Getting Your Company Ready for an ESOP: The Ownership Culture Perspective

Virginia J. Vanderslice
Alexander P. Moss
Praxis Consulting Group, Inc.

Reprinted from

Selling to an ESOP

Sixth Edition

A comprehensive guide for owners, managers, and advisors of closely held companies

Copyright © 2000 by the National Center for Employee Ownership (NCEO)
Visit us on the Web at *www.nceo.org*

Appendix A

Getting Your Company Ready for an ESOP: The Ownership Culture Perspective

Virginia J. Vanderslice
Alexander P. Moss
Praxis Consulting Group, Inc.

In the process of making innumerable decisions about how to structure and implement a plan for putting company stock in the hands of company employees through an employee stock ownership plan (ESOP), company leaders typically give little, if any, consideration to what employee ownership could do for the company's performance. Legal and financial advisors are generally concerned with the many details of getting the transaction completed, not with the post-transaction effect of the ESOP on the company. In the rush to complete the ESOP transaction, advisors may neglect to inform the company's leadership about the performance opportunities that employee ownership presents for the company or about the responses employees might have to the ESOP if people's ownership expectations are not well managed. Typically, companies receive recommendations to communicate their ESOP so people will understand it, assuming that this alone will be enough to motivate employees in their new roles as shareholders. However, the process of turning ownership through an ESOP into a performance-enhancing element of a company's culture extends far beyond explaining ESOP mechanics. If a company wants employee ownership to have a motivational impact, there is much more work than this to be done.

This appendix describes the initial challenges that all ESOP companies face, and offers suggestions for meeting those challenges. Next, it introduces a model for linking ownership with performance and outlines the major organizational development work that is necessary for companies to undertake to create high-performance ownership cultures.

Performance Enhancement Opportunities of Employee Ownership

It is logical to expect that putting stock in employees' hands without their having to pay for it should result in employees feeling and acting "like owners." Knowing that they have a financial stake in the company's performance ought to motivate employees to work hard to enhance the company's performance. Making employees owners of company shares does, in fact, present an opportunity for performance improvements. However, share ownership alone is not enough. Research completed during the last 10 years consistently indicates that employee ownership alone is not likely to have an impact on standard available measures of company performance such as sales growth, growth in number of employees, or operating cash flow performance.[1] On the other hand, researchers have found that companies that combine employee ownership with participation perform better than they did before implementing an ESOP and perform better than similar companies that are not employee-owned.[2]

The data make it clear, then, that employee ownership can provide more than a financial benefit to companies, but that the other payoffs are not automatic. Unfortunately, the fact of ownership doesn't translate automatically into either a feeling of ownership or into ownership behaviors. This reality can frustrate selling shareholders who believe not only that their efforts to create an ESOP should be appreciated and applauded, but also that, as a result of becoming stock holders, employees' behavior should instantly change.

✔ The First Step: Defining Desired Goals for Employee Ownership

The first thing a company's leadership should do once it decides to implement an employee ownership strategy is to consider the options and decide what, if anything, it wants from employee ownership. In addition to influencing their organizational strategy, there also may be implications for the design of the employee ownership plan itself. In some companies an ESOP is viewed only as a financing strategy that provides a tax-favored method for a retiring owner or selling shareholders to gain liquidity. The fact that employees will end up owning stock is a more or less coincidental, and relatively unimportant, byproduct of the strategy. For others, the value of employee ownership lies in its function as a retirement benefit either replacing or supplementing other benefits. Another position is that employee ownership is one of several components of a company's culture. It is intended to fit with and reinforce other aspects of the company, but does not stand out as a major driver of the company culture. Finally, companies may decide that employee ownership represents a core value of the company and, as a foundation for the company's culture, can be used to organize and integrate the company's values and to facilitate performance improvements.

If a company decides a goal of the ESOP is to enhance company performance, then company leaders have to believe that an ownership culture will help the company achieve its business goals. Particularly in situations where developing an ownership culture will mean making a significant change from the company's current culture, leaders must believe that there is a compelling business reason to invest the time, energy, and money in making that change. If the company is functioning successfully without an ownership culture, then changing the culture because the ownership structure changed may not be a good idea. If the company has not been performing well or if the leaders truly believe that company performance could be improved if employees felt and acted more like a community of owners, then using the potential offered by employee ownership to develop a new culture may make sense.

The outcomes desired from employee ownership will determine, in part, the actions a company needs to take. For example, if employee ownership is a relatively unimportant byproduct of a financial transaction, then it should be communicated, along with other benefits, but not emphasized. In this circumstance it would make sense to position employee ownership as similar to owning stock in any other company. This will minimize the possibility of unrealistically raising employees' expectations. Nothing in the company will change as a result. On the other hand, if employee ownership is valued as a retirement benefit (and, therefore, possibly as a retention strategy) then employees must be educated about the mechanics of the employee ownership plan. If, however, employee ownership is seen as an opportunity to increase employee motivation and thereby enhance company performance, companies must take actions such as thoroughly educating employees about the employee ownership plan, the value of the company, and how their individual and collective actions affect company value.

Depending on the company dynamics before the employee ownership transaction, a company may have to change its entire culture if it wants to maximize the performance benefits of employee ownership. The goals that are desired from employee ownership will determine both the content of the company's communication of the employee ownership plan to employees and other changes and actions the company must take.

Initial Challenges

Experience has shown that there are some predictable challenges that ESOP companies must address if they are to gain performance improvements from employee ownership. These include employees' suspicion and skepticism about the employee ownership plan itself, misaligned expectations about what employee ownership will mean, and lack of management styles and organizational structures that encourage constructive employee involvement. The specific form that each of these issues takes in a particular company is often influenced by the circumstances surrounding the implementation of the ESOP.

✔ **Initial Perceptions of Employee Ownership: Suspicion and Skepticism** Employees often learn that they have become shareholders through an announcement by the company president or CEO, after the transaction is completed. It is typical for employees to greet such an announcement with suspicion and skepticism. This reaction may arise from any of several sources. First, many employees have never owned stock in anything before. The further employees are from the top of their organization, the more likely that they will view stock as "just a piece of paper." Stock just doesn't seem "real" to them. In addition, from their perspective, the stock doesn't really belong to them since they can't actually spend it or even borrow against its value. In some cases, even if they leave their company with any substantial stock in their accounts, they can't get all of their stock, or the cash value of it, until anywhere from five to ten years after their departure. And, of course, the company value isn't guaranteed. By the time they retire or leave the company, the stock could be worth a great deal or nothing at all.

Many employees live paycheck to paycheck. Depending on their ages and life circumstances, they may be focused on how to get more money today to support their families or pay for their children's schooling. Leaving the company or retiring may not be on their minds. In most ESOPs and other ownership plans, having stock does not give them the right to vote on many company issues. Without feeling they have any real say in how the company is run, employees may feel that the value of the stock, short or long term, is really out of their control anyway. Add to this the fact that in many companies their new ownership status isn't reflected in any changes in their day-to-day work experience that they would associate in their own minds with "being owners." Finally, in most cases, becoming employee owners was something that was "done to them," not something that they chose. This suspicion and an often attendant lack of appreciation is difficult to accept for selling owners from whose perspective employees are being "given" stock.

ESOPs as "Something for Nothing." There are other factors that contribute to employees' suspicions about employee ownership. In situations where employees get company stock without paying for it directly or without making concessions (as with many ESOPs created in a transaction where the owner sells to the ESOP to obtain the tax-deferred "rollover" under section 1042 of the Internal Revenue Code), the idea of "something for nothing" generates suspicion. After all, we've all been taught "there's no such thing as free lunch." It is not unusual for employees to assume that someone else must be the real beneficiary of the ESOP—probably whoever was most responsible for establishing the ESOP. Or, they may think that the selling shareholders know something that employees don't and therefore are trying to cash in their shares before the company becomes a "loser."

Trading Compensation or Benefits for Company Stock. When an ESOP is an alternative to a shutdown by a parent company or some other external threat, even having employees vote on whether or not to implement an ESOP won't necessarily make them feel like owners once the transaction is completed. While these situations are not the norm with ESOPs, they present special challenges. If the employees' choice was between an ESOP and shutting down the company versus selling the company to a competitor who would have no loyalty to current staff, the ESOP "choice" may have been less a decision to become employee owners than a job-saving strategy. Skepticism will be greater in these situations when employees have taken wage or benefits cuts in trade for company stock. In this case, employees, in their anxiety to get back to "good old days" and recoup their "losses," may be hypercritical of management and suspicious of all leadership decisions. In fact, in companies that have become employee-owned as a response to a potential shutdown, occasionally the employee owners have voted out management and/or union leadership that was involved in the buyout (assuming employees have the voting rights to do so). Givebacks tend to create a great degree of resentment that turns into distrust, which is difficult but essential to overcome in order to effectively develop an ownership culture.

Some of the initial suspicion and skepticism arising in this kind of ESOP situation can be minimized if new management comes in with the implementation of the ESOP and if employees believe they have strong representation at the board level. United Airlines' ESOP exemplified this situation. When their ESOP was implemented, the new CEO was identified and approved by representatives of key employee groups. He also appointed a new company president. In addition, each of the major employee ownership groups within the company had board seats. In these kinds of cases, employee skepticism centers around the extent to which stock ownership means employees will have the opportunity to participate in decision-making and problem-solving related to company and/or unit operations.

Replacing Other Benefits with an ESOP. Viewing an ESOP with suspicion and skepticism is also a typical response when the implementation of the ESOP involves decreasing other benefits: e.g., shutting down a profit sharing plan or suspending contributions to a 401(k) plan. In these situations, employees are likely to feel something has been taken away from them, even if the company's contribution to the ESOP is substantially greater than it was to the other benefit plans. Of course, the better the performance of stock in those other benefit plans has been, the more unhappy employees are likely to be with the ESOP as a replacement.

The suspicion and skepticism that arises in each of these cases should be anticipated, but with careful attention and directed efforts it also can be overcome.

✔ **Misaligned Ownership Expectations** A second major challenge that nearly every employee-owned company must address is to align the ownership expectations of all company members. In the United States, everyone is familiar with the term "ownership," and therefore everyone is likely to have his or her own definition of what it should mean to be an "employee owner." Unfortunately, what people expect from employee ownership may differ dramatically among individuals and between organizational levels. Some employee owners initially will expect to get rid of management; a few will think this will be a great opportunity to share in the company's success; others will expect to vote on every decision made in the company or to learn or determine everyone's salaries; still others will expect to be able to tell everyone else what to do but won't expect to have to listen to anyone else tell them what to do; a scattering will see employee ownership as a reason to focus on learning about the business; and some will think it's all just a trick to line management's pockets. At the very least, most nonmanagement employees expect to have more say or influence in company decisions, and to get more information (and more often) about the company, its finances, its business strategy, and how it is doing. For some managers, employee ownership is not any different than being a shareholder (like owning stock in any company). For others, employee ownership means employees should be willing to stay past five o'clock without any additional compensation, be particularly careful about wasting resources, and generally do whatever is necessary to keep the company successful. They may not want rank-and-file employees questioning management decisions or asking for financial information and they may not be comfortable with the idea of giving people more financial information. For still other managers, employee ownership means providing employees with more information about the business and deeply involving them in company problem-solving and decision-making.

These diverse expectations of employee ownership that people bring to their roles in ESOP companies present the company with a major challenge. Until people's expectations for "ownership" are consistent throughout an ESOP company, tensions arising from disappointed expectations may present a roadblock to maximizing company performance. This is as much a problem for companies that only see their ESOP as a financial tool as it is for companies that want to make their ESOP the foundation for developing a high-performance ownership culture. The specific meaning that ownership takes on in any individual company is often less important than having the ownership expectations aligned throughout the company. If people at any level expect changes that do not happen, the result may be escalating tensions between individuals or groups with differing expectations, or a letdown that will lower morale and negatively affect performance.

✔ **Cultural Contradictions** Another kind of challenge exists for companies that want employee ownership to result in performance improvements but that have historically had cultures with characteristics that are inconsistent with principles such as participation, collaboration, mutual respect, and open communication. The nature of a company's culture before and at the time an ESOP is implemented can greatly affect employees' initial responses to the ESOP and the company's ability to transition to a culture that maximizes the performance-enhancement opportunities that employee ownership presents.

Command and Control Management Styles. One of the essential factors in releasing the potential of employee ownership is that employees must feel valued and experience themselves being treated respectfully as partners in making the company successful. If you want employees to act like owners, you must treat them like owners. Companies that have had authoritarian management styles are likely initially to have a much more difficult time using their ESOP as a motivational tool. Leaders in companies with these kinds of cultures tend to approach developing an ownership culture from the perspective of "Let's fix these employees. Let's get them to change their behavior." In reality, making the changes necessary to generate ownership behaviors in such situations will require a change in identity and behavior for both managers and non-managers. Treating employees as respected co-owners while still maintaining appropriate management authority will be difficult for managers used to managing by giving unquestioned orders. They must change their beliefs about employees and appropriate management behaviors as well as develop new management skills.

For their part, employees who are used to being "outsiders" or seeing themselves in opposition to management will not easily adjust to "insider" status. They are likely to be better at complaining than at solving problems. Initially they are most likely to want to use participation opportunities to gripe about previous "issues" with management or to test their power. A typical scenario in many ESOP companies is to begin participation efforts by offering unstructured forums for employees to share their ideas. In companies where employees' ideas have not previously been sought or responded to, these early meetings are likely to degenerate into "gripe sessions." Managers are unlikely to know how to appropriately structure and facilitate these meetings and employees are unlikely to know how to offer constructive suggestions. In the end, both groups will leave such meetings convinced that the other group didn't really care.

A History of Distrust. Distrust between management and nonmanagement employees can develop for any number of reasons. When distrust is part of a company's culture, people's initial views of all decisions and actions are likely to be filtered through a lens of suspicion and cynicism no matter on which side of the "management divide" they sit. A situation in a manufacturing firm that had recently become 100% employee-owned provides one example. This company had a history of tense union-management relations. Upon becoming employee-owned, an enthusiastic senior manager, inspired by what he had learned at an employee ownership conference, wanted to facilitate employee participation in his company. He brought together a team of shop floor employees to work with him to solve some routing problems. Rather than being pleased to have been asked to share their knowledge and willing to get involved, the shop employees' response to the meeting was that the manager was trying to get out of work by getting them to do his job. For his part, the manager concluded that his earlier beliefs had been right: employees really didn't have the knowledge, ability, or interest to be effective participants in solving production problems. When distrust is a cultural norm, participation will be difficult to implement. Managers won't want employees to have any say in decisions and employees won't want to be involved unless they are given total authority.

Companies with a history of distrust between management and nonmanagement employees are usually companies in which management has not shared much company financial information with employees. Managers in these companies often have strong beliefs about why this information shouldn't be shared, but in essence they usually don't trust that nonmanagement employees will treat the information appropriately. When employees don't have actual information, they tend to fill in their lack of knowledge with the conclusions they draw from their own experience. So, for example, when employees' experience is that they have been working many hours of overtime, have been under a great deal of pressure to produce, and have seen an enormous amount of product move through the company, they conclude the company is doing very well. When management then says the company must lay people off or cut back hours because the company hasn't been profitable, they don't believe it. By not giving employees information about the company's profitability and the factors that can make a difference, distrust is fostered.

When a high level of distrust exists between management and nonmanagement employees at the time an ESOP is implemented, rebuilding trust must be one of the first steps taken in making employee ownership the foundation for performance improvements. Improving communications between groups and building better relationships will necessarily take priority over more substantial structural changes.

Meeting the Initial Challenges

✔ **Strengthening Trust** It will be easiest to capitalize on the potential presented by employee ownership in companies where trust between and among individuals and groups is already a strong characteristic of the culture before implementing an ESOP. In companies where trust is an issue, company leaders must be particularly cognizant of acting in ways that enhance it. Trust results when people set clear expectations and meet them and when there is open, honest communication. While there are some specific actions companies can take to enhance trust, in general trust is a characteristic that evolves over time as a result of people's experience with each other. Thus, all of the other steps discussed in this appendix, in addition to the specific goals they are intended to serve, should be considered in the context of having trust enhancement as an intended byproduct.

It is possible that through a carefully designed culture change process, trust can be built, but the changes will be slow and difficult, particularly in the beginning. Non-managers will be intent on watching to see if managers really mean what they say: are *managers* going to behave differently? Managers will be watching employees equally intently to see if employees' actions move beyond self-interest. Will employees begin to think about and act in ways that are for the good of all of the employee owners and the whole company? Education and communication programs can help to build trust, but in reality it will be the daily behaviors of all individuals that convince people to trust one another.

One strategy that has been particularly effective in building trust between management and nonmanagement employees can be part of the process of explaining the company's ESOP and how it works. In several cases in which we have been involved, groups of 30 to 50 employees have been invited to a day-long workshop to learn about the ESOP. In addition to providing those attending with detailed information about the ESOP transaction and ESOP mechanics, one segment of the day had the company CEO and CFO presenting basic company financial information. This was done in the context of linking the company's performance to its stock value. Then employees were given the opportunity to anonymously ask senior managers any questions or to check out any rumors. Senior managers answered any and all questions and explained their rationale for any decisions that were questioned. By demystifying the ESOP, sharing previously unshared financial information, and openly answering all questions, managers demonstrated that they were going to behave differently. Employees who attended these retreats left feeling much better about management and the ESOP. This kind of process, then, can jump-start the trust-building process. However, it must be followed up by ongoing communications efforts and consistent willingness of management to answer questions and share information.

In the process of implementing cultural change, three actions may be particularly helpful in building trust. The first is to develop a formal system through which employees can question the degree to which specific policies are consistent with the new culture and suggest changes. One example could be establishing an employee committee that becomes a liaison between senior management and employees. Another would be a regular forum with senior management intended as a place for employees to ask questions and check out rumors. One company even established a "rumor hotline." The second is to create a grievance system so that people can feel safe to fully participate, share their ideas no matter how unpopular they may be, and make suggestions without fear of repercussions. The third is to establish a performance review process through which everyone, including managers, is held accountable for behaving in ways that are consistent with the vision for the new culture. Where a good performance feedback system is already in place, these "ownership behaviors" can be integrated into that system.

Trust among different subgroups will undoubtedly go up and down during the course of any culture change process (and during any changes that occur in the company). Under pressure, for example, people often revert to behaving in ways that are familiar rather than using new behaviors that are consistent with the culture being developed. Managers easily can slip back into command and control behaviors if a company's performance begins to slip, and employees can just as easily stop being cooperative. Using these "old" behaviors will cause trust to go down. It will be helpful to pay careful attention to situations which may erode trust and to correct them as soon as possible.

✔ **Assessment** After clarifying the desired goals for the ESOP, one of the first things a company should do to begin the process of building an ownership culture is to undertake a thorough assessment of both the company's leadership and the company culture. The information that results will be extremely helpful in directing and prioritizing the activities the company must undertake to build the desired culture.

Assessing Leadership. Before committing to developing an ownership culture, company leaders would benefit from self-reflection regarding their interest in and personal ability to facilitate and support the development of an ownership culture. They should ask themselves whether their values, beliefs, and skills are consistent with what is needed to build and maintain such a culture.

As part of a research project designed to help us understand what characteristics, if any were shared by leaders of successful ESOP companies, we and our colleagues interviewed more than 20 such leaders.[3] The results indicated that those leaders shared some common values and skills. First and foremost, they held strong values about fairness. They were consistently concerned about how to best balance out the fairness concerns of all subgroups in the company. Fairness concerns ranged from the way the employee ownership plan was structured to the way perks were handled. Perks, such as company cars, were given only when there was a clear business reason for them that resulted in cost savings for the company. Alongside this value, these leaders held general humanistic values about the basic goodness of each person and the importance of valuing and respecting what each individual brings to a work situation. They tended to hold a strong belief that input from diverse perspectives would result in a better decision and that decisions were best when they were made with the input of people who had to implement them. They were comfortable sharing information and power as long as both were used to the benefit of the company, although they were clear about their responsibility and accountability as company leaders. Finally, all of them either were reasonably good communicators themselves or surrounded themselves with other senior managers who were strong communicators.

Although the commitment of the CEO is necessary, it isn't sufficient to lead the culture change effort. In fact, the intentions of a committed CEO can be undone by other senior managers' lack of support, commitment, or skills. One assessment that the CEO should make early in the ownership transition process is whether there is a strong enough core of leaders on his or her management team with the requisite values and skills to support the new culture. In some cases, it may be wise to make changes in leadership personnel; in other cases, leadership development training efforts may be desirable. Either way, building a strong, supportive leadership team to drive the change process is often one of the keys to successful culture change.[4]

Efforts to develop ownership cultures in companies in which leaders are not personally willing or able to actively promote values consistent with a more open, participatory culture are destined for failure. A particularly illustrative example is that of a CEO who said he was very interested in developing a high performance ownership culture but who ultimately admitted, "watching this happen, encouraging all of this participation instead of just calling the shots, goes against my grain. It really makes my stomach churn." This CEO was willing to stand back and watch but not to actively lead a culture change effort. It was no surprise, then, that efforts to change the culture were quickly stopped as soon as the company hit a momentary financial problem. As a result, the company had spent considerable time, effort, and money laying the foundation for changes it didn't follow through to completion. In addition, the company then suffered from employees' disappointed expectations (although employees had all along questioned what appeared to be a lack of active support by the CEO, so they were not as surprised as they might have been when the change efforts were stopped).

Assessing the Current Company Culture. By conducting an objective assessment, leaders can gain critical insight into the strengths and opportunities for improvement in their company's current culture. A cultural assessment may be quantitative or qualitative and may be conducted by means of an employee survey,[5] focus groups, individual interviews, and so on. Assessment information can also be helpful in providing baseline data against which to measure culture changes. Although many company leaders believe they already fully understand their company's culture, an objective assessment can highlight the relative strengths of different characteristics. For example, if trust between management and nonmanagement employees is low in a company, a good assessment will not only make the extent of distrust clear but also will pinpoint the major sources of distrust.

In one company, an assessment indicated that distrust emanated from a lack of communication from the top executives. The people who had direct contact with the senior leadership team felt informed and confident. Unfortunately this included very few people. The further away from the top employees were, the less they understood the rationale for company decisions and the less trust they felt. Specific examples employees raised indicated that the general lack of trust had resulted in bizarre rumors about even very minor actions, which tended to erode trust even further. Once the assessment was completed and senior managers could clearly see the extent of the problem, they were able to correct it quickly and easily. First, they developed a series of open dialogues between themselves and employees throughout the company. By answering all questions and speaking to all rumors directly and honestly, they demonstrated openness and showed people they had strong and thoughtful rationales (for the benefit of the company) for each decision that was questioned. In addition, they established a regular communication program to keep rumors to a minimum. Through these relatively easy actions, employees felt informed and respected and a new level of trust was quickly reached between management and nonmanagement. Once trust was reestablished, it was possible to take other actions to build the culture. Without an assessment, this leadership team might have begun with other actions that may have failed because employees were skeptical about management's real intent.

An organizational assessment serves another function early in the process of developing an ownership culture by communicating to employees that their opinions and perspectives are valued and will be listened to. An assessment process can be an initial signal that employee involvement will be a component of the new ownership culture. The distribution of the assessment results to all employees will enhance people's experience of open communication and, thus, build trust. Of course, soliciting suggestions from employees about how best to respond to problems identified is another opportunity to actively reinforce a commitment to employee involvement.

✔ **Aligning Ownership Expectations** One of the early steps that must be taken to begin building an ownership culture as well as to avoid frustrated expectations is to align employees' diverse conceptions about what ownership will mean. Once the goals for employee ownership are clear, it will be easier to begin engaging the organization in giving shared meaning to employee ownership.

Changing Language. Scholars and researchers alike have attested to the power of language to mold thought, rather than the reverse.[6] Organizational researchers have demonstrated that changing job labels is a much more effective process for changing people's perceptions of their jobs and their work behaviors than even extensive retraining programs.[7] Through working with employee-owned companies, it has become clear that one source of problems associated with employees' expectations about being owners stems from the term "employee ownership" itself. For many people in the United States, the term "ownership" carries a set of individualistic expectations that do not work when many people share ownership of a company. For example, nonmanagement employees' typical associations with the term "owner," include: "control," "boss," "come and go as I please," "free access to all company information," "telling others what to do and how to do it," "involvement in all important decisions," "setting the company's strategic direction," "responsibility only to myself," "in charge," "control of profits," "rich," "long vacations," "big cars," "job security," "expensive 'toys,'" etc. Of course, if you imagine 80 or 800 or 8,000 people all adopting this set of ownership expectations, you can easily see a company in chaos.

Owners and senior managers, on the other hand, tend to describe their association with the term "owner" in terms of responsibilities such as staying until the job is done, worrying about sales and profits, continually being concerned with expenses, bearing the burden of making the payroll each week, being the ones who are ultimately accountable, and so on. In short, they produce a picture that connotes little of the joys of being an owner but many of the burdens. A company full of folks who emphasize only these characteristics would be depressing.

However, a simple change of terminology can trigger a major change in expectations. If, instead of the term "owner," people are asked to think about "shared ownership" or "joint ownership," their associations are different. Almost everyone has had some kind of "shared ownership" experience such as jointly owning a house or even sharing a room with a sibling or classmate. It is clear to people at all levels in a company that making shared ownership situations work involves cooperation, communication, caring, trust, mutual respect, common goals, division of labor, accountability, responsibility, sharing of benefits, reliability, and so on.

When you imagine a company in which the employees are committed to this list of shared ownership behaviors and characteristics rather than either chaos or burden, you can picture a well-performing company. Sharing ownership with all other employee owners (and shareholders) creates an image of a community of people that will sink or swim together depending on the effect of their joint effort. The success of any company depends on the effort of all company members, not just on a few, and not the individualized efforts of people who may not be rowing in the same direction or cooperating in their efforts. This idea of a company as an interdependent community of employees is not captured in either "fat cat" notions of ownership or "weight of the world" notions of ownership that the term "employee ownership" seems most often to invoke. Shared ownership connotes a community of people with common goals cooperatively working together to achieve them. Rather than implying everyone is the "boss," it implies a reasonable division of labor for the good of the whole (the company).

So, one of the first actions a company should take to begin aligning ownership expectations is to determine what language or terminology is likely to provoke a workable and desirable image of an ownership culture. Then the task is to make that language part of the company's everyday communications. It needs to be incorporated into the vocabulary of company leaders, written documents, and general conversations between and among employees. This process can be started through a series of company workshops, whole company meetings, or training programs in which employees at all levels work with the new language and develop a personal understanding of its meaning and a personal commitment to it.

Developing a Shared Vision for an Ownership Culture. Within the frame of selected ownership language, another important step in aligning expectations is the creation of a widely shared vision for an ownership culture. We have developed a process for doing this that has been described in more detail elsewhere.[8] Although leaders must initiate and guide the process of developing an ownership culture, leaders alone cannot create a culture.[9] Employees must be involved in defining the cultural vision not only to overcome any natural resistance to change that they may have, but also because they will insist on being involved one way or another. Paul Bate, a scholar who has studied culture change in many organizations, says:

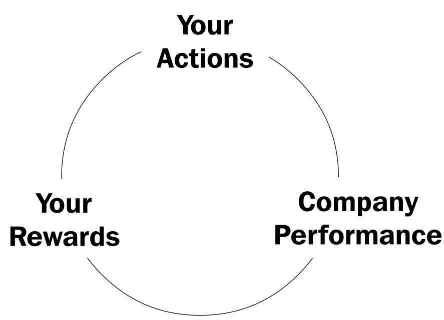
> Organizational culture is . . . a complex social process in which people at all levels will demand some involvement and if this is not forthcoming will simply help themselves to it. They will not be content to be consumers; they will also insist on being producers. And if these demands are not met, they will resist or simply go off and make their own cultural product.[10]

Specific behavioral expectations for company members as employee owners can be derived from a shared ownership vision. By involving as many people in the company as possible in the development of a vision for a shared ownership culture, an aligned set of expectations will emerge and take form. At all levels of a company, ongoing conversations about ownership expectations such as those suggested by Mackin[11] can result in an evolution of consensus about the meaning of ownership and community buy-in to the related behavioral expectations.

Turning Ownership into Motivation

✔ **The Employee Ownership Performance Cycle™** For stock ownership to be a motivational force, employees must understand the links between their individual actions, the company's performance, and their individual reward (see figure 1). The more opportunities a company's "architecture" provides for employees' actions to affect company performance and for company performance to result in rewards for employees, the stronger the links will be and the stronger will be employees' motivation to enhance company performance. There are four major categories of activities through which an ESOP company can reinforce employees' understanding of the linkages and develop company practices that strengthen the linkages. These are communication, education, participation, and short-term incentives. The rest of this appendix provides an overview of each of these areas.

Figure 1. The Employee Ownership Performance Cycle™



✔ **Communication** Communication plays a central role in getting an employee-owned company "off on the correct footing" and in establishing and maintaining a high-performance ownership culture. Issues around communication can be divided into two areas. The first is communicating with employees regarding establishment of the employee ownership plan. Second is the company's ongoing communications plan.

Initially Communicating the Employee Ownership Plan. Initial communications to employees about the company's employee ownership plan are critical in setting the tone for how employees will perceive the plan going forward. First and foremost, communications should be as open and honest as possible. Cloaking an already suspicion-raising concept such as an ESOP in any mystery by not answering questions or giving full information can only make people's skepticism deeper and harder to overcome. How the employee ownership plan is communicated will either build trust or create distrust. Although it is easier to explain an ESOP transaction than most managers imagine given the complexity of these transactions, it is rare that employees can gain an appreciative understanding of such a transaction through written documents or cursory presentations. Employees come to understand their employee ownership plan best when it is explained in detail in several different formats over a period of time. Companies are most successful in their early communications when they follow these guidelines:

- Develop a clear idea of what part employee ownership is intended to play in the company going forward and make that expectation part of the initial presentation (e.g., if an ESOP is only intended as a retirement benefit, with no other intended effects or related company changes, communicate it as such).
- Design a communication program about the employee ownership plan that is highly interactive and fun so that people can gain a hands-on understanding of how the transaction works (nothing is worse than a boring benefits presentation of charts with lines and arrows if your goal is to capture people's interest and strengthen their motivation).
- Communicate the employee ownership plan through several different mediums (e.g., a management overview, a module of a larger education program, a question and answer handout, an ESOP hotline, a newsletter Q&A column, an ESOP facts crossword puzzle, or a review "game" at a company meeting).
- Connect possible gains in individual account values with employees' behaviors and company performance (this lays the foundation for other education and performance improvement efforts).
- Be sure that people have ample opportunities to ask questions about the ESOP and/or the company when the plan is being presented (find ways to make asking questions safe and comfortable).
- Anticipate the major concerns that employees are likely to have and design communications to address those concerns directly (e.g., if an ESOP is replacing a well-liked profit-sharing plan, it may help to project expected increases in company value based on past performance and compare those to performance of the profit-sharing plan).

- Include, as part of the opening presentation, an explanation of what will and won't change as a result of the ESOP in order to calm any anxieties that employees may have and to begin framing expectations.
- Explain why the company and present owners are setting up the ESOP and what would happen absent an ESOP (such as a sale to a third party).

Unfortunately, leaders of employee-owned companies too often believe that communicating the ESOP is the only major effort they must make: once employees understand how their ESOP works, increased motivation will automatically follow. In fact, effectively communicating the employee ownership plan is only one step in a much more comprehensive effort to develop an ownership culture.

Ongoing Communications Plan. After the employee ownership plan is initially presented, it is important to keep communications flowing in the company. To strengthen the links in the Employee Ownership Performance Cycle™, employees should be given information on a regular basis about their unit's performance and the company's performance. The more quickly people receive feedback on unit and company performance, the more they will be able to link their own actions with the performance results. This link in the cycle, between individual behaviors and company performance, can also be strengthened if there are a few specific performance measures that are identified as affecting the bottom line, if people understand how the way they do their job affects those measures, and if those measures are reported regularly.

The more information about the company that can be communicated, the better. The only way people can know what effect their actions are having is to be given the results. As Jack Stack says, how can players decide on their strategy if they don't know the score?[12] Rather than giving out information on a "must know" basis, information should be thought of as a resource that should be widely shared. In the case of an employee-owned company, regularly providing information about how the company is doing and how individual units are contributing is one of the things that makes people feel like owners and that keeps them focused on the company's performance. In addition, open communication builds trust. Without open communications, facts get replaced by rumors and misunderstandings grow.

Just as it is important to communicate *out from* management, it is also important to develop processes for employees to be able to communicate *in to* management. Processes and practices that encourage employee input are discussed in more detail below under “Participation.”

✔ **Education** To maximize the effect of communication efforts, companies also must educate employees about the information that is being provided.

Business Literacy. Companies that have begun their communications efforts by handing out the company’s P&L statement or balance sheet and then watched people drop them unceremoniously in the “circular file” can attest to this. In these cases, rather than concluding that employees just aren’t interested, a better conclusion would be that employees don’t understand what they’re looking at or why. In terms of their company, it is not unusual that a typical employee won’t understand how their company makes (or loses) money, what the difference is between sales and profits, why a board of directors would choose to reinvest profits rather than pay them out to employees and how that choice could benefit employees in the long run, or even what stock is. In order for employees to “see” the link between their company’s performance and individual reward (through their employee ownership plan), they must have a basic understanding of the factors that affect how a company is valued. Learning which of these factors they can and cannot affect will also facilitate their understanding of the linkages.

Skills Training. Beyond learning about their company and its finances, and the mechanics of the employee ownership plan and how they can contribute to making it more valuable, skill development is another area of education that may benefit employees. If, for example, employees are going to be involved in problem-solving teams or task forces, they may need training in group problem-solving. If they are working on committees or teams, they may need communication skills, meeting skills, etc. Employees who become ESOP trustees and/or board members may also need training about their role responsibilities and more detailed financial and/or strategic business decision-making.

Leadership and Supervisory Training. One area of education that many companies need is training for supervisors that is related to the skills the supervisors must have to be successful in helping the company achieve its ownership vision. People in leadership and management positions must learn new behaviors that support the desired culture. Unfortunately, it is common for leaders who previously have operated in an authoritarian style to either continue in that style or to abdicate their management role when they learn that giving orders isn't acceptable. Learning how to lead by inclusion, to coach, and to inspire is a major undertaking that usually requires additional training and skill development.

Middle managers are often the employees who are forgotten as companies try to develop ownership cultures.[13] However, in culture change efforts, it is the person to whom employees directly report that most affects their own behavior shifts. This means that supervisors can have a significant effect on a company's ability to shift its culture. Without training in participatory leadership and coaching skills, supervisors may resist changes and discourage other employees.

Just-in-Time Training. Rather than planning out a comprehensive education program that all employees will go through, it is better to design training modules that are matched to the information people will be receiving in the immediate future or to skills they will be using as soon as the training is over. This assures that people will have the opportunity to use what they have learned before they forget it.

✔ **Participation** Employees' expectations about where and how they will be involved in decision-making and the level of authority they will have is one of the major areas of potential tension and frustration in employee-owned companies. If these issues are addressed and clarified early, unnecessary friction can be avoided. Also, as cited earlier in this appendix, participation often results in improvements in company performance. The questions that may need clarification center around the kinds of decisions in which employees will have input, the forums for employee participation, and the amount of decision-making authority they will have. For example, will employees have one or more seats on the board of directors? Will they have a voting representative on the company's executive committee? Will a new ESOP advisory board be created, and if so, what kinds of responsibility and authority will it have? Will their supervisor be required to listen to their ideas? Will they get to vote on the company's strategic direction? Will they have any voice in the selection of new employees? These are only a few of the questions about which employees will have opinions and for which they will want to have answers.

Participation generally takes two forms. First is people's voice in their day-to-day job-related activities. In highly participative companies, people are involved in decision-making about issues related to their own jobs, and supervisors solicit and pay attention to their input. Supervisors also provide people with the information, resources, and skills to make as many decisions themselves as possible. Second are formal channels for participation. These are the channels through which employees have a say beyond their own jobs. Formal participation channels might include any or all of the following: creation of new standing committees (e.g., an education committee, a new-employee orientation committee, or an ESOP advisory board); creation of employee roles in established decision-making forums (e.g., boards or ex-officio membership on executive committees); or the ongoing establishment of ad hoc task-focused groups that dissolve or change composition once a specific task is completed (e.g., hiring teams, cross-functional problem-solving teams, or benefits policy committees). In general, the more forums employees have for participation, the more strongly they will perceive the links between their behavior and company performance.

Channeling Expectations About Participation. It isn't necessary at the start for companies to be able to spell out what specific forums there will be for participation. Because employees expect employee ownership to result in more participation, it is useful if a company's leadership can clarify its broad initial intentions in this regard. For example, when asked whether employees would be involved in strategic planning now that the company was 100% employee-owned, the CEO of one company told employees that they wouldn't be directly involved because strategic planning was his job. He didn't expect them to do his job, any more than he would imagine that he could come out into the field and tell them how best to do their jobs. On the other hand, in this particular company, there were several other venues through which employees would have an opportunity to have formal input, including seats on an ESOP advisory committee, task forces to revise personnel policies, and a longer-term plan to give employees more decision-making power directly related to their jobs. By clarifying when and how employees would have more voice in decision-making, both management and nonmanagement employees knew what to expect. In addition, the company was able to develop a training program that was directly related to the skills and knowledge people would need to participate effectively as well as what training managers would need to encourage and support employee participation.

✔ **Short-Term Productivity-Based Incentives** Although an employee ownership plan itself may operate as an incentive, it is a long-term incentive. Like any retirement plan, the ESOP by itself feels too far off for many employees for it to have much incentive value. This is particularly true in companies with large proportions of younger employees and/or high turnover. Furthermore, many ESOP companies conclude that "the ESOP does not work as an incentive" when in fact their other compensation elements create strong disincentives against employees behaving in ways that enhance long-term growth in share value.

In addressing these challenges, it is essential to treat the ESOP in the context in which employees actually receive benefits from their employer: an ESOP is a form of compensation, but it is just one element in a company's total compensation package. To contribute effectively to overall company goals, the ESOP must be carefully coordinated with the other compensation elements to insure that the package as a whole generates the intended results and that the ESOP begins, over time, to feel "real" to employees.

Ideally, the overall reward system should actually encourage behaviors that are good for the company—i.e., consistent with the overall ownership vision. As simple as it sounds, this is often not the case. Therefore, the first task in using the ESOP as part of the total incentive/reward system is to identify and address any existing "negative incentives," i.e., assessing whether other incentives are undermining the ownership vision. This involves reviewing the full range of compensation and noncash incentives from the perspective of "does each element encourage employee behavior that is consistent with our overall vision?" and adjusting other elements to bring all of the individual pieces into alignment. This challenge is not unique to ESOP companies, but removing these barriers is essential before employees will be able to see and respond to the positive potential of the ESOP.

The second task is to fill in the gaps. Many ESOP companies find that it is important to either modify existing bonus plans or add some form of short- or medium-term incentive compensation to reinforce the ESOP's incentive power. These other incentives generally have one central goal: they provide an immediate tangible reward to employees for behavior that the company believes will contribute to long-term success (and therefore make the ESOP more valuable as well). This can take several forms. One common alternative is to pay a cash bonus based on specific productivity, profitability, and other performance targets that are linked to long-term success. Another alternative is to issue cash dividends on ESOP stock. These dividends are generally tax deductible, unlike dividends paid on non-ESOP shares. They have the additional benefit that they are distributed among employee-owners on the basis of *ownership criteria*—i.e., an employee-owner with more ESOP shares in his or her account will receive proportionately more dividends—rather than on the basis of *employment criteria*. ESOP dividends therefore not only reinforce ownership but also provide short- or medium-term cash. Whatever the final mix, the short- or medium-term incentives as a whole should help employees see the link between their day-to-day behavior and the creation of long-term share value that will benefit them through the ESOP.

Conclusion

To maximize the opportunity for an ESOP to result in company performance improvements, company leaders must spend adequate time up front determining their goals for the ESOP and their own willingness to make personal and organizational changes necessary to achieve their goals. When a change in a company's culture is needed to maximize the performance-enhancement possibilities presented by an ESOP, everyone in the company must be prepared for a long-term change effort. Most culture change experts agree that a full change in a company's culture can take at least five to seven years. In addition to general issues related to successful culture change efforts, employee-owned companies must be cognizant of specific challenges that employee ownership itself entails. Overcoming employees' typical reactions of suspicion and distrust as well as aligning ownership expectations are critical issues that must be addressed early to build a strong foundation for making the ESOP a motivational resource. Once a process for open communication is established, ESOP companies can continue to build the culture they desire. Finally, companies should not be surprised to encounter resistance to change at all levels. Resistance is a normal reaction to change, and culture change efforts are no different. Developing a high performance ownership culture requires planning, leadership commitment, patience, and persistence.

Notes

1. See the summaries of studies by Rooney (1990), Conte (1989), and Ducy and Igbal (1996) in *Employee Ownership and Corporate Performance* (Oakland, CA: National Center for Employee Ownership, 1998).
2. See the summaries of studies by Quarrey (1987), the U.S. General Accounting Office (1988), and Winther (1994) in *Employee Ownership and Corporate Performance.*
3. Virginia J. Vanderslice and Sherman L. Kreiner, "Characteristics of Leaders of ESOP Companies with Successful Participatory Cultures" (1995). Unpublished manuscript.

4. John P. Kotter, *Leading Change* (Boston: Harvard Business School Press, 1996).

5. Ownership Associates, Inc., in Cambridge, Massachusetts, has developed a survey for this purpose called the Ownership Culture Survey.

6. Isaiah Berlin, *Vico and Herder: Two Studies in the History of Ideas* (London: Chatto and Windus, 1980).

7. John Adams and Sabina Spencer, "The Strategic Leadership Perspective," in *Transforming Leadership: From Vision to Results,* edited by John Adams. (Miles River Press, 1995).

8. For a more comprehensive explanation of the process of developing a shared ownership vision, see Virginia J. Vanderslice, "Harnessing the Power of Ownership Passions: Creating a Shared Ownership Vision," chapter 10 in *Journey to an Ownership Culture,* edited by Dawn K. Borhawn (Lanham, MD: Scarecrow Press, 1996), 79–85.

9. Paul Bate, *Strategies for Cultural Change* (Oxford: Butterworth-Heinemann, Ltd., 1994); Peter Senge, Charlotte Roberts, Richard Ross, Bryan Smith, and Art Kleiner, *The Fifth Discipline Fieldbook* (New York: Doubleday, 1994).

10. Bate, p. 244.

11. Christopher Mackin, "Creating an Ownership Culture," *Journal of Employee Ownership Law and Finance* 2, no. 4 (fall 1990): 79–94.

12. Jack Stack, *The Great Game of Business* (New York: Doubleday, 1992).

13. Jim Bado and Dan Bell, "From Obstacles to Catalysts: Redefining the Role of Employee Owner Supervisors," *Journal of Employee Ownership Law and Finance* 5, no. 1 (winter 1993): 25–46.

Order Form for "Getting Your Company Ready for an ESOP: The Ownership Culture Perspective" from *Selling to an ESOP*

Selling to an ESOP is published by the National Center for Employee Ownership (NCEO). The book costs $25 for members and $35 for non-members (a one-year membership is $70). You can order it by telephoning the NCEO at 510-208-1300; by using the secure online order form at our Web site, *www.nceo.org;* by faxing this page (using your credit card to order) to the NCEO at 510-272-9510; or by sending this page with your credit card information or check to the NCEO at 1736 Franklin Street, 8th Floor, Oakland, CA 94612. If you join as an NCEO member with this order (or are already an NCEO member), you will pay the discounted member prices.

Name

Organization

Address

City, State, Zip (Country)

Telephone Fax E-mail

Method of Payment: ❑ Check (payable to "NCEO") ❑ Visa ❑ M/C ❑ AMEX

Credit Card Number

Signature Exp. Date

Checks are accepted only for orders from the U.S.

Title	Qty.	Price	Total

Subtotal	$
Sales Tax	$
Shipping	$
Membership	$
TOTAL DUE	$

Tax: California residents add 8.25% sales tax (on publications only, not membership)

Shipping: First publication $4, each additional $1 ($9 each outside North America)

Introductory NCEO membership: $70 for one year ($80 outside North America)