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PATTERNS OF EMPLOYEE PARTICIPATION AND INDUSTRIAL DEMOCRACY IN UK EMPLOYEE SHARE OWNERSHIP PLANS

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ABSTRACT

This paper examines the institutional characteristics of UK Employee Share Ownership Plans (ESOPs) and considers the extent to which ESOPs extend employee participation and industrial democracy. It is suggested that ESOPs in themselves do not extend industrial democracy. Instead patterns of employee participation are substantially determined by the goals of those primarily responsible for establishing the ESOP. Three constellations of ESOPs are discerned on the basis of their participative characteristics: `technical ESOPs' where there is little or no development of industrial democracy; `paternalist ESOPs' which tend to develop individualistic forms of employee participation; and `representative ESOPs' where new institutions are created to give some opportunity for involvement of employee representatives in top decisions.

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Introduction

One of the less-remarked upon innovations in recent analyses of employee financial participation is the Employee Share Ownership Plan (ESOP). Originating in the US, where there are now some 10,000 organisations with ESOPs, the ESOP concept was developed in the UK in the mid-1980s. Its core principle is that equity is purchased by a trust for disbursement to employees, usually at no direct cost to the recipients. The first UK ESOP was created in the motorway services station organisation Roadchef in 1987 when a quarter of the company's equity was purchased by an Employee Benefits Trust with the help of a loan from the trade union bank Unity Trust. Since then the development of ESOPs has been associated primarily with the Government's privatisation programme. In the bus industry, for example, management-employee buy-outs based around the ESOP concept have become a widespread response to privatisation, and around a fifth of the industry's employees were to be found in ESOP firms by mid-1994. Even so ESOPs are still a peripheral feature of British industry and services, and their numbers are dwarfed by the more conventional profit-share and share option schemes which became so widespread in the 1980s. A precise statement of the number of UK ESOPs is difficult to provide (most variants of the ESOP concept do not have distinct legal identities and are thus not recorded in official statistics) but most observers estimate that there are between 50 and 100 ESOPs.

Despite their comparatively small numbers so far, there are a number of features associated with ESOP firms which makes them of great interest to managers and trade union representatives, as well as academic researchers. (1) Whereas most `conventional' share schemes facilitate transfer of relatively modest proportions of equity to employees - typically less than 5 per cent - ESOPs can enable flows of up to 100 per cent of equity to employees, usually at no cost to the employees themselves. (2) As might be anticipated where equity transfers are large, ESOPs schemes may be a centrepiece of company organization. In contrast, most conventional share schemes tend to be marginal in character, with few discernible effects on the management of the company. (3) Whereas conventional share schemes do not lead to the creation of new institutions of employee participation or representation, ESOPs are a potentially democratic form of financial participation. Since equity is usually held collectively before disbursement to individual employees there is the potential for developing collective institutions of corporate governance. In other words, ESOPs appear to have the potential, more or less absent from conventional financial participation schemes, for ownership to be translated (to some degree at least) into control. For this reason some of those opposed to or at best neutral about conventional share schemes (eg some parts of the trade union movement) are much more favourably inclined towards ESOPs.

The extent to which ESOPs fulfil the apparent promise of greater industrial democracy, however, cannot be read-off from the institutional and financial structures of the ESOP since other factors are likely to affect the extent of employee participation in practice (cf Marchington, Wilkinson, Ackers and Goodman, 1994). US experience indicates that participation arrangements vary widely between ESOPs: relatively few have developed new forms of corporate governance, such as worker representatives on the company board, and many do not `pass through' voting rights on shares held in trust. Rather more have expanded participation at the individual, or task-related level (see General Accounting Office, 1987). The reasons for establishing ESOPs also vary: many are formed to provide pension funds, some to obstruct hostile takeovers (the so-called `poison pill'), and only a small number to advance industrial democracy (see Klein and Rosen, 1986). Unsurprisingly there is a broad association between the objectives behind establishing an ESOP and the extent and character of employee participation in decision-making. Those forming an ESOP for democratic reasons are likely to introduce more advanced participative structures than those creating an ESOP for pension planning. These observations from abroad provide the starting-point for our study of UK ESOPs. On the basis of an extensive empirical study in progress since 1991[1], we attempt to assess the extent to which ESOPs meet the expectations of those who believe this new form of financial participation will extend employee involvement in decision-making. Our findings suggest a constellation of three forms of ESOP which we term `technical ESOPs', `paternalist ESOPs' and `representative ESOPs'. Only in the latter is it possible to discern a sustained attempt to develop employee participation in decision-making. These three categories are distinguished not only by the extent to which employee participation is developed but by the relative involvement and objectives of key actors, such as trade union representatives, top managers, etc. Our underlying argument, therefore, is not that the ESOP form *per se* extends employee participation but that the extent to which ESOPs extend industrial democracy is substantially determined by the goals of those establishing them.

1. Forms of Employee Share Ownership Plan in the UK

Compared to the USA, where ESOPs first appeared on the scene in the late 1950s (Cotton, 1993), UK ESOPs are a relatively recent development. The ESOP first appeared by name in the second half of the 1980s when the motorway services firm Roadchef passed a quarter of its equity from one of its owners to the workforce.[2] A few months later Peoples' Provincial, a bus company in the throes of privatisation (from the National Bus Company), created an ESOP as a way of effecting a management-employee buy-out. In this instance 80 per cent of the equity was passed to the workforce using ESOP mechanisms, with the remaining 20 per cent being purchased directly by employees. Subsequently the main driving force behind the creation of new ESOPs has been the UK Government's privatisation programme. In the late 1980s and early 1990s a succession of bus companies created ESOPs in response to pressures to privatise, to the extent that by mid-1994 around a quarter of the industry's workforce was covered by such schemes. ESOPs have been less prevalent in other privatisation initiatives but examples (sometimes short-lived) can be found in automotive manufacturing (Llanelli Radiators) and railway engineering (RFS, formerly known as Doncaster wagon works). They have emerged also in response to deregulation, as for example amongst labour-only contractors created in South Wales after the abolition of the Dock Labour Scheme (see Turnbull and Weston, 1993), and are now starting to develop in local authority services in response to competitive tendering and pressures to externalise service provision.

Unlike conventional share schemes, whose development can be traced directly to legislative encouragement by central government, the main spur to the development of ESOPs has been the threat posed by government policy. In the bus industry, for example, ESOPs have grown so rapidly because employee ownership has come to be viewed by workforces as the most effective form of defence against purchase by hostile predators or by firms whose competitive strategies centre around reductions in wages and conditions of employment (see Forrester, 1993). However, once the ESOP form emerged, government policy has been to encourage their development on the basis that this form of employee involvement will increase commitment, co-operation and flexibility, and in turn lead to improvements in company performance (see Employment Department Group, 1989). Statutory recognition of the ESOP concept has been provided since 1989 but rather more important in encouraging the spread of ESOPs has been the preferential sale terms given to management-employee buy-outs during privatisation.

Given the nature of ESOPs development in the UK it is perhaps inevitable that a number of different legal/financial structures have emerged. Currently there are three main basic forms of ESOP, which partly correlate with the three constellations of participative structures to be discussed shortly. The first is known as a `case law' ESOP since the structure adopted to spread share ownership is based on an amalgam of legislation (that relating to trusts from the 1920s and more recently the 1978 profit sharing legislation) and case law, ratified for tax exemption purposes by the Inland Revenue on a case by case basis. Typically an ESOP of this type is composed of one or more Employee Benefits Trusts (EBT) and a Profit Sharing Trust . When the ESOP is created the EBT acquires equity in the company, in most cases by purchase but by gift in some, generally using a loan repayable over 5-10 years. In most of the early ESOPs the trade union bank Unity Trust provided the source for these loans but more recently a wider range of financial institutions have been used. Assuming profitable trading by the company, a portion of profits is passed each year to the Profit Sharing Trust to purchase shares from the EBT for distribution to the workforce in most cases free of charge and on equal terms (usually in equal amounts or according to length of service). The EBT uses the receipts from this activity to repay the original loan. At the same time the EBT will need to purchase shares from departing employees (if, as is common, the sale of shares is restricted) so further loans or financial transfers from the company will be necessary to finance this. In effect money circulates around institutions connected to the trading part of the company, to provide a zero-cost, low risk vehicle for employees to acquire a share of their company's equity. Employees are exempt from income tax on the value of their acquired shares as a benefit from employment if the shares are retained in trust for five years (though they become beneficial owners after two years, and hence acquire direct voting rights (Arrowsmith and Anderson, 1992)). Most bus company and philanthropic ESOPs take this form.

The second type of ESOP is the so-called `statutory ESOP' introduced by the Government in the 1989 Budget. The thinking was that a unified set of ESOP provisions would simplify ratification of ESOPs structures for tax relief purposes, and hence make it easier for firms to introduce ESOPs. ESOPs incorporating these provisions are known as `statutory ESOPs'. Their key characteristics are a unified trust structure in which an Employee Share Ownership Trust (ESOT) or Qualifying Employee Share Ownership Trust (QUEST) acquires, holds and distributes equity, a requirement that equity be passed to the workforce within seven years, and a requirement that a majority of the trustees be employees of the firm and elected by a majority of the workforce. If these requirements are met the company's contributions to the ESOT are given statutory exemption from corporation tax, capital gains tax rollover is available, and the administrative start-up costs are tax deductible (Reid, 1992). The take-up of the statutory ESOP has been very low - certainly in single figures - and the consensus amongst ESOPs supporters is that the statutory stipulations are too restrictive to be attractive (see Cornford, 1990). Firms considering conversion are thought to require greater flexibility in their choice of structures. In response two pro-ESOP Conservative MPs tabled amendments (accepted by the Government) to the 1994 Budget which loosened the statutory requirements. The period for distributing shares was extended to 20 years and the requirement that a majority of trustees be employees was relaxed. Furthermore employee trustees are now electable by a simple majority of those returning completed ballot papers instead of a majority of the entire workforce. It remains to be seen whether these new provisions will kick-start the development of this kind of ESOP.

The third type of ESOP has a number of important differences with case law and statutory ESOPs, and in so far as this kind of ESOP is a technical device rather than an instrument of industrial democracy it can be misleading to refer to organisations with these arrangements as ESOPs. ESOPs of this type are often referred to as `unapproved ESOPs' since the ESOP structure in its entirety is not submitted for Inland Revenue approval and no tax breaks are secured on equity transfers to the Benefits Trust. This form of ESOP developed after the 1989 Companies Act allowed PLCs to purchase their own shares in certain circumstances. Typically a company with an unapproved ESOP uses an offshore trust (usually operated by a clearing or merchant bank) to purchase shares in the company on the open market. The main reason for using this mechanism is to acquire existing equity for distribution to employees through existing Inland Revenue-approved profit-sharing, share option or executive options schemes (see Carnell, 1992 for further details). This is deemed to be necessary when the volume of employee share schemes is such that new share issues to meet scheme requirements would lead to unacceptable dilution of earnings per share and would breach Association of British Insurers rules on share scheme issues. In this instance, therefore, the ESOP is primarily a technical instrument of corporate finance aimed at supporting conventional share schemes. There are no tax breaks on the ESOP though employees benefit from the tax relief provisions attached to the share schemes supported by the ESOP. Where, however, the bank operating the trust retains shares till distribution the dividends payable on these can be offset against loan charges. Since ESOPs of this sort are not statutorily registered (unlike statutory ESOPs) and are created without publicity, it is not known how many firms have this kind of structure.

To complicate matters further, many ESOPs, particularly of the case-law variety, also make use of the two other main forms of employee ownership (see Toscano, 1983). These are direct ownership, where individuals purchase equity directly in a similar fashion to any other shareholders, and co-operative ownership where all or most employees subscribe equal portions of capital and in return receive equal voting rights. Direct ownership, or `worker capitalism' as it is often termed, is most strongly associated in the UK with the National Freight Corporation buy-out in 1982 (see Bradley and Nejad, 1989) and has been used as the main vehicle for employee ownership in a number of bus companies where workforce or management have opposed the ESOP principle[3]. It has become common in ESOP buy-outs to supplement the ESOP mechanism on the grounds that direct purchase of equity is likely to have stronger motivational and attitudinal effects than the indirect, risk-free approach of the ESOP mechanism. Some financial institutions have insisted that direct share purchases take place as a condition of the main loan advanced to purchase the company where it is proposed that in excess of 50 per cent of equity be passed to an ESOP. Participation rates in these schemes tend to be in excess of 50 per cent, reflecting the efforts made by buy-out teams to secure high participation, and considerably in excess of the typical participation rates in conventional share option schemes (see Baddon *et al*, 1989; Dunn, Richardson and Dewe, 1991). Since universal participation is aimed for, some firms have incorporated co-operative principles in their organisational design (see Mason, 1992). Chesterfield Transport, for example, supplemented an 85 per cent ESOP with a direct purchase scheme in which 86 per cent of the workforce subscribed to equal blocks of equity. Voting rights for the latter are on a one-person, one-vote basis, and come into play on special resolutions concerning fundamental issues such as acquisitions and divestments. Some firms make equal use of all three forms of employee ownership. At Barry Stevedores, a labour-only contractor divested from Associated British Ports, employees loaned their redundancy settlements to a statutory ESOP to purchase shares on their behalf, with voting rights organised on a co-operative basis. It should be apparent from this outline of the various legal/financial structures coming under the ESOP umbrella that ESOPs vary widely and that hence any attempts to generalise about ESOPs need to proceed with a degree of caution. Nevertheless, it is clear that most ESOPs, with the exception of most unapproved ESOPs, embody a more advanced level of financial participation than most conventional employee share schemes. Studies by Poole and Jenkins (1989) and Baddon *et al* (1989) indicate that the vast majority of deferred profit share and share option schemes account for less than 5 per cent of total equity. By contrast, our preliminary outline of ESOPs indicates that employee equity shares may be substantially larger. Furthermore, where direct share purchase is used in conjunction with an ESOP participation rates are considerably higher than in conventional share option schemes. Employee ownership appears likely, therefore, to be more central to the firm's operations, and, all things being equal, pressures for ownership to be translated into some degree of employee control are likely to be greater. In the following section we consider the character and extent of employee participation in ESOPs, drawing on the findings of our empirical investigation of UK ESOPs.

2. Participation and Industrial Democracy in ESOPs

At least three possibilities offer themselves concerning the character of employee participation in ESOP firms. One is that participative structures are more or less similar in all organisations with ESOPs. The second is that the institutions and character of participation correlate broadly with the three main legal/financial forms of ESOP, whilst the third is that participation will vary according to the level of employee share ownership. Employee participation will be more advanced and structures more extensive in those firms where employees own a greater proportion of the firm.

The first proposition does not survive beyond even the briefest scrutiny of UK ESOPs. Some have developed few if any new forms of participation alongside the ESOP whilst others have made comprehensive changes to structures of decision-making. Even within the group of firms which have sought to extend employee participation there are marked differences in the character of participation: in some the emphasis is on direct participation by individuals in task-related decisions whilst in others the main emphasis is on indirect representative participation in strategic decisions. Such diversity reflects the American experience (see Klein and Rosen, 1986). Some studies have found that most ESOPs introduce few if any extensions of participation (eg Rooney, 1988). Others have noted how relatively few have introduced new mechanisms of corporate governance, such as worker representation on the company board, whilst rather more have extended direct individual participation (General Accounting Office (GAO), 1987). These differences partly correspond to the various legal/financial forms that ESOPs can take in the US (see GAO, 1987; Conte and Svejnar, 1990). One form of ESOP, mainly used for pension fund purposes, did not even pass through voting rights until recently. Yet in turn the adoption of particular legal forms is determined in large part by the objectives of those establishing the ESOP. Those forming ESOPs to extend industrial democracy make use of different legal structures than those creating ESOPs for pension fund planning or other financial purposes. In other words the legal structures themselves do not determine the forms of participation chosen: rather both legal and participative structures are better viewed as outcomes, determined in large part by the objectives of the actors involved.

Similar observations can be made of UK ESOPs. There is a partial association between legal form and the extent and character of participation but both are better viewed as outcomes. As we shall see shortly, the `unapproved ESOPs' described in the previous section tend to introduce few new forms of participation to accompany the ESOP. This reflects the rationale for forming an ESOP, namely a `technical' requirement to purchase existing shares on the open market rather than to issue new shares to support conventional employee share schemes. However, no such associations can be discerned with the other two forms of ESOP. The number of statutory ESOPs is too small to make any sustainable generalisations, whilst considerable diversity can be found between those using the `case-law' mechanism. Some have concentrated on developing task-level participation whilst others have devoted their attention to developing representative structures. In some cases participative arrangements have been extended considerably in tandem with employee ownership whilst in others there are few if any innovations.

The third proposition, that the degree of participation is related to the extent of employee ownership, appears to be broadly supported by both US and UK experience. Firms with very high levels of employee share ownership tend to have more participative institutions than those with say a 5 per cent employee stake in both countries. Furthermore the character of participation seems to be broadly related to the ownership stake: where it accounts for a high proportion of total equity, the tendency is for opportunities to be developed for employees or (more usually) their representatives to take part in strategic decision-making. However, there are a number of problems with this proposition. One, (as Bradley and Nejad, 1989, have remarked) the extent of ownership is not as straightforward as it might appear at first. As well as the proportion of equity held by employees, other relevant dimensions are the extent of ownership participation by employees and the distribution of equity amongst the employee owners (Long, 1980). In addition the balance between direct ownership by individual employees and indirect ownership by trust structures could be important (see Toscano, 1983). A second problem, (as Young has remarked, 1990) in relation to US ESOPs there appears to be no necessary relationship between ownership characteristics and employee participation. Many examples can be found of firms with small levels of employee ownership which are highly participative. In the UK we know of firms with very similar ownership characteristics which have quite different approaches to employee participation, reflecting differing objectives of the architects of employee ownership. This takes us to a third objection, which is that participation structures do not flow automatically from ownership arrangements (though the particular configuration of ownership may give rise to pressures for particular forms of participation). These institutions have to be created by some human agency. The broad association between the extent of participation and the extent of ownership can be discerned in many cases because those key actors committed to high levels of economic democracy are also likely to be committed to or at least accept the need for high levels of employee participation in decision-making, at least in some form.

We therefore propose that a focus on the philosophies and objectives of those involved in creating employee ownership and participation is necessary to categorise and understand the differences between participative arrangements in ESOPs. This approach is similar to that in earlier studies of workers cooperatives, where it has been found that the orientation of founder members is very important in shaping the development of co-operative structures (see Cornforth, Thomas, Lewis and Spear, 1988, pp.8-10), and in studies of US ESOPs where the research evidence indicates that management philosophies are very important in determining the character of employee ownership and participation (Pierce, Rubenfeld and Morgan, 1991; Klein, 1987; Long, 1981). In the case of UK ESOPs the two main groups of actors tend to be senior management and employee representatives, usually but not necessarily trade union representatives. Where management are the dominant influence on the design of employee ownership it may be anticipated that in most cases the dominant objective is risk sharing or some other performance-orientated objective rather than any extension of industrial democracy which might challenge the management prerogative. In these cases it may be expected that the employee equity stake will be relatively small and that there will be limited development of new forms of employee-shareholder representation. The exception is where management or previous owners have a philosophical commitment to employee ownership. In these cases we could expect to find a larger employee equity stake but it is questionable whether the departing owner's commitment to economic democracy will extend to developing industrial democracy.

Where employees or their representatives are an equal or dominant influence on the design of the employee-owned firm we can anticipate that there will be a greater concern to develop institutions to pass some control of decision-making to employees. Large equity stakes for employees may well be seen as part and parcel of this, in that the larger the stake the more likely employees will be able to exert some control of decision-making. A complicating factor, however, is that many trade union representatives fear that new institutions of employee-shareholder participation may undermine traditional trade union institutions. Where this anxiety is especially strong the development of new forms of participation may well be limited, and existing union structures might continue to be the main avenue for employee participation. However, many union representatives also fear that use of union structures for expressing shareholder issues may well blur the division between owners and employees, and hence undermine the traditional role of the union as the vehicle for expression of employee interests vis a vis the employer. In those cases, therefore, where new forms of participation are created we would expect these to be separate, at least in procedural terms, from existing union structures but subject to scrutiny or control by union representatives (see Pendleton, Robinson and Wilson, 1995). Whatever the precise configuration of institutions, however, we can expect that where employee representatives are the dominant influence on organizational design, there will be a greater emphasis on industrial democracy than in cases where employee representatives play a more subordinate role.

On the basis of these considerations we believe that ESOPs and similar firms can be grouped into three categories. In each group there will be broad associations between the objectives of those involved in developing employee ownership, the extent of employee ownership (broadly defined) and the extent and character of employee participation. These categories are based on our research findings to date and although ideal-typical in character they have a firm empirical grounding.

2.1. technical ESOPs

The first type of ESOP corresponds to the unapproved form of ESOP described above, and we call it a `technical ESOP' on the grounds that the ESOP is introduced not to extend employee ownership or participation but to facilitate the operation of conventional share schemes. The ESOP is primarily viewed as a technical measure and is generally driven by corporate financing issues. In most cases the key factor is the danger that conventional employee share schemes will dilute earnings per share and breach City guidelines on new share issues. Typically these schemes are devised and implemented by the highest levels of management, mainly in the finance or legal function, with little or no involvement of other management groups within the firm. Indeed in one subsidiary of a major drinks and leisure firm we visited, the personnel director of the subsidiary was unaware that head office had introduced an ESOP of this type. Employee representatives have little if any role in the design and introduction of these schemes. In some cases, these is because the firm does not recognise trade unions (as in the case of a speciality chemicals manufacturer we studied) but the most important reason appears to be that these schemes are not perceived by their architects as having an HRM or industrial relations dimension. We have come across only one exception to this finding - a highly-unionised `Pheonix' offshoot from British Steel where trade union representatives were informed of the formation of the ESOP structure.

Given the objectives of those involved in establishing these ESOP schemes, it is probably not surprising that the equity stakes vested in the ESOP are relatively small and that mechanisms for employee participation are not introduced side-by-side with the ESOP. The level of equity held in the Employee Benefits Trust awaiting dispersal through profit share, share option and executive option schemes is just large enough to ensure that the firm does not breach the guidelines mentioned above, and is typically less than 5 per cent. The level of participation in option schemes varies widely: in some cases it is similar to the norm for these types of scheme (ie under

30 per cent) whilst in others it has been in excess of 80 per cent. Voting rights are not passed through to the workforce whilst shares are held in the benefits trust but individual employees acquire these rights when they become direct owners. We have come across no cases of trustees consulting the eventual owners of the shares prior to votes being taken. The trusts themselves are usually located offshore and operated by financial institutions with little representation from the firm itself. With one exception we have not unearthed any cases where employees sit on these trusts or have any part in the selection of trustees. Nor is board-level representation for employees a feature of these firms, and nor do employee shareholders have any explicit rights written into the company's Articles. In short any rights that employees chose to exercise as shareholders are in effect entirely separate from their role as employees and are exercised through traditional institutions of corporate governance eg the Annual General Meeting. Since they comprise a very small minority of the owners they have very little or no influence on the direction of the firm. In short the establishment of ESOPs in these firms does not extend industrial democracy.

This is not to argue, however, that these firms are not participative. Some of them place great emphasis on developing those individualist forms of participation such as team briefing and quality groups, which have been fashionable in recent years (see Marchington, Goodman, Wilkinson and Ackers, 1992; Ramsay, 1991). The `conventional' share schemes supported by the ESOP are one part of this. Furthermore, since this form of ESOP is essentially a technical mechanism, it is in principle possible that firms committed to extending industrial democracy might chose to use this type of ESOP for financial reasons. To date we know of just one firm where this observation applies. The workers' collective running the Centre for Alternative Technology in North Wales set up an ESOP structure in conjunction with a PLC structure to raise capital in a way that protected the decision-making role of the collective's members.[4]

2.2. paternalist ESOPs

The second group of ESOPs is altogether more interesting since issues of economic democracy, if not industrial democracy, are much more prominent in the establishment and operation of ESOPs structures. In this group the ESOP may be the outcome of two types of initiative by company owners or top management, generally in private rather than publicly-traded companies. The first is where an owner seeks to give employees an opportunity to share in the financial well-being of the firm and to benefit from the fruits of their labour. These philanthropic motives often come to the fore when the company's owner wishes to retire. If no members of the owner's family wish to take over the running of the firm, selling the company to an ESOP (which in turn gives it to the employees) may well be viewed as preferable to selling the firm to a third party who might dismember or contract the firm's activities. The other context where ESOPs of this type are introduced is the management buy-out. Introduction of an ESOP structure is perceived by the managers mounting the buy-out as a mechanism to improve industrial relations. Typically there is some measure of idealism amongst these managers in conjunction with a desire to modify employee attitudes away from a conflictual perspective towards a more `positive' orientation towards the firm and its new management. In other words the ESOP is introduced as a risk-sharing device. In this group, then, management and/or owners are the dominant, usually the sole, force behind establishment of the ESOP. In contrast to the `technical' ESOPs described earlier, these ESOPs are more focused on the management of employees, and although the precise motives differ between the two sub-groups, paternalism is the pervasive orientation amongst managers and owners in this category of ESOP.

Employees and their representatives typically have minimal involvement in the decisions to introduce and design an ESOP. However, trade unionism is fairly strong in many of these companies - overcoming adversarial patterns of industrial relations is after all a motive for ESOP creation in many cases - and it is usual for trade union representatives to be consulted over the introduction of the ESOP though generally not until the new arrangements are about to be introduced. In most cases (the GMB in Roadchef being a notable exception) the attitude of the union and local representatives can be described as `bored disinterest'. Unenthusiastic consent is usually given for the creation of the ESOP as long as assurances are given that existing collective bargaining arrangements will not be undermined.

The managerial motives outlined above explain many of the characteristics of this kind of ESOP, in particular the combination of a quite substantial degree of economic democracy but a very limited level of industrial democracy. Their architects believe their workforces should receive more of the fruits of their labour than is customary but have a limited conception of employees' rights as owners and certainly do not believe that any substantial modifications should be made to management structures, functions and practices. The proportion of equity passed to employees ranges from 10 to around 30 per cent: ie substantially more than in conventional share schemes but an insufficient proportion (given the typical concentration of ownership of the rest of the equity) to pass control of the company to employees. Employee ownership gives limited scope for employees to influence the direction of the company. Rarely do companies in this group have elected employee directors on the main board, though Roadchef's board includes non-executive directors selected for their sympathetic orientation towards employee and employee-shareholder interests. Nor do trust structures (most companies in this category are `case-law' ESOPs) provide a vehicle for collective control. Whilst some of these ESOPs have some employee trustees they are usually in a minority and usually selected by management rather than elected by employees.

In so far as firms in this category introduce innovations to employee participation in conjunction with the ESOP the main emphasis in on changes to direct individual participation and communication rather than representative participation in strategic decision-making. Some firms make very few changes at all. A vehicle components manufacturer based in Coventry (whose 12.5 per cent ESOP was bought out a couple of years ago) accompanied its ESOP with bulletins on company performance, and no more. The ESOP trustees in this case were selected from management by the managing director. In other cases ESOPs are introduced alongside other forms of participation, such as quality circles or problem solving groups, but there is little integration of the various forms of involvement and little change to traditional hierarchical patterns of management (see the case study of an engineering ESOP by Wilkinson, Marchington, Ackers and Goodman, 1994).

This type of ESOP tends to be unstable in practice, and tends either to degenerate into a conventional profit sharing scheme or (more rarely) to develop its structures to give employees a greater opportunity to influence decision-making. There are a number of reasons for this. In those cases where the ESOP was introduced as a risk sharing device to improve industrial relations, the marginal impact that the ESOP tends to have on employee attitudes and behaviour leads management to lose interest and for the ESOP to decay. This process has the air of inevitability about it. An employee involvement mechanism with little employee participation either in its creation or its operation, and which makes little difference to the way that the firm is run is unlikely to bring about the attitudinal and behaviour changes sought by its architects, as Wilkinson *et al* (1994) found in their study. As Wilkinson and colleagues note, involvement initiatives of this sort are frequently the brainchild of one top manager (`the champion') and should they leave the firm or change jobs the initiative associated with them is left without a sponsor.

In a very small number of cases, however, the process runs the other way - the ESOP becomes more democratic over its lifetime. This seems to be mostly associated with the more philanthropic ESOPs. In these cases the often substantial degree of equity passed to employees coupled with an emphasis on ownership and sharing rewards conflicts with the limited opportunities for employee owners to influence the running of the firm. It is common in ESOPs of this type for an `employee ownership' crisis to develop, often some years into employee ownership, when some incident causes employees and their representatives to challenge the limited rights conferred in practice by employee ownership. The most common outcome seems to be some degree of democratization such as expansion of the number of employee representatives on trust structures and creation of new institutions to give employees a greater say in the running of the firm. In our research we have come across a number of cases where this has occurred. One was in a bus company privatized from the Scottish Bus Group, where the employees had acquired a 20 per cent stake through direct subscription and a further 10 per cent via an ESOP (senior management took a 40 per cent stake). Unusually amongst bus company ESOPs the trade unions had little involvement in the transfer to employee ownership, and the management reason for giving employees a stake was a mixture of philanthropy and risk-sharing. No changes to employee participation were made after the buy-out except some marginal improvements to communications. Management style was autocratic in character. A few months after the buy-out a crisis developed over the annual pay negotiations. During this episode employees and union representatives claimed that the employee stake had made no difference to the way the company was managed. ACAS was called in to avert a threatened strike and a new participative structure was devised which comprised a joint consultative committee and a series of depot meetings attended by directors. At this point this company in effect started to move into our third category of ESOPs. Another illustration is provided by the heating firm Baxi, which created a Partnership Council composed of employees to govern the firm several years after the former owner transferred his shares to an Employee Benefits Trust and in the wake of employee complaints that little had changed to reflect the changes to ownership structure.

2.3. representative ESOPs

This third kind of ESOP is concentrated amongst management-employee buy-outs in the bus passenger industry. In contrast to `technical' and `paternalist' ESOPs, employee representatives have been deeply involved in the creation of ESOPs of this type - in most cases so far it has been union representatives who initiated the buy-out process. Their primary motive has been to protect their companies, their jobs and conditions of employment when their firms pass from public to private sectors. Not only are they concerned to secure immediate protection from predators they also aspire to influence the way the firm is run in the future. Their motives for developing employee ownership are therefore much more centred on industrial democracy than in the other cases. These concerns have meant that the equity stakes passed to the workforce are substantially larger and the institutions of employee participation more advanced than in the other two forms of ESOP. Top managers have also been deeply involved in the transfer to employee ownership but their role has mainly concentrated on compiling business plans and arranging loan finance. Management views on the value and purpose of employee ownership are sometimes hard to discern in these circumstances since acceptance of the virtues of employee ownership is a pragmatic response to political realities when union representatives within the firm have strong alliances with the local authorities from whom the company is to be bought (virtually all municipal bus buy-outs have been in Labour controlled areas). Nevertheless employee ownership is seen as a potentially powerful risk-sharing device in a context where managers are likely to have to purchase equity directly to secure loans to finance the buy-out. Overall the common assessment seems to be that employee ownership is worthwhile as long as employees do not secure the right to the degree of involvement in management decision-making perceived to be the hallmark of workers' cooperatives.

In these types of firm the equity share held by employees is substantial. Initially the norm in the bus industry was for 49 per cent to be passed to employees with top managers purchasing the majority share directly, mainly at the insistence of those financial institutions loaning capital for the buy-out. More recently employees have acquired larger, majority shares in many cases, either exclusively through an ESOP or through a combination of ESOP structures and direct share purchase. Where direct purchases have been used it is most common for equity to be sold in equal portions linked in some cases to a co-operative voting structure on major strategic issues. In a number of recent cases the entire equity has been transferred at the outset (by valuing shares at such low levels that they are not considered as gains from employment and therefore do not attract the tax liabilities which more gradual schemes are designed to avoid).

The coincidence of union and management views in these organizations explains not just the greater level of industrial democracy in these firms but the character and structures it has taken. Extensions to employee participation developed in association with the ESOP have centred on indirect representative participation in strategic decisions rather than on the more direct, individualist participation in task performance decisions found to some extent in the other two forms of ESOP. Trade union representatives have favoured indirect forms of participation partly to ensure that the substantial levels of economic democracy are translated into industrial democracy and partly because of fears that the currently fashionable forms of individual participation could undermine trade union functions and collective bargaining. Representative modes of participation have been viewed as more amenable to union control either because of their proximity to institutions of union representation or because the unions take on this new aspect of representation themselves. Surprisingly perhaps top managers too have preferred this approach to participation. The danger of direct employee participation in the employee ownership context is that employees may choose to exercise property rights in unpredictable and damaging ways, perceiving managers as their agents and expecting them to act on their demands. By contrast, indirect, representative participation takes place at one remove from day-to-day management activity and, if employee representation is controlled by the trade unions, will usually involve representatives who will probably act `responsibly' (given that unions in these ESOPs are concerned to protect the value of the employees' `investment') and who have an ideological aversion to close involvement in management functions. Rather at odds with trends in employee participation over the last fifteen years or so, top managers in these organisations have therefore favoured collectivist rather than individualist approaches to employee participation.

Representative participation takes a number of forms in these ESOPs. In most cases employees are the majority group on the EBT and profit sharing trusts, in some cases elected by employees, in others selected by trade union representatives. Furthermore it is common for the Articles of Association to stipulate in some detail the kind of decision-making issues upon which Trust agreement is required, even where the Trusts hold a minority of the equity, and to stipulate that the agreement of all or some of the Trustees is required before managers take certain courses of action (eg investment) which would not normally be put to a vote of the shareholders. In virtually all cases, however, the Trusts do not have an active role in corporate governance - they are designed primarily to act as `warehouses' for storing equity and to provide protection for employees' interests. The main exception to this is Chesterfield Transport where the Employee Benefits Trust was designed to function as a German-style upper board. More active in decision-making are the non-executive employee directors or employee-nominated directors found on the Board of Directors of most companies in this category. As with the trustees the employee directors are either elected by the workforce or in effect selected by trade union representatives. Although they usually constitute a minority on the Board, the Articles usually provide explicit protection for the role of these directors, requiring for instance that at least some of the employee directors vote with the majority for a decision to be valid. The research evidence so far suggests that these employee directors are more active and more influential than those investigated by Brannen, Batstone, Fatchett and White (1976), Batstone, Ferner and Terry (1983) and Towers, Chell and Cox (1985) in the years surrounding the publication of the Bullock Report (see Pendleton, Robinson and Wilson, 1994).

In most firms in this category, both trade unions and management have viewed procedural separation between employee representation and employee-shareholder representation as being highly desirable. From the union perspective it prevents the trade union role being muddied by ownership concerns whilst from the management point of view it helps to prevent contamination of the potentially integrative features of employee ownership by aspects of `traditional' industrial relations. It is usually stipulated, therefore, that trustees and employee directors resign any shop steward positions upon appointment. One interesting exception to this is a large ex-Passenger Transport Executive bus company where the Employee Benefits Trust is designed to be `guardian of last resort' of the employees' investment: in this case the Trust is composed entirely of senior shop stewards from each of the company's depots. The danger for trade unions of separating industrial relations and shareholder representation is that the shareholder representatives will pursue policies inimical to the unions or what the unions see as the long term interests of the company. For this reason the trade union architects of representational structures in these companies have introduced a number of controls over selection or nomination of trustees and employee directors, and required that those holding these offices give regular reports to union branches. A number of new institutions have also been created such as `shadow boards' - composed of directors and senior trade union representatives -, and trade union-trustee liaison committees. Managers have consented to the introduction of such institutions to reassure union representatives that their functions will not be undermined by new institutions of employee ownership. In a small number of cases, however, union representatives have viewed the potential threat of employee directors and the like to be too great, whilst being unwilling to leave corporate governance to management and the AGM. In one large ex-PTE company, therefore, the joint convenors' committee also acts, with a different hat on, as the Shareholders Representation Committee.

All companies in this category of ESOP have attempted to introduce new forms of representative participation in some form or another. Much less common have been innovations in individual employee involvement such as team briefing and TQM schemes. Around a third of firms in this category have introduced measures of this type, and we believe that the conjunction of union and management fears about the threats posed by direct employee involvement underlies the low incidence of these forms of participation. Nevertheless both union representatives and managers in some firms have believed that some measure of direct employee involvement will be necessary to bring about the changes in employee attitudes that employee ownership is thought to be capable of instigating. In these firms this form of participation has proved to be the most sensitive aspect of employee ownership, and moves to develop it have been tentative and hesitant. One of the first bus industry ESOPs experimented with employee seminars but persistent uncertainty about the role of these in the management of the company meant that this innovation failed to take-off. Managers were reluctant to indicate to what extent they could influence management decisions, and in response to this employee interest soon waned. The seminars evolved into a form of joint consultation parallel to union structures (supported by union representatives) which was essentially indirect and representative in character.

Conclusions

Doubt has been expressed in some quarters whether ESOPs facilitate industrial democracy and employee participation. In the US Rooney finds that levels of employee influence over decisions differs little between employee-owned and conventional firms (1988). In the UK Wilkinson *et al*'s (1994) case study of an ESOP in the engineering industry it was found that establishment of an ESOP made little difference to the level of employee participation. Furthermore what little impact it made initially was short-lived. By contrast, the results presented in this paper suggest that introduction of an ESOP can provide a vehicle for the extension of industrial democracy though only in certain cases. It is only where those involved in establishing employee ownership seek to extend industrial democracy that the democratic potential of ESOPs appears to be realised. In practice this means the development of industrial democracy is confined to those cases where employees or their representatives play a dominant role in the creation of an ESOP. Our results are therefore consistent with those of Wilkinson *et al* in so far as their ESOP was established by management with little input from employees or their representatives. We have found that the same process of decay observed by Wilkinson and colleagues can be observed in other ESOPs set-up in a similar way.

The novelty of employee participation in those ESOPs where meaningful extensions of industrial democracy are secured is that participation primarily takes a representative form and is directed at strategic rather than day-to-day or task related decisions. This is plainly at odds with developments in employee participation since the end of the 1970s (see Ramsay, 1991). We have found that individualistic employee involvement schemes are more widespread in employee-owned than otherwise similar conventional firms but the differences are not pronounced. Indeed as far as provision of information is concerned employee-owned firms tend to be less advanced than conventional firms. This configuration of participative mechanisms is arguably surprising given that US research has found that the most widespread innovations are at the task rather than strategic level (see Russell, 1988). The explanation for it lies in the fears and objectives of those involved in establishing employee ownership. Trade union representatives have been concerned that the perceived threat posed to trade union representation by individualistic employee involvement could be intensified where employees are also shareholders. Managers, meanwhile, fear that employee ownership could lead to worker interference in day-to-day decision-making which would be difficult for managers to resist given that they are in effect the agents of the employee-shareholders. Overall, then, explanation of the form that employee ownership and participation has taken in the UK needs to be located in the interaction of the beliefs and objectives of those actors most deeply involved.

ENDNOTES

1. Data has been collected using case-study methods from 25 employee-owned firms, supplemented by survey data from 42 matched firms in the bus sector and by employee attitude surveys in 8 firms.

2. The equity of the John Lewis Partnership, the UK's largest employee-owned firm, is also held in trust but unlike ESOPs it is not distributed to individual employees (see Flanders, Pomeranz and Woodward, 1988).

3. Those preferring direct ownership to ESOPs argue that the cost-free, indirect pattern of ownership in ESOPs is unlikely to bring about attitudinal and behavioural change amongst employees. Some trade union representatives also prefer the direct ownership approach since it tends to maintain the separation between ownership and employment to a greater extent than in ESOPs, and hence is less likely to threaten the traditional role of the union. Critics of the direct ownership approach, however, claim that it uses the workforce as a cheap source of capital for the purpose of mounting buy-outs in which management maintains its dominance in the governance and management of the company.

4. The PLC issued a relatively small number of voting shares to an ESOP whilst selling a much larger sum of non-voting shares to the public. The ESOP shares are gradually released to employees, with voting rights being on a co-operative basis ie one person-one vote. The issue of non-voting shares was a way of raising larger sums of investment capital than had been possible with the collective's previous structure.

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