Center for American Progress

Mitigating Risk to Maximize the Benefits of Employee Ownership

By Karla Walter and Danielle Corley   October 2015

Introduction and summary

Employee ownership can be a powerful tool to ensure that workers at all levels are able to share in the gains of a company's collective performance. Research shows that employee ownership typically provides a host of benefits—not just for workers but also for businesses and investors. If these programs were to grow throughout the economy, they could promote broad-based wealth creation, thereby fostering sustainable economic growth and reducing inequality.

In today's economy, expansion of these sorts of programs would be particularly helpful to working Americans. Over the past several decades, productivity in the United States has increased, yet the resulting economic gains have largely gone only to those at the very top. Among the top 20 percent of families by net worth, average wealth increased 120 percent between 1983 and 2010, while the middle 20 percent of families saw their wealth increase only 13 percent, and the bottom fifth of families saw their debt exceed their assets.[1] Meanwhile, corporate profits are capturing a growing share of national income.[2] Employee ownership can help reverse this trend by allowing workers to take home a greater share of the wealth that they help create.

Yet policymakers and worker advocates are often slow to embrace these strategies as a means of addressing the challenges facing the economy, and they are also hesitant to advance policies that greatly expand the adoption of these practices. This reluctance is due in part to questions of risk to workers, particularly when employee ownership is a part of a retirement plan.

Indeed, workers do accept an additional measure of risk—with the potential for a larger reward—by participating in employee ownership programs. For the vast majority of workers, however, the benefits of these sharing programs far outweigh the risks. Research shows that adoption of an inclusive capitalism program in a workplace, on average, leads to increased employee participation in decision-making, greater job security and satisfaction—and perhaps most importantly—larger, long-term wealth accumulation and better pay and benefits for workers.[3]

Moreover, companies reap tangible benefits—such as increased productivity, lower turnover rates, and greater survival rates—and investors benefit from better overall performance.[4]

Despite these findings, policymakers and worker advocates often question whether the risk of company failure—which would cause workers to lose their jobs and potentially a portion of their retirement savings—outweighs all of the positive benefits that occur when employee ownership is part of retirement. The most common forms of employee ownership as part of retirement are employee stock ownership plans, or ESOPs, and 401(k) plans that include company stock.

Headline-grabbing tales of company stock ownership gone awry at firms such as Enron, United Airlines, and The Tribune Publishing Company, which publishes the *Chicago Tribune*, the *Los Angeles Times,* and other media outlets—have furthered the fear that such programs saddle workers with more risk than the retirement benefits are worth.

This report has two goals. The first goal is to answer questions about undue risk in order to prevent companies from adopting employee ownership structures that endanger workers and jeopardize the collective benefits of broad-based sharing. The second goal is to help create widespread support for policies that would encourage greater adoption of beneficial employee ownership and other sorts of broad-based profit-sharing programs throughout the economy.

The report reviews existing research on risk for workers participating in ESOPs or investing in company stock through a 401(k) plan and finds that the vast majority of workers who are participating in these programs are not exposed to undue risk.

The report also features analysis of the high-profile failures of Enron, United Airlines, and the Tribune Publishing Company—both in terms of the effect of an employee ownership structure on company failure and the ensuing effect on workers.

Building on existing research and the lessons from these cases, this report offers the following policy solutions to mitigate risk while still allowing workers to benefit from inclusive capitalism:

- First, the federal government should limit 401(k) investment in company stock to 15 percent of total holdings. This would protect workers who are invested heavily in their employer's stock, either by their own choosing or as a result of matching contributions from the company.

- Second, the federal government should allow early diversification for workers who are participating in an ESOP that requires wage and benefit concessions or when the employer does not contribute to another retirement vehicle, such as a 401(k). ESOP companies rarely require wage and benefit concessions, and they are far more likely to offer another retirement plan than comparable companies without an ESOP. Yet in companies that do require concessions or do not contribute to another retirement vehicle, company failure would have a much greater adverse effect on workers.

- Third, the federal government should strengthen its oversight to ensure that companies correctly value stock that is being sold to workers. The government can do this by requiring companies to adopt valuation best practices at the outset of a company sale and better targeting the riskiest ESOP sales for audit by the U.S. Department of Labor, or DOL.

These policies will not affect the vast majority of companies that have employee ownership and that are already acting in employees' interests. In fact, policies such as better targeting of DOL audits hold the promise of reducing burdens for employee-owned companies with few risk factors. Rather, they are targeted to address the minority of companies with employee ownership where workers face undue risk. In sum, this report aims to start a dialogue about how to better protect workers while still offering the benefits of inclusive capitalism.

In July 2015, the Center for American Progress released the report "Capitalism for Everyone," which details policies that encourage greater employee ownership and broad-based profit sharing throughout the economy.[5] That report should be read as a companion to this report, and the policies outlined in "Capitalism for Everyone" should be adopted in conjunction with the policies profiled in this report.

Employee stock ownership plans vs. 401(k) plans with company stock

The most common forms of employee ownership as part of retirement packages are employee stock ownership plans and 401(k) programs that include company stock. There is, however, a significant difference between the two. ESOPs were conceived as a way for workers to share company ownership, and in most cases, all of the ESOP contributions come from the company.[6] Company 401(k) plans were originally designed as additional retirement plans to supplement defined benefit plans, and a significant proportion of 401(k) contributions generally come from the employee.[7] The increased reliance on 401(k) plans as the primary source of retirement security for most workers developed later, complicating the use of company stock in these plans.[8]

ESOPs are tax-qualified benefit plans that provide workers a share in the company without having to spend their own money to buy the stock themselves. Instead, the employer establishes a trust and contributes new stock or cash to buy existing stock—typically amounting to 6 percent to 10 percent of the employee's salary.[9] The company may borrow money to do this, making it a leveraged ESOP. Shares of the trust are distributed to individual employee accounts. When employees retire or leave the company, the employer must buy back the stock in their individual accounts at its fair market value unless it is available for public sale.[10]

401(k) plans with ownership of company stock are employer-sponsored retirement savings plans that allow workers to put aside part of their paychecks for retirement before taxes are taken out. Workers can choose to invest their money in a mixture of stocks, bonds, and mutual funds.[11] Employers then typically match employee contributions up to a certain level.[12] The average employer-promised match is 4.2 percent of pay, and the median match is 3 percent of pay.[13] In some instances, company stock is offered as an investment option or is the form of employer contribution. Overconcentration occurs when an employee has a 401(k) invested heavily in the employer's stock, either by his or her own choosing or as a result of matching contributions from the company. Experts generally recommend that no more than 10 percent to 15 percent of a worker's portfolio be invested in company stock.[14]

Our Mission

The Center for American Progress is an independent, nonpartisan policy institute that is dedicated to improving the lives of all Americans, through bold, progressive ideas, as well as strong leadership and concerted action. Our aim is not just to change the conversation, but to change the country.

Our Values

As progressives, we believe America should be a land of boundless opportunity, where people can climb the ladder of economic mobility. We believe we owe it to future generations to protect the planet and promote peace and shared global prosperity.

And we believe an effective government can earn the trust of the American people, champion the common good over narrow self-interest, and harness the strength of our diversity.

Our Approach

We develop new policy ideas, challenge the media to cover the issues that truly matter, and shape the national debate. With policy teams in major issue areas, American Progress can think creatively at the cross-section of traditional boundaries to develop ideas for policymakers that lead to real change. By employing an extensive communications and outreach effort that we adapt to a rapidly changing media landscape, we move our ideas aggressively in the national policy debate.

Center for American Progress

1333 H STREET, NW, 10TH FLOOR, WASHINGTON, DC 20005 • TEL: 202-682-1611 • FAX: 202-682-1867 • WWW.AMERICANPROGRESSACTION.ORG