

TEACHING NOTE

Employee Ownership Teaching Module and the Topics in Entrepreneurship Courses¹

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This Teaching Note gathers the main topics that anchor a session (a week or a unit) of a class in the entrepreneurship curriculum. Under each topic you will see:

Current topics include:

This section lists themes or concepts included in a typical syllabus.

EO materials that could be added:

This section suggests both some ideas and some specific cases and readings, which indicate how to include Employee Ownership (EO) and thereby expand how the themes or concepts are addressed. The materials suggested can be found on CasePlace.org, which includes a full abstract and source information.

Please see also two other resources on CasePlace.org on teaching employee entrepreneurship, both generally and in the entrepreneurship curriculum:

Featured Collection. [Employee Ownership: A Topic for the Entrepreneurship Curriculum.](#)

[A Closer Look at Business Education: Employee Ownership.](#) October 2008.

Session topics from courses in the entrepreneurship curriculum.

1. Where do entrepreneurs come from?

Current topics include:

Innovation, vision, emergence

The discovery of entrepreneurial opportunity

Entrepreneurship and the shape of an industry

EO materials that could be added:

¹ Based on course syllabi from several schools, particularly drawing from the Case Western Reserve University, the Harvard Business School, and the University of California Berkeley.

Entrepreneurship courses increasingly note that entrepreneurs are not heroes or mavericks, but that they “stand on the shoulders of giants.” They draw both new product ideas and organizing principles from their environment. As such, they can tap the wide extent of diffusion of EO across the economy.

See the research article on EO as a spur to innovation:

Who Has a Better Idea? Innovation, Shared Capitalism, and HR Policies

By Erika E. Harden, Douglas Kruse, Joseph Blasi.

In Joseph Blasi, *Economics of Shared Capitalism*, 2008.

Abstract: We investigate the relationship of "shared capitalist" compensation systems—profit/gainsharing, employee ownership, and stock options—to the culture for innovation and employees’ ability and willingness to engage in innovative activity. Using a large dataset with over 25,000 employee surveys in over 200 worksites of a large multinational organization, we find that both shared capitalism compensation and high performance work policies contribute to these innovation outcomes. Owning company stock is the most consistently positive compensation variable in predicting both an innovation culture and willingness to engage in innovative activity. We also find that shared capitalism and high performance work policies have stronger effects in predicting an innovation culture when they are combined, and that the effects of shared capitalism and high performance work policies are partially, but not wholly, mediated through greater employee alignment with company strategy. The findings are consistent with agency theories predicting that the principal agent problem can be addressed by a combination of shared incentives and cooperative culture which encourages mutual monitoring and opportunities to share information.

2. Creating the product and pulling together the team

Current topics include:

Legal issues in the protection of intellectual property

Legal issues regarding at-will employment.

EO materials that could be added:

Supporting new product development and mobilizing the talent to work on projects are both advanced by EO. The book, *The SAIC Solution*, documents how new business creation and EO were intertwined in the technology sector.

3. The business plan: Shaping the enterprise, attracting funding

Current topics include:

Writing a sound business plan

Understanding the value added and the niche of the business

Determining how much financing is needed

Choosing and approaching a venture capitalist

Setting milestones and anticipating growth

EO materials that could be added:

EO can give an organization a distinctive stamp and logic, from the time of its founding. It does not have to be implemented only at a more mature stage of business development.

EO can be part of the logic for how the new enterprise will create value. EO can shape a corporate culture. See the Keller Williams case – the gain-sharing aspect of the incentive structure was fundamental to the business model and competitive strategy. Employees had incentives to collaborate, to make referrals among one another, and to avoid internecine competition that increases employee turnover and creates a negative tone for customers in this industry.

4. Establishing the start-up

Current topics include:

Legal forms of organization, articles of incorporation

Restricted stock purchase agreement

Incentive stock plan

EO materials that could be added:

Employees can be patient investors, taking a longer view. For example, employees at Google play a strong role in investing capital in their company.

These segments of a course tend to include very specific readings on generating funding. Specific details on types and implementation of employee ownership plans can be added.

The decision-maker's guide to equity compensation.

By Corey Rosen, Pam Chernoff, Daniel N. Janich, Scott Rodrick

The National Center for Employee Ownership, 2007

The entrepreneur's guide to equity compensation.

By David Binns and Ron Bernstein. The Beyster Institute, 4th edition, 2006.

The main points in this book are summarized in a Harvard Business Review column, Briefings from the Editors, by Katherine Zoe Andrews, March-April 1996.

5. Venture capital: Types, current practices

Current topics include:

Types of venture capital

Venture capital as more than money

Managing relationships between venture capitalists and entrepreneurs

EO materials that could be added:

There is a parallel topic of “EO as more than money.” EO helps create a culture of innovation and participation. It attracts new employees to become stakeholders to the growing venture – investing their human capital as well.

See the research findings in:

Creating a bigger pie? The effects of employee ownership, profit sharing, and stock options on workplace performance.

By Richard Freeman, Joseph Blasi, Douglas Kruse, Christopher Mackin.

In Joseph Blasi, *The Economics of Shared Capitalism*, 2008.

6. The legal structure of venture capital

Current topics include:

Technical issues with boards of directors, shareholders, incorporation

Private placement of Series A preferred stock

EO materials that could be added:

Technical issues involving setting up equity compensation need not be daunting. Many classes delve deep into the specifics of venture capital. There are resources for a similarly close look at the plan types and features of employee ownership (see books, above).

7. Alternative sources of funding

Current topics include:

Angel funders

Bootstrap financing

EO materials that could be added:

EO is not solely for mature companies nor mainly for turnarounds and rescues, although it has played a significant role in some well-known cases of turning around business in trouble, such as United Airlines:

United Airlines/Harvard Business School. By Stuart C. Gilson and Jeremy Cott.

United Airlines: Employee Buyout/Darden Business School – University of Virginia. By Susan Chaplinsky.

United Air Lines/MIT Sloan School of Management (Available from CasePlace.org). By Thomas A. Kochan. The case explores the same transaction as the above two cases, as part of the Rebuilding the Social Contract at Work project at MIT Sloan School of Management's Institute for Work and the Employment Relationship.

While these cases showcase a significant aspect of EO, it is important to represent the sometimes less well-known ways in which EO can be utilized during founding.

The following update on a recent study comes from The National Center for Employee Ownership. <http://www.nceo.org/columns/cr258.html>

Study Finds Broad-Based Options in Venture-Backed Companies Both Common and Effective

Data on the extent and effectiveness of broad-based equity plans in closely held companies are scarce and based on samples too limited to be persuasive, but we recently came across one significant exception. In "Give Everyone a Prize? Employee Stock Options in Private Venture-Backed Firms" (2005, unpublished), John R.M. Hand of the Kenan-Flagler Business School looked at data from 2004 and 2005 provided by VentureOne, a provider of data on venture-backed firms. The sample consisted of 1,032 venture-backed companies responding to the survey for which adequate data were available. The study found the mean percentage of employees getting options was 89%, and 74% of the companies granted options to everyone. In other words, contrary to the conventional wisdom that broad-based equity awards have been disappearing in venture-backed companies, they are in fact almost universal.

Hand's study looks at whether granting options deeply into the organization is a good strategy for venture investors. He correlates the fraction of the firm's employees receiving shares and finds that granting options to more employees results in better performance than granting them more narrowly. The specific measures are too complex to describe here, but they essentially create a hypothetical optimal depth of options granted. Using that optimal depth, Hand concludes that firms that err on the side of too many people getting options do better than those that err on the side of too few.

The argument here is that granting options too far down poses minimal risk because lower-level employees usually get smaller grants. In contrast, not granting far enough down the ladder can create a substantial risk that potentially critical people will not be retained or motivated. So it is better to err on the side of caution.

8. Rewards and incentives

Current topics include:

Personal testimonies from entrepreneurs on the challenges and joys

Managing and motivating the start-up team

EO materials that could be added:

EO is an engine for motivation and retention. Its prevalence as a reward flies in the face of conventional wisdom about the free rider problem and worker aversion to risk-taking where there are group rewards. See the materials in the **Featured Collection** on employee ownership; there is a section devoted to managing human resources.

9. Strategic alliances

Current topics include:

Managing intellectual property

Negotiations with alliance partners

Taking alliances global

EO materials that could be added:

Alliances with socially responsible ventures can be aided by a shared approach to EO. See the mini-case on Equal Exchange and Wainwright Bank, in the Featured Collection.

10. Valuation: Analyzing and supporting the value of a start-up

Current topics include:

Valuation in private equity settings

Valuation of venture capital deals

EO materials that could be added:

A case on valuing stock options from an accounting perspective offers a cautionary tale.

eBay, Inc.: Stock Option Plans (A, B, and C), Harvard Business School.

By Mark T. Bradshaw.

This case examines the impact on profits of accounting for employee stock options. It can also be used in conjunction with the case, eBay Inc.: Internet Success or Fairy Tale? By David F. Hawkins and Jacob Cohen.

11. Mergers and acquisitions

Current topics include:

When to sell the company

Implications of being acquired

EO materials that could be added:

Selling the company to employees can leave the company intact.

The Ultimate Employee Buy-In:

Sell the company to your employees? It's a great idea – both for you and the company you leave behind.

By John Case

INC. Magazine, December 2005

Employee ownership also gives the employees a significant voice in proposed mergers and acquisitions.

Case: Spiegel-Verlag Rudolf Augstein GmbH & Co. KG

By Belen Villalonga, Daniela Beyersdorfer, Vincent Dessain

Harvard Business School, 2008

Abstract: Der Spiegel is Germany's most influential political news magazine. In the 1970's, its founder Rudolf Augstein gave a 50% ownership stake to his employees and sold another 25% to rival publisher Gruner+Jahr, but retained significant control during his lifetime by stipulating in the bylaws that every important business decision would require a 76% shareholder approval. When Augstein died in 2002, however, his co-owners exercised the option the same bylaws gave them to buy a 0.5% stake each from Augstein's heirs, who thus lost their veto rights. In September 2007, the benefits and costs of sharing ownership with employees become particularly salient when the employees block the CEO's proposal to acquire 50% of the Financial Times Deutschland. Faced with the new balance of power, Rudolf's eldest son Jakob Augstein is forced to rethink the role that his family can play in Spiegel going forward. Should he try to buy back the pivotal stake? Sell the family stake altogether? But to whom, and at what price?

12. Initial public offerings

Current topics include:

Distribution of venture investments

EO materials that could be added:

EO is an alternative method. There are costs and benefits of staying privately held.

See the book, *The SAIC Solution*, on employee ownership as an alternative to IPOs and on the benefits for new venture development of remaining private.

13. Creating a brand and image

Current topics include:

Defining distinct features to attract investors, employees, and customers.

EO materials that could be added:

EO – and the employee involvement culture often associate with it – can be hallmarks of a business, which can attract customers as well as employees.

See two cases on companies in the retail sector that stamped their identity in this way: Starbucks Coffee Company/Dartmouth College Tuck School of Business. By Alison Stanley and Paul A. Argenti. This case considers the company's growth and unique progressive workplace culture.

Iggy's Bread of the World/Harvard Business School. By Alexis Gendron and Kathleen Valley. The case examines a bakery that used profit sharing and developed a strong local following.

14. Entrepreneurship and minority-owned businesses

Current topics include:

Particular challenges and opportunities for minority-owned businesses

Entrepreneurship in the inner city

EO materials that could be added:

Another angle on these questions is what kind of access minorities have to employee ownership in companies. This research article presents a study by Ed Carberry, who found that racial minorities and women in firms with “shared capitalism” practices are significantly more engaged in the firm if they have a combination of shared rewards and employee empowerment. Much recent work in human resource management focuses on combinations of practices that jointly bring benefits; this the way to get a diverse group of employees engaged.

Who Benefits From Shared Capitalism?

The Social Stratification of Wealth and Power in Companies with Employee Ownership
By Edward J. Carberry.

In Joseph Blasi, The Economics of Shared Capitalism

Abstract: This chapter analyzes social stratification in patterns of access to shared capitalism programs, the value of shared capitalist plan assets, and access to workplace power and authority in a sample of over 40,000 employees in 14 companies with various forms of shared capitalism in the United States. The results reveal substantial disparities between the outcomes of women and men, nonwhite and whites, and employees with and without disabilities in terms of access to shared capitalism and the financial value provided by this participation. Although many of these effects appear to stem from existing mechanisms of occupational segregation, women and African Americans have lower plan values, even accounting for differences in education, occupation, and salary. This suggests that the structure and operation of certain forms of shared capitalism generates disparities beyond those created by extant mechanisms of stratification. The analysis provides a more mixed view of barriers to power and authority because formal structures of employee involvement appear to open up access to workplace power for some groups. The findings also reveal that, despite these disparities, access to shared capitalism and participation in employee involvement practices have positive effects on employee attitudes among all of the demographic groups.

15. Entrepreneurship in emerging markets

Current topics include:

Taking U.S. ventures global into emerging markets

Sourcing labor and production from emerging markets

EO materials that could be added:

The model of cooperatives for workers and farmers returns more of the gains to emerging economies, with fewer intermediaries. This case offers an example:

Honey Care Africa: A tripartite model for sustainable beekeeping.

By O. Branzei and M. Valente

Richard Ivey School of Business, 2007.

Abstract: The director and co-founder of Honey Care Africa (Honey Care) looks back over the six years of operations and describes the original business model and several sequential changes based on feedback from rural communities, partner organizations, and learning by doing through field operations. Increasing international recognition highlights the potential impact of the model on inspiring sustainable grassroots ventures in the agriculture sector in Kenya. For Tanzania and other developing countries, he ponders the potential opportunities and challenges in replicating the Honey Care model elsewhere. The case also tackles alternative routes for scaling up the model in East Africa. Students are presented with several specific challenges which illustrate the growing tension between Honey Care's original commitment to the farmers and its prospects for international take-off, and are asked to propose alternative model reconfigurations to resolve this tension.

16. Cause-based entrepreneurship

Current topics include:

Green businesses

Sustainability

EO materials that could be added:

Involved employees are stewards of sustainability. The case on Just Us! Coffee Roasters (see the Featured Collection) discusses this approach. The purpose of the business and the manner in which employees are engaged are synergistic in creating a commitment to sustainability.

17. Growing the start-up

Early challenges and opportunities

Moving beyond the founder team

EO materials that could be added:

A company's compensation philosophy may have to adapt as it considers recruiting a large number of new workers, as discussed in this case:

Compensation at Level 3 Communications/Harvard Business School. By Lisa Meulbroek. The company is a \$1.2 billion revenues 6,211 employee firm that rewards managers and employees only if its stock price exceeds the increase of the market in general. The case discusses the compensation philosophy as the firm needs to recruit a large number of workers.

18. Surviving difficult economic times

Current topics include:

Riding out ups and downs in the business cycle

EO materials that could be added:

The economic difficulties of 2008 might have students talking about whether a stronger role for employee involvement, via EO, might either prevent some crises in the first place or at least help businesses stay afloat and provide employment in difficult times.

This article examines the role of EO as traditional U.S. manufacturing centers faced plant closings, layoffs, and difficult economic times.

Rustbelt buyouts: Why Ohio leads in worker ownership.

By John Logue.

Dollars and Sense, Sept/Oct 1998.

The case of the employee buyout of Springfield Remanufacturing Company offers an example:

Jack Stack (A, B) Harvard Business School/Business Enterprise Trust. By Kirk O. Hanson and David Bollier.

19. “Intrapreneurship” within large organizational settings

Current topics include:

How to create a culture of innovation, widely or in pockets within large corporations

EO materials that could be added:

A case on the Corporate New Ventures Group at Proctor and Gamble discusses employee ownership as a motivational tool.

Corporate new ventures at Proctor and Gamble

By Teresa Amabile and Dean Whitney

Harvard Business School Publishing, 1997

The case mentions: “In 1887 it introduced a profit sharing plan, and in 1892 an employee stock ownership plan – one of the first companies to do both.” It is one of several elements of the culture that is mentioned as foundational to how the Corporate New Ventures group was able to generate and spread a sense of entrepreneurial excitement within the company.

In closing, the following short article discusses how to create a culture of entrepreneurial involvement in a mature company and summarizes several of the themes in this Teaching Note.

Creating Entrepreneurial Employee Ownership at SAIC

By J. Robert Beyster, Founder, Science Applications International Corporation (SAIC)

Source: <http://www.entrepreneurship.org/Resources/Detail/Default.aspx?id=11162>

SAIC has an interesting recruiting and retention challenge. It's an extremely diversified, decentralized, \$7-billion, employee-owned corporation. Just to give you an idea, [SAIC](#) has over 500 divisions operating somewhat like their own companies, although quite often they must act in unison to perform on large contracts. At any one time, we have more than 5,000 active contracts.

I would estimate that half of our 44,000 employees are directly involved in entrepreneurial activities—building an organization, proposing new ideas, exploring how our existing technologies and services can be applied to new customers and/or leading proposal efforts to bring in new business. Our challenge: to recruit, retain, and reward *entrepreneurial people*, who are also team players, in order to grow the company.

Why is growth important to us? First, at the top of the list of what drives entrepreneurial employees are new and exciting opportunities. Growth provides these opportunities. Second, growth enables us to provide a healthy return to our employee shareholders.

Yet growth is a double-edged sword. The difficult side of growth comes with managing growth—ensuring it is financially healthy, increasing our efforts to incorporate new employees into our employee ownership culture, making sure the *right leaders* are in place to manage increasingly larger organizations.

In addition to new opportunities, entrepreneurial employees want to be rewarded for their efforts—they want *ownership* in what they are building. We've worked hard to create "entrepreneurial employee ownership" at SAIC. Our ownership philosophy is, "those who contribute to the company should own it, and ownership should be commensurate with employee contribution and performance as much as feasible." We go to great lengths to ensure all employees are encouraged and given the opportunity to own SAIC stock through stock purchases, a 401(k) plan, and an ESOP. Also, a number of SAIC's programs target performance-based equity incentives to all employees.

Ownership as Reward

Each year we set aside stock to be offered as stock options and stock bonuses to employees based on past and future (expected) performance. The total bonus pool is determined by the company's financial performance for the year and is allocated among all operating groups based on the group's respective performance. The option pool is based on projected growth and is used by the groups to incentivize the performance required to meet strategic goals. At year-end, about half of our employees receive a bonus comprised of cash, bonus stock (restricted and/or unrestricted), and stock options. All employees are eligible, but the management team determines who receives awards.

Ownership as Incentive

To focus employees on specific performance targets, we initiated a negotiated stock option program. A written agreement is set e between a manager and an employee promising the employee a fixed number of stock options if he or she meets meet a stated performance goal. The goal can be bringing in a certain level of new business, completing a contract on time and under budget, or preparing a winning proposal for a contract. Employees understand what is expected of them and what goals are critical to the company. It is a powerful incentive tool.

Aligning Employee and Company Interests

For our senior managers, the goal is to have them acquire stock holdings of three to five times their annual salary over five to ten years. They are encouraged to purchase stock at our quarterly trades and receive stock bonus and option awards to get them to this level. Having a management team with a significant investment in company stock helps align their interests with the company's strategic goals.

Stock Purchases Build Commitment

All employees are eligible to purchase stock at our quarterly trades. Any employee who desires to purchase SAIC stock notifies his or her manager, who determines if the employee is deserving of matching option shares. A study we conducted several years ago proved a correlation between stock ownership and retention levels. Among employees who had been with the company for at least three years, those who had never purchased stock had a turnover rate of 12 percent while those who had purchased stock, whether it was a few shares or many shares, had a turnover rate of 5 percent.

Retaining Future Leaders

A few years back we recognized a problem. The company was growing fast, and thus hiring fast, and many of our emerging leaders—those not yet in the senior ranks but clearly with the potential to be—were not building their stock account balances fast enough to keep them from being enticed away by other companies.

We developed a program to retain these future leaders. We set up a deferred stock compensation plan (using a Rabbi Trust) and now, each year, we make some 200 awards valued at approximately \$25,000 each to employees identified by management as key to the company's future success. This award is invested in SAIC stock and held in the trust as it vests over seven years at 0 percent for the first four years and 33 1/3 percent for each of the last three years. During this period, hopefully, the stock increases significantly in value and the employee assumes a leadership role in the company.

Unvested stock balances, or what we call "glue," are important to retaining employees. Our stock bonus and stock option awards vest over four years. Our goal is to ensure that top performers receive annual stock awards so after a number of years the value of their unvested stock is meaningful enough to make an employee think twice before accepting another offer.

We also use restricted stock and options in the recruiting process to bring in key individuals. We've had employees and new recruits turn down offers of significantly

higher short-term compensation because the entrepreneurial, employee-ownership environment and rewards SAIC offers over the long-term were more attractive.

We recognize that stock is only one piece of the puzzle in recruiting, retaining, and rewarding top performers. At SAIC, it is a core component of our strategy for growing this entrepreneurial, employee-owned, high-technology corporation. Indeed, it has given us a significant competitive edge.