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# Epilogue (and Prologue)

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At this writing the US model of capitalism faces great problems. The implosion of Wall Street due to excessive leverage, inadequate regulations, and poor incentives and financial contracts that induced many at the top of the financial hierarchy to undertake highly risky investments, has produced the greatest economic decline since the Great Depression. Many see the US economic model as driven by Wall Street finance that has failed to deliver the goods. This book has studied a different part of the American model—one that has received less attention but has proven far more successful. Shared capitalism has long been of interest for its potential to affect workplace productivity, employee-management relations, quality of work life, job security, worker pay, the distribution of wealth, and broader participation in the economic system. In exhibit 1 in the introduction we listed six key "take-away" findings from our research:

1. Shared capitalism is a significant part of the US economic model.
2. Worker co-monitoring helps shared capitalist firms overcome incentives to free ride.
3. The risk of shared capitalist investments in one's employer is manageable.
4. Shared capitalism improves the performance of firms.
5. Shared capitalism improves worker well-being.
6. Shared capitalism complements other labor policies and practices.

Hopefully the preceding chapters have convinced the reader that these are reasonable conclusions to reach from the evidence, despite the limitations inherent in nonexperimental science.

Taken together, these findings create a picture of shared capitalism that is at odds with some common complaints about it. Economists have two major criticisms of shared capitalism: that free riding will undo any positive effects of group incentives on effort and performance, and that workers are generally risk-averse and will be harmed by the financial risk in shared capitalism plans.

Both free riding and financial risk are real concerns. Free riding clearly exists: profit sharing and gain sharing appear to work best in small groups where the incentive to be a free rider is reduced, and some workers admit free riding off the efforts of others in response to shirking co-workers (saying "some other employee will probably take action")(chapter 2, this volume). And financial risk is obviously a concern: some workers express a desire for lower fixed pay over higher average pay that varies, and some prefer their next pay increase to be all fixed pay with no profit sharing, stock, or options (chapters 1 and 3).

The picture of shared capitalism in the book shows that free riding and financial risk are surmountable concerns, and that broad-based financial participation can create a framework for cooperative corporate culture even in large groups or firms. The combination with a more cooperative corporate culture is what helps overcome free riding and create the performance benefits.

Our overall interpretation builds on the ideas of reciprocity and gift exchange, and the body of theory and research on bundles of high performance work practices. There is increasing evidence that reciprocity plays a strong role in a wide range of economic and social relationships, helping encourage norms of cooperation (Axelrod 1984; Fehr and Gachter 2000; Gintis et al. 2005). Formal economic models also show how employment relationships can be built on reciprocity and gift exchange (Akerlof 1982).

A key element in our overall interpretation is that shared capitalism pay and wealth appears to generally come on top of standard pay and benefits—that is, it represents "gravy" for the worker rather than substituting for other pay and benefits. This is consistent with the other studies on this question, several of which use administrative data and pre/post designs on firms and individuals (Kim and Ouimet [2008]; Sesil et al. [2007]; Blasi, Conte, and Kruse [1996]; Kardas, Scharf, and Keogh [1998]; Kruse [1998]; Renaud, St-Onge, and Magnan [2004]; and others reviewed in Handel and Gittleman [2004], and Kruse [1993, 113–14]). If this is true, in the long run shared capitalism firms must be getting productivity increases, because there is no other way for a competitive firm to pay for the "gravy" aspects of the compensation package. The evidence presented here shows a number of performance benefits, such as decreased turnover, increased loyalty, increased monitoring of shirkers, increased willingness to work harder for the firm, and increased investments in formal and informal training. This is consistent with efficiency wage theory in which higher compensation levels can essentially pay for themselves through higher productivity. In particular, the gift exchange version of efficiency wage theory shows how firms can provide a "gift" of high compensation that raises worker morale, and workers reciprocate with a "gift" of greater productivity (Akerlof 1982). The message sent by a "gift" of profit sharing, stock, or options on top of regular pay and benefits may be especially good for creating and reinforcing a sense of common interest and the value of a reciprocal relationship. In addition, the increased performance benefits are consistent with known evidence about the role of high performance work practices, which complement and strengthen the gift exchange. The lower supervision that is optimal under shared capitalism and such work practices may create an opportunity to save on supervisory costs, which itself increases productivity.

The higher compensation associated with shared capitalism helps address financial risk concerns. Risk is obviously an important issue when variable pay (of any sort) is substituting for fixed pay, and risk-averse people will require a risk premium (higher average pay) to compensate for the added risk. We find that the shared capitalism package generally includes more than enough compensation for the added risk associated with variable pay—it provides gravy even after taking the extra risk into account, as shown by the reduced turnover intentions. Some firms combine lower risk forms of shared capitalism—such as profit sharing and gain sharing and stock options—with higher risk forms of shared capitalism—such as those based on buying company stock with worker savings. Even when shared capitalism is not gravy, portfolio theory suggests that shared capitalism can be part of a prudently-diversified portfolio if properly managed (chapter 3, this volume). Having a separate diversified retirement plan in addition to an employee ownership plan, being paid above market wages, and not funding employee stock ownership using worker savings, can all play a role in minimizing risk. So concerns over financial risk can be overcome: it is striking that even the most risk-averse workers are likely to prefer some shared capitalism in their pay (chapter 1, this volume).

The higher compensation may also help address the free rider problem. Workers may reciprocate the extra compensation from shared capitalism by wanting to "keep work standards high," which was one of the most common reasons cited by shared capitalism employees for taking action against shirkers. Keeping standards high is part of the "gift" that workers give to firms in return for higher compensation, helping substitute for close supervision. Unlike a simple increase in fixed pay, shared capitalism can also create norms for reciprocity among workers, since workers collectively will benefit from higher performance (another common reason for taking action against shirkers is "poor performance will cost me and other employees in bonus or stock value"). The finding that close supervision is counterproductive when combined with shared capitalism is consistent with this interpretation—close supervision may send a mixed message that undermines the gift exchange understanding of the employment relationship.

The complementarity between shared capitalism and other human resource policies is an important part of our story. Overall these results show that shared capitalism can have positive effects on workplace performance and worker outcomes, but one does not automatically get these effects by simply installing a shared capitalism plan. The context matters greatly. The effects are more likely and more pronounced when shared capitalism is extended to workers who are not closely supervised and who are covered by high performance policies like employee involvement and training. This makes sense: shared capitalism provides some financial motivation, but this motivation will make little difference if workers do not have the opportunities and skills to improve workplace performance. High performance policies can provide these opportunities and skills, and help to create a more cooperative gift-exchange culture in which workers share information and discourage free riding. One implication is that the benefits from adopting a high performance policy like employee involvement or training will depend on what other policies are already in place, or are being adopted at the same time.

Such complementarity is strongly supported by recent research on how bundles of high performance work practices can reduce turnover, increase, productivity, and improve the stock market performance of firms. The idea is that the human resource policies and practices of the firm work better when they form a coherent whole; namely, when selection and recruitment, training, work organization, performance management, and reward systems are all pulling in the same direction and are integrated with the strategy of the firm. A significant body of evidence and thought laying out this effect now exists (see Huselid [1995]; Ichniowski, Shaw, and Prennushi [1997], Jackson and Schuler [1995]; Appelbaum et al. [2000]; and the meta-analysis in Combs et al. [2006]). This fits with a major theme of this book: that employees should not simply be provided shared capitalist incentives without a supporting group of firm policies and practices to engage them in taking greater responsibility for the welfare of the firm. Throughout the studies included in this volume, we consistently see that bundles of human resource policies that support high performance play a strong complementary role together with shared capitalist practices. This finding cuts across the different data sets, countries, and outcomes under study.

The broad spread of shared capitalism across industries and different types of jobs is consistent with a gift-exchange/reciprocity and supportive corporate culture interpretation. If shared capitalism were implemented primarily for one narrow purpose, such as to reduce turnover or to motivate creative activity that is hard to monitor, then its effects would likely show up only in particular industries, firms, or jobs where it serves that purpose best. As shown in chapter 1, however, while the prevalence of shared capitalism varies by industry, with the highest level in the computer services industry, shared capitalism is well-represented throughout the economy. This is not consistent with the notion that shared rewards will only work in particular niches or for particular groups. Rather, it indicates that shared capitalism can be useful wherever workers have some discretion in how they do their jobs. Such discretion appears to be widespread—in fact, close to 85 percent of employees in the General Social Survey (GSS) report that it is very or somewhat true that they have a lot of freedom to decide how to do their work. This figure varies little by major industry or occupation, and is above 80 percent even for blue-collar workers. If one takes this at face value, 85 percent of employees have a "gift" they can give to the company, by using their discretion in ways that can help the company. This gift can be given in reciprocal exchange for the higher compensation, training, employee participation in decisions, job security, and other worker benefits that we have found to be part of the shared capitalism package. As long as employees have some discretion in how they do their jobs, such a gift exchange is a possibility. Viewed in this way, it is not surprising that firms across the economy have implemented shared capitalism, and that nearly half of all workers participate in some form of shared capitalism.

The ideas of gift exchange and reciprocity may also help to explain the high prevalence of shared capitalism plans in large firms. Viewed strictly from the perspective of the free rider problem, the higher prevalence of shared capitalism in large firms is a puzzle, since theory and evidence indicate that the free rider problem is worse there than in small firms. The puzzle might be partly explained by the fixed costs of setting up plans, which can be spread across a larger number of participants in large firms. But if the free rider problem is overwhelming in large firms, why set up shared capitalism plans at all? What good are they, even if the fixed costs can be spread around? The answer seems to be that shared capitalism plans can help performance even in very large companies. For example, a pre/post comparison using productivity data and matched pairs of similar firms found significant productivity increases among firms adopting profit-sharing plans that had more than 12,000 employees as well as among smaller firms (Kruse 1993). Such a result makes no sense from the perspective of the free rider problem (each worker gets only 1/12,000th of the profits from his or her increased effort), but can make sense if the workers are responding with reciprocity to a new plan that is perceived to be generous to workers. In effect, it appears that shared capitalism and a complementary culture may allow large firms to function like smaller firms.

The idea of bundles of high performance work practices may also help to explain why employee perceptions of greater influence, lower levels of supervision, the presence of teams, and employer-sponsored training are more common with some types of shared capitalism. (chapter 1). It would appear that some managers have found the right way to imbed shared capitalist practices into their organizational culture, or conversely, to alter that culture to complement shared capitalist modes of pay. When managers combine various forms of shared capitalism, as is common, they are also combining the work practices that are usual with each type of reward sharing. (It is nonetheless the case that simply observing what firms do does not necessarily tell us what may be optimal.)

In sum, we think gift exchange/reciprocity and high performance work practices play a large part in explaining the positive effects of shared capitalism for both employers and workers. Workers seem to generally respond well to shared capitalism when it is perceived as coming on top of standard pay and benefits, and is connected to high performance policies such as employee involvement, training, and job security that gives workers extra skills, opportunities, and incentives for higher work standards. Close supervision, however, sends a contrary message that undercuts norms of reciprocity and the potential for better performance.

### Two Scenarios of Shared Capitalism

Taken as a whole, the empirical results of this research suggests two scenarios of shared capitalism, one that is more likely to optimize its advantages for firms and workers and one that is less likely to do so.

One can characterize the more optimal shared capitalism as having these characteristics:

- Fixed wages at or above the market rate.
- Combinations of shared capitalism that balance more and less risky approaches and reduce wage substitution by avoiding financing shared capitalism with worker savings.
- Training, employee involvement in decision making, job security, and other complementary high performance work practices.
- Low supervision of workers.
- Prudent diversification of worker wealth.
- Retirement plans in addition to shared capitalism to protect workers' futures.
- Higher than average grades on employee-management relations and trust in management.

One can characterize the less optimal shared capitalism as having these characteristics:

- Pay below the market rate.
- Combinations of shared capitalism that shift risk to workers by financing shared capitalism with lower wages and out of worker savings.
- Lack of complementary high performance work practices.
- Close supervision of workers.
- Imprudent diversification of worker wealth.
- Lack of retirement plans in addition to shared capitalism to protect workers' futures.
- Lower than average grades on employee-management relations and trust in management.

### Implications for Social Science Analysis of Economic Behavior

As these studies show, shared capitalism directly engages several fundamental issues in economic theory. Many if not most economists will be surprised by the current wide prevalence of shared capitalism documented in the recent GSS surveys. The broad prevalence and variety in shared capitalism arrangements make it a promising area of study for testing and elaborating existing theories, and developing new ones. Some of the fundamental issues involved in shared capitalism are:

- *Theory of the firm and principal-agent theory:* Under what conditions is it efficient for all profits to go to a central monitor (Alchian and Demsetz 1972)? How does this depend on the informational content of monitoring done by workers versus supervisors (Nalbantian 1987; Putterman and Skillman 1988)? In what ways might shared capitalism plans mitigate the myriad of principal-agent problems that exist throughout every organization? Can these plans work well only in companies where workers have homogeneous interests (Hansmann 1996)? How do these plans affect a range of investment, employment, and other issues debated in the traditional labor-managed firm literature (Dow 2003)?
- *Residual control and residual returns:* What does shared capitalism teach us about the broader issue of the benefits of matching residual control to residual returns, and how this should be done (Milgrom and Roberts 1992)? Employee involvement without any gain sharing may be efficiency-destroying—for example, employees in employee involvement plans may just make their jobs more comfortable (residual control without residual returns). Shared capitalism plans give some of the residual returns to a broad group of employees, which may be efficiency-enhancing only if these employees have significant discretion (residual control) in how they do their jobs.
- *Risk aversion and portfolio theory:* How can we learn from shared capitalism about how workers decide about alternatives involving risk and why and how this can aid or hurt their economic well-being? While behavioral finance is being applied to people's investments and other financial decisions, shared capitalism provides an interesting setting in which to examine millions of workers who confront decisions about and experience reactions to employee stock ownership, profit sharing, gain sharing, and broad-based stock options in the American workplace. The broad implications of behavioral decision theory for economics has been addressed by Kahneman (2003). We have only begun to explore the many questions raised by this important literature. The wealth portfolios of these millions of shared capitalist workers also involve important issues of portfolio theory (Markowitz 1959). How does the financial risk of shared capitalism fit into portfolio theory, and how can and do workers respond to and manage that risk? How does the

increased employment security with shared capitalism affect the financial risk? How do combinations of low risk and high risk shared capitalism programs help employees and employers manage such risk? What is the role of forms of employee stock ownership that are not funded by employee savings (such as ESOPs and company stock matches) in reducing the high risk of company stock ownership? How can shared capitalist programs be better structured for workers who have high economic insecurity?
- *Game theory and the free rider problem:* How can cooperative solutions to the "Prisoner's Dilemma" in game theory be established and maintained in market settings? What types of policies and relationships are needed?
- *Compensation theories:* How and when is shared capitalism a substitute or complement to other compensation methods such as efficiency wages, implicit contracts, tournaments, bonding, and deferred wages, particularly when information about workers and the work process is imperfect and supervision is costly?
- *Strategic human resource management:* Is the shared capitalism/complementary work culture scenario an optimal combination for most firms? Or does this depend on the strategy that each firm has for satisfying customers and creating profit? Are there firms where the potential positive effects of the complementary scenario are outweighed simply by concentrating most of the rewards in a very small group of special employees? Or is there a role for shared capitalism that broadly includes all employees yet also differentially and richly rewards top performers? That is, can the benefits of shared capitalism and a complementary corporate culture be obtained where there is broad shared capitalism and large differentiation of rewards at the same time?

Shared capitalism also raises issues central to social sciences other than economics. In the field of psychology, study of shared capitalism can also yield insights into the psychological contract between employees and employers, determining if and how employee attitudes and behavior are affected (Rousseau and Shperling 2003). For sociologists, shared capitalism can provide lessons about the functioning and effects of corporate culture, the effects of differential versus shared rewards on the position of social groups within organizations and society, and whether the distribution of power, prestige, and rewards in social organizations are amenable to change that maintains efficiency of performance while reducing inequality. For political scientists, shared capitalism involves issues of social capital (Putnam 2000) and the spillover effects of workplace decision making on broader political participation and engagement (Pateman 1970; Mason 1982; Dahl 1985). It raises questions of political economy and the design of public policy. For example, are there governmental and legislative levers that can advance shared capitalism in a way that maximize its advantages to society while minimizing its disadvantages, if that were a political goal of a society?

In sum, shared capitalism provides a rich opportunity for social scientists to address these and many other questions that touch on basic theories about how people live and work together. Our findings and those of others working in this area show that shared capitalism has met the market test of surviving and prospering in a competitive economy that J. B. Clark posed for it over a century ago. There still remains much to be learned about this fascinating and important part of the capitalist world. We look forward to seeing future analyses of the shared capitalist story, using better data, more sophisticated econometrics, field and lab experiments, and stronger theoretical models than those we have employed. We also look forward to learning more from firms about their experiences with this innovative form of arranging work and pay.

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