

Why do firms run all-employee stock purchase plans?

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Alex Bryson, John Forth and Richard Freeman present research into the benefits of all-employee stock purchase plans. They find that employees who joined the plan were more committed to the firm, more satisfied with their jobs and behaved in ways which were productivity-enhancing, namely working longer hours and taking less sickness absence.



Across Britain around half of all listed firms run some kind of all-employee stock purchase plan (ESPP). These offer workers the opportunity to buy shares in the firm at discounted rates. But why do firms do this, and what do they hope to get out of them? Perhaps they are just a tax-efficient way of paying workers? In Britain government subsidises these schemes – known as Share Incentive Plans, or SIPs – through tax breaks offered both to the employee (low or zero tax on gains from share trading) and the employer (in the tax treatment of the shares firms offer to employees to match their own purchased shares). But multi-national firms offering ESPP in Britain are increasingly likely to offer them elsewhere, even when their tax treatment is less favourable. This is not the whole story.



A second possible explanation for the popularity of ESPP's is that firms have a hunch that they are the "right thing to do", either because they want to share the rewards from the firm's good performance; they are eager to engender a culture of inclusiveness and "engagement", as promoted by policy-makers and business gurus; or because senior executives see a fit between the ethos behind ESPP's and what they are trying to achieve as a business. When you ask CEOs why they introduced an ESPP they often use this sort of language in explaining their motivations. And when you ask their employees why they think the firm introduced the plan they tend to confirm what their bosses say – whether they have actually joined the plan or not.



Table 1 presents evidence from a recent study we undertook among employees in a multinational service sector firm offering an ESPP, which we call ShareCo. Seven-in-ten employees say the company offered it "to make me feel part of the firm", while six-in-ten said it was "to keep me with the company longer".

Table 1: Employee Views on Why The Firm Introduced the ESPP

Reason:	Non-member	Member	All
To build team spirit	30	33	31
To make me work harder	31	35	33
To keep me with the company longer	53	65	58
To make me feel part of the firm	68	74	71
As a gift	8	10	9
Because other companies do it	33	33	33
So I can vote on how the company is run	14	11	13
Other	7	6	6

Source: *Bryson and Forth, 2014*

If we think of the economics here these responses are not wholly satisfactory. Imagine two counterfactual worlds, one in which ShareCo offers an ESPP and one in which ShareCo does not offer an ESPP. All else in the world is constant. In the world in which ShareCo offers the plan it incurs some costs. There are some direct costs, such as those related to administering the scheme, and the costs incurred in matching the shares purchased by employees. There are some opportunity costs – what else could the company have done with the money spent on the scheme? And there are potential and quite substantial indirect costs. For example, shareholders may balk at the prospect of diluting the company ownership base by divesting ownership to employees. These employees are also able to share in employee profits in a way that might not otherwise happen. These two issues – diversifying ownership and limiting the value of holding stock – may act as a disincentive for external traders to hold ShareCo stock or, if they do, will limit the price attached to that stock. One might even imagine – as [Robert Gordon](#) did some time ago – that corporate stock holders face disincentives to invest in the firm’s capital when some of that investment is recouped by the employees.

In the light of these potential dangers in offering stock to employees under an ESPP, why do so many firms choose to do so? One possibility is that the benefits described in Table 1 translate into an income flow that exceeds – or at least balances – the costs of the plan to the firm. Our recent ShareCo study suggests this is indeed a possibility for two reasons: ESPP participation is associated with attitudes and behaviours which are pro-productive and there is a perception that the presence of an ESPP attracts more talented job applicants. In other words, ESPPs seem to accomplish the two objectives set by most incentive plans, as discussed by [Ed Lazear](#) and others.

How did these benefits show up in our survey? First, the study found that, when compared to observationally equivalent non-members of the Plan, employees who joined the plan were more committed to the firm, more satisfied with their jobs – a trait [linked to](#) higher workplace-level productivity – and behaved in ways which were productivity-enhancing, namely working longer hours and taking less sickness absence.

Table 2: What Effect Did the Plan Have?

Extent to which Plan:	Non-member	Member	All
<i>Increases your motivation:</i> Some extent Great extent	24 3	47 9	34 6
<i>Increases motivation of other employees:</i> Some extent Great extent	31 4	43 5	36 4
<i>Reduces the chance you will leave the firm:</i> Some extent Great extent	21 5	40 11	29 7
<i>Reduces the chance others will leave the firm:</i> Some extent Great extent	29 4	41 5	34 4
<i>Attracts talented people:</i> Some extent Great extent	28 4	35 5	31 5
<i>Makes it more likely you’ll recommend the company to others:</i> Some extent Great extent	28 6	46 9	35 8

Source: [Bryson and Forth, 2014](#)

Although it was difficult in our study to establish whether the link between plan membership and productive behaviours was a causal one, a majority of members said that membership increased their motivation, while almost half also thought it increased the motivation of others (Table 2). There is also some evidence of a positive spillover of the plan to non-members who thought their own motivation was positively influenced by the plan members around them. Over one-third of employees also thought that an ESPP was likely to attract talented people to the company, in keeping with the idea that firms with plans can attract more productive applicants than might be possible in the absence of a plan.

Of course, even if ESPPs can increase labour productivity via incentives and worker sorting, the gains need to be sizeable to meet the additional costs incurred by running such a scheme. In our [previous work](#) and the [work of others](#) both in Britain and the United States, there is evidence that these effects do translate into higher workplace and firm performance.

How does it work?

We have established that many large listed firms adopt ESPPs, and that they appear to be behaving rationally in doing so, in the sense that they benefit from their adoption. But how do these ESPPs actually *work*? In [a paper](#) just released, we argue that ESPP's are a hybrid between a form of gift exchange, on the one hand, and an incentive contract on the other. The discounted rate creates a gift exchange, where the firm hopes that workers who accept the gift reciprocate with greater loyalty and effort. But ESPPs diverge from standard gift exchange or efficiency wage models. Employees have to invest some of their own money by purchasing shares at the discounted rate to accept the gift. A sizeable number choose to reject the gift. In addition, the value of the ESPP gift varies with the share price and thus with the performance of the firm and the effort of workers in total. For workers who buy subsidized shares, an ESPP sets up a group incentive pay system analogous to profit sharing, all-employee stock options, or an employment ownership scheme that makes part of workers' compensation depend on company performance.

Using data from the UK establishments of ShareCo we compared the workplace behaviour of employees who join the ESPP with that of observationally equivalent workers who do not join the plan. We find that workers who purchase shares at subsidized prices work harder for longer hours and have lower quit and absence rates than workers who do not join the plan. We also find perceptions of peers' plan participation influences workers' behaviour. What is particularly intriguing is that ESPP joiners socialise more with colleagues outside work than non-joiners: this greater sense of social identity with colleagues, predicted under some gift exchange models, lowers their costs of work effort and may explain why they are more productive than those who do not join the ESPP. These findings highlight the distinct place of subsidized share purchase schemes in the spectrum of gift exchange and group incentive pay systems.

Note: This article gives the views of the authors, and not the position of the British Politics and Policy blog, nor of the London School of Economics. Please read our [comments policy](#) before posting. Featured image credit: [Vase Petrovski](#) CC BY-NC 2.0

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