Employees owning Companies

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Abstract: ESOP increases revenues and sales and profitability. ESOP increases employee involvement. ESOP is worth it

At start ups that I have worked for I came to know that these companies since they do not have much cash in hand, offer prospective recruits, shares of companies rather than great salary. And that seem to help them get employees from blue chip multinational companies.

Management practices seem to have completed a 360 degree circle. Earlier it was the time of family owned enterprises and this moved to professionally run businesses. However, soon companies have started giving employees stocks or stock options, which is something of a return to some sort of family run business come to think of it. And then many companies and organizations offer jobs to children of employees. How much more family run a business can get?

Let us discuss ESOP - Employee Stock Option - first. Employee Stock Option is an option for employees to buy stocks of companies at low prices. This is almost like giving ownership of a company to an employee for free. Clearly, this will build a sense of camaraderie towards the company and a sense of family feeling towards the company.

Does it work? Does it help the company? Does it help employees?

In a largest study of ESOP by Douglas Kruse and Joseph Blasi of Rutgers has found that ESOPs increase sales per employee, sales and employment by 2.4% over what it would have been in absence of ESOPs.

Employee Ownership Foundation published an ESOP report in 2019 and found that almost 20% of companies had their profits increase by more than 50%. The increase in profits far exceeded the increase in revenues. ESOPS not just helped companies but also helped employees with the wages of employees in ESOP companies increasing more than 3-4 %.

But it is not just quantitative parameters that ESOP has had an effect on. Indeed ESOP has shown significant benefit in qualitative effect. For instance, 85% of ESOP companies experienced an improvement in the culture of the company and 60% saw an improvement in the productivity levels of the company.

An article by Corey Rosen and Michael Quarrey in Harvard Business Review confirms that employee stock options do indeed improve the performance of companies where they are offered. For instance, companies that offered ESOPs found that the performance of companies offering ESOPs grew 5.5% per year more in terms of employment offered and sales growth after offering ESOP than other companies whereas before offering ESOP these companies only grew 1.2% more in sales and employment. Almost 73% of ESOP companies improved their performance after ESOP. The article provides the information that almost 8 million American employees benefit from ESOP.

Thus there is enough data that ESOP has an advantage for both employees and companies and it is worthwhile for all companies to go for ESOP.

Jobs being offered to children of employees are much rarer. This is because the children of employees may not have the skills that companies seek. Plus the children of employees may prefer to work elsewhere.

However, in India, there have been jobs for children of Indian Railways employees offered in lower grades if the employee chooses voluntary retirement before the expiry of the term. This scheme was started in 2004 but stopped in 2017 due to some legal hassle and hurdles. However, Railway Employee Union has put pressure on the government to continue this scheme.

Employment to children of employees does not seem to get the same traction as employees owning companies through ESOPs and that is to be expected.

After all, if a company does not offer employment to children of employees then the children would still find some job commensurate with their education and experience within 6-9 months. Hence by offering employment to children of employees a company is not doing any favour of sorts.

But providing stock options to employees creates a sense of ownership in the company and that improves performance.

There may be a case for exploring if companies can consider offering jobs to shareholders of companies commensurate with their education and experience. This is ESOP in reverse.

Instead of offering shares to employees, this scheme would offer jobs to shareholders provided of course these shareholders own enough shares without diluting the merit consideration of the company.

The option of offering jobs to shareholders of a company has not been studied as much and is an arena that needs exploring considering the substantial effect of ESOP on the performance of the company.