3	$7,702 n = 1
Total Paid to Participants: CD94+CD99+CD03	$882,102,282 20.9% n = 275	$15,289,632 0.36% n = 18	$4,363,516 1.03% n = 11	$48,061,067 1.14% n = 37	$23,841 0.0% n = 3	$3,270,835,056 (Data from 1999 CD was missing. CD2001 was used to estimate) 77.5 % n = 1
Total Gain in Value of Plan Net Assets over period under study	$3,137,842,111 39.8% n=274	$75,878,598 1.0% n=18	$22,766,606 0.3% n = 11	$243,639,179 3.1% n = 36	($38,347,692) -.5% n = 2	$4,451,676,657 56.4% n = 1
Estimate of minimum wealth created in period under study: total paid to participants plus net value gained	$4,019,944,393 33.18%	$91,168,230 0.75%	$27,130,122 0.22%	$291,700,246 2.41%	$(38,323,851) -0.32%	$7,722,511,713 63.75%

Long- and Short-Term Membership: Since Ohio's Employee-Owned Network is primarily a training association, any impact of Network membership would be felt only after some time has passed, as insights gained from training are incorporated into the company culture, and as the proportion of employees who have attended one or more training programs increases. Therefore, the companies with memberships of two years or

less – a mixed category of recent members and members who joined for just one or two years in the more distant past -- would not be expected to be much affected by participation in the Network. A more realistic test of the benefits of Network membership could focus on those companies that have had long-term membership and compare them to companies with shorter periods of membership, where there has not been time for Network activities to be broadly or fully experienced.

From Table 3 above, members for 3-5 years are a little younger than members for 6-15 years, and they are notably less wealthy, on an absolute basis as well as per capita. Their median plan value is $12,906 per participant, as compared to $31,987 for the long-time members. The annual growth in the plan value per participant is lower as well: short-term members report growth of $1,031 per participant per year over the period under study, as compared to $1,608 per participant per year for the long-time members. The growth rate of the longer-term members is about 60% higher than that of the short-term members. Even though the two groups are small, the differences are so large as to be statistically significant.

While the data above reinforce the impression that Network members improved performance, it is impossible to be certain that the observed effect was generated by participation in the Network. Since the Network emphasizes and enables changes in management style, the companies that join it may be predisposed in that direction and perhaps they would have adopted a more participatory style in the absence of the Network and benefited even without the Network. There could be a Darwinian effect as well – the long-term Network members may simply be better-run companies, and weaker companies in their cohort have been closed or sold.

A possibly confounding Network phenomenon

Among companies in the Network, there is an observed tendency for employees to increase their share of ownership over time. Increased ownership adds value to the pension plan. It is not known if a similar pattern occurs among all Ohio's employee-owned companies. One possible reason for the pattern may be that in closely held companies (which are the most numerous employee-owned companies), sellers often want to see how employee ownership succeeds before transferring a controlling interest to employees. To receive tax benefits under U.S. law, the owner must transfer at least 30% of the company to the employees (Internal Revenue Service Section 1042). Many owners prefer to sell the minimum initially, so that they will retain control of the company should the transfer to the employees create significant problems. However, if all goes well, they may then willingly allow the employees to purchase majority ownership. Of course, purchase of additional stock cannot occur if the company is not prospering, and additional stock purchases of their prosperous companies do enhance the wealth of employee-owners. However, increasing the value of the plan through additional stock purchases is not the same as increasing plan value through outright growth. In 1998 -- the first year for which data is available, 16 of 52 Network member companies increased

their employee ownership percentage from an average of 45% to an average of 69% (OEOC Annual Report Fiscal Year 2003). Thirteen Network members were already 100% employee owned in 1998, so an increase was not possible. From 2001 to 2002, eight companies of the 52 in Ohio's Employee-Owned Network increased their ESOP ownership, with the mean ownership percentage rising from 55% to 71%. Twenty-two Network companies were already 100% employee owned in 2001.

To sum up, the evidence from two very different datasets points to Network effects that enhance firm performance and employee wealth, and possibly also employee control. The case for the beneficial impact of the support organization is not closed, but the accumulating evidence lends support to the conclusion that, over time, a network support organization can enhance the longevity and economic success of employee-owned companies.

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