A REAL STAKE FOR WORKERS

Inclusive ownership funds have been promoted by many on the left as a way of giving employees more say in the way businesses are run. But is there a better means to a fairer end? Ciaran Driver takes a look.

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The proposal for inclusive ownership funds (IOF) included in the 2019 Labour party manifesto is likely to remain on the political agenda for some time, having attracted post-election approval in various quarters including a Guardian editorial and Social Europe. IOFs are intended to

redistribute income and wealth, foster a committed workforce, and encourage a long-term investment. Large companies would be obliged to transfer shares from existing investors to worker 'ownership' although these shares would not be tradeable, but would be collectively managed by a trust of worker representatives. Excess dividends, beyond a small individual pay-out, would accrue as a tax for social projects.

Surprisingly for a left-leaning proposal, the pushback from employer interests to the IOF scheme has been measured. The CBI was concerned about the financial burden on business but noted that most companies agreed with "the fundamental aim of these policies – to engage and motivate employees, deliver for customers and share prosperity". The Financial Times acknowledged that "Labour […] is in some ways pushing at a half-open door with its search for new models of governance." The former City Editor of the Times, Anthony Hilton went even further, remarking that the total cost would be no more than a typical long-term fluctuation in equity value. So, is this proposal a winner? In this review, I assess it and ask whether its aims might better be achieved by other means.

Shareholder primacy vs stakeholding

The doctrine of 'shareholder first' (shareholder primacy) has held sway since the 1980s. Shareholder primacy is normally defended as follows: all stakeholders except the shareholder are protected by a contract under which they are compensated for their risk. Shareholders by contrast assume all 'residual' risk and are entitled to any residual income after contracts have been honoured. This entitlement needs to be enforced against attempts to divert it to self-serving executives (the 'agency problem'). Shareholders therefore need the right to control the board.

The objection to this view is that while its logic may be internally valid, it misrepresents the factual context. Contracts may be unevenly balanced against workers; contracts are never complete anyway; many stakeholders – for example those affected by environmental damage – have no contracts at all; and shareholders have distinct self-interests from other stakeholders. Further, the control rights of shareholders are generally implemented via high-powered compensation schemes which can be totally counterproductive, as executives engage in gaming the system.

Shareholder primacy has always been opposed by the political left for its exclusion of worker voice but in recent times other commentators

have added weight to the criticism, noting: dysfunctional behaviour by some financial institutions; debilitating effects on labour relations and enterprise; and discouragement of long-term firm commitments. Similar criticisms of shareholder primacy are now heard from, *inter alia*, the business press, the OECD, and even institutions representing financial investors.

These serious critiques are welcome but they do not constitute a reform programme. The most popular remedy is some form of voluntary restraint whereby institutional investors step in to moderate the behaviour of short-term or self-interested actors. This – like many other of the solutions on offer – ignores the political tension over the distribution of profit and suffers from the 'myth of impartiality'. For the centre left, the opportunity is there to design workable forms of stakeholder governance, which can deliver a long term focus, fair workplace relations, better upwards communication of knowledge and perhaps greater attention to external costs and benefits.

Two models of stakeholding

If it is agreed that shareholder primacy is flawed, what is the solution? Two contenders are shared ownership such as IOFs and stakeholders on the board. The IOF proposal is arguably an easier political sell. Although it was trialled as a left alternative programme by Sweden's Social Democrats in the 1980s, the general notion of workers owning company shares is something that has found full acceptance in all main political parties in the UK. In the Guardian's two editorials on the topic, IOFs are 'hardly subversive' (September 17 2019) while they "allow Labour to outflank the Tories by rethinking the firm and who controls its surplus rather than just nationalising it" (January 20 2020). But that is an odd choice of words. IOFs give some ownership, but not much corporate control. Even if the full target of a 10 per cent shares stake were to be controlled by a worker trust, it would amount to far less control than the other stakeholder commitment in the 2018 Labour manifesto for a one-third worker representation on company boards. The danger is that in a hunt for popular appeal – some have referred to IOFs as the equivalent of Thatcher's 'right to buy [council houses]' – the essential difference between ownership and control will be missed. It is often neither necessary to own companies outright, nor to own them as workers, for a significant element of social and worker control to be exercised at board level. Indeed, the power of shareholder primacy does not come just from ownership of shares, which after all is not the same as ownership of a company. It

derives from a combination of corporate law, soft law and corporate governance that determines how ownership confers control.

For the IOF scheme, the most certain benefits – which may not be large – relate to redistribution and a small degree of democratic control. Its effect on economic enterprise depends on the contested extent to which such individual 'ownership' conveys a collective sense of purpose that increases motivation and productivity. There are also risks. The cost to the firm may be offset by a downward wage adjustment either in response to market forces or to the minimum wage commission recommendation. If a firm's dividend becomes part of workers expected income and workers have a say in dividend pay-out, this may then encourage excessive pay-out at the expense of reinvestment in the firm. The political and economic leeway to tax capital gains will be reduced by the scheme which will prevent taxation being used as a lever to encourage capital spending.

Contrast the uncertain net gains of this scheme with the simple solution of workers (and potentially other stakeholders) on boards which even standard economic accounts suggest works well in northern Europe. There has been considerable research done by the TUC and labour economists to chart the existing modes of operation and to envisage how the plan would work in practice. A major argument for workers on boards is the contribution that workers – especially middle management – can make to an informed discussion of company strategy and in preventing rent-seeking by senior executives. A further advantage is that such representation tilts the time horizon away from the short term given that these managers' tenure will likely be longer than the CEO's which now averages under five years. If worker representation on the board increases the investment horizon and raises motivation it could have significant effects on productivity and efficiency.

Summing up

The shareholder/stakeholder debate is complex but it must be fully explored if change is to be effective. Two stakeholding proposals have been highlighted here. The IOF plan is likely to redistribute income progressively to some extent, though it is not clear that that aim would not be better served by a broader based wealth tax on unproductive capital. The worker representation plan, if thoughtfully implemented, would bring both economic gains and give greater control rights to workers. Although these two proposals are not mutually exclusive, there is a limit to the political capital available so that it may be necessary to choose between them. The IOF scheme

may have more immediate popular appeal because there is already cross-party support for broadening share ownership. Ownership, however, is not to be confused with control rights and the IOF scheme does not address the fundamental problems inherent in the shareholder primacy model. Indeed, IOFs run the risk of making matters worse if the financial burden exerted by IOFs on business precludes any reform of corporation tax to spur investment. The alternative proposal of worker representation seems a superior policy as long as it recognised that it requires a significant amount of preparation, not least on the part of stakeholders.

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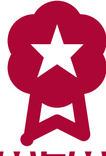

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