RESEARCH BRIEF

Institute for the Study of Employee Ownership and Profit Sharing

Where Employee Ownership Works Best

<u>Questions:</u> How do community-level factors contribute to the prevalence of employee share ownership companies? How do community-level factors affect the survival of employee share ownership firms?

<u>Summary</u>: This research explores the prevalence and survival of broad-based employee share ownership (ESO) firms and characteristics of the communities where they exist. We examine ESO firms in California from 2009 to 2019 to determine whether they gain legitimacy by aligning with the exchange systems in their local environment. We find ESO prevalence and community-level volunteering are positively linked. We also find strong evidence that ESO firms located in communities with high levels of volunteering have better survival rates.



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This research highlights the critical role of community exchange systems in shaping the success and longevity of organizations. We find that Employee Stock Ownership (ESO) firms thrive in communities with strong traditions of generalized exchange—systems that emphasize trust, social cohesion, and collective commitment.

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Direct and Generalized (Indirect) Exchange

Direct Exchange

- Two parties exchange with each other with the expectation of direct reciprocity.
- Examples include bartering goods, trading services, or sharing resources within a community.
- Commercial transactions, in which money is exchanged for goods or services, are a form of direct exchange.

 $\bigwedge^{\bullet} \rightarrow \bigwedge^{\bullet}$

The "giver" receives reciprocation from the person they gave to.

A "giver" receives reciprocation from a different party than they gave to.



Generalized Exchange

- Parties exchange with the expectation of indirect reciprocity where the exchange of goods, services, or benefits occurs among a group, rather than being directly reciprocal between two individuals.
- A person gives to someone without expecting a direct return

from that specific individual. Instead, the giver trusts that they will benefit indirectly from others in the group in the future.





Generalized Exchange in ESO Firms

- □ ESO operates as a system of generalized exchange.
- Workers see the small direct rewards of their own efforts but more greatly benefit from the collective rewards of their colleagues' efforts.
- Successful ESO depends on the efforts and productivity of any one person being reciprocated by others.

Hypotheses and Analytic Approach

- Because ESO is a system of generalized exchange, firms in communities with more generalized exchange will be viewed as more legitimate.
- Hypothesis: ESO firms will be more common in communities with more generalized exchange.
- Hypothesis: ESO firms will be less likely to fail in communities with more generalized exchange.
- These hypotheses are tested using data from the Department of Labor and US Census.
- Two different models are specified, one testing whether the *prevalence* of firms with ESO is affected by community conditions, and another testing whether the survival of firms with an ESO is affected by these conditions.
- Two important community conditions: (i) percentage of residents who volunteer, and (ii) number of hours that residents volunteer.
- □ Also controlled for: income, education, and percent white at the county level.
- Ordinary Least Squares models are used to estimate the relationship between community-level volunteering behavior and ESO prevalence.
- Cox Proportional Hazard models to estimate the relationship between communitylevel volunteering behavior and ESO survival.





Results: ESO Prevalence

- □ ESO prevalence and community-level volunteering behavior are positively linked.
- □ A one standard deviation increase in the volunteer rate is associated with a 15% rise in the proportion of firms with ESO.
- □ A one standard deviation increase in the average number of volunteer hours is associated with a 10% increase in the proportion of firms with ESO.
- □ Using an overall volunteer engagement index, the results confirm that greater community volunteering is strongly tied to a higher presence of ESO firms.







Results: ESO Survival (Full Sample)

- ESO firms located in communities with high levels of volunteering have better survival rates.
- □ ESO firms in communities with a one standard deviation increase in the average volunteer rate see their risk of dissolution drop by 5%.
- Similarly, in communities where people spend more time volunteering, a one standard deviation increase in average volunteer hours corresponds to an 8% reduction in the likelihood of firm closure.
- Model fit improves with the addition of measures of community-level generalized exchange



ESO Survival - Full Sample





Results: ESO Survival (Smaller and Younger Firms Only)

- □ We repeat the analysis with the bottom 75% of firms by size and find that smaller firms located in areas with higher volunteer engagement fare better.
- □ A one standard deviation increase in the volunteer rate corresponds with 4% lower dissolution risk.
- A one standard deviation increase in average volunteer hours corresponds with 8% lower dissolution risk.



- □ We repeat the analysis with ESO firms that are three years old or younger.
- Young ESO firms in areas with a one standard deviation higher volunteer rate see their dissolution risk decrease by 19%.
- Young ESO firms in areas with higher volunteer hours experience 13% lower risk of closure ESO Survival - Younger Firms



Conclusions

- Alignment between an organization's practices and its community's values can enhance legitimacy.
- □ For ESO firms, this alignment reduces the risk of dissolution, particularly for newer and smaller organizations, which are typically more vulnerable to failure.
- Entrepreneurs wanting to establish firms with ESO may find more success in communities with more generalized exchange.
- Firms wanting to transition to ESO may fare better in communities with more generalized exchange.
- □ Social-exchange research shows that acts of generosity are more likely to be reciprocated when they are visible or build a sense of gratitude and shared effort.
- Exploring how awareness of collective efforts within ESO firms affects their success could help explain why the benefits of ESO vary across firms.

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