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SHARING THE RISK AT EXPENSE OF POWER: PAYING WAGES IN EQUITY TO FACE THE COVID-19

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Abstract

This paper aims to discuss which basic implications firms need to be aware of if they decide to include equity shares as a part of salary payments in order for them to tackle financial risks due to the COVID-19 crisis, benefiting with better liquidity. We discuss this alternative from the strand of potential financial benefits, but also include a power perspective, emphasizing how firms could share with employees their decision-making processes as well as part of their position of traditional hegemony. We concluded that firms' decision regarding this financial alternative fits into a short-term benefit and at the same time threatens a long run position of power.

Keywords: COVID-19, coronavirus, financial crisis, equity payment, recession, cashflow, firm ownership, power.

Introduction

Since the World Health Organization (WHO) officially declared the COVID-19 pandemic in mid-March 2020 (WHO, 2020), many organizations have had to face different challenges regarding their financial health, supply chain disruptions, loss of jobs, lack of demand, among many others, even including several threats for their survival. According to United Nations Conference on Trade and Development (UNCTAD, 2020), foreign direct investment (FDI) would drop down in about 30 % during 2020-2021, severely affecting the international financial systems, which in turn would decrease the global annual GDP up to 2 % (OECD, 2020), leading worldwide economy into an unprecedented recession (UNIDO, 2020).

The financial crisis caused by the coronavirus outbreak would drive governments and firms into difficult decisions for them to be resilient and survive. The corporations face severe trade-offs to stay alive such as firing employees to improving their liquidity. To face these unprecedented challenges and avoid massive layoffs, the States have taken radical decisions. The European Union launched Next Generation EU, a € 750 billion economic stimulus plan. The US Congress voted the Coronavirus Aid, Relief, and Economic Security (CARES) Act, a $ 2 trillion economic relief package. The World Bank provided $ 160 billion in financial assistance to developing countries, and the Latin American Development Bank injected $ 2.5 billion into this region.

To face the consequences of the COVID-19 crisis, the public aid certainly won't be enough and radical changes from private companies will help. Appeals for radical changes were published during the containment in many countries such as the #Democratizingwork.org initiative with the slogan: "it is time to democratize firms, decommodify work, and remediate the environment".

We claim that an option to address the economic and societal issues at the same time is to have the employees become shareholders of the company they work for. Employee ownership has the potential to share the risk among the different stakeholders but the employees must have their word in the management of the company as a counterpart. Sharing the risk and power implies a radical change in the spirit of capitalism leading to shared capitalism. Kruse et al (2010) defines shared capitalism as "employment relations where the pay or wealth of workers is directly tied to workplace or firm performance. In many of these firms employees also participate in employee involvement committees or workplace teams that help management make decisions regarding the economic activities of the firm" (p. 1).

The financial markets recovered from the COVID-19 crisis but some companies did not. Just like after the 2008 crisis, non-conventional monetary policies will resume, and public money will have to be spent to prevent bankruptcies or to help companies with cashflow problems recover from the crisis. Among all the potential initiatives to finance, the European Federation for Employee Share Ownership calls for a public aid plan to develop employee share ownership[1]. There are also calls in the US to use public money to stimulate employee ownership[2]. This paper discusses the implications of sharing the risk and power within corporations to tackle the dramatic consequences of the COVID-19 crisis on their financial structures.

[1] http://www.efesonline.org/CORONA/Proposal%20-%20An%20employee%20share%20ownership%20found%20to%20help%20companies.pdf
[2] https://newrepublic.com/article/157055/toward-economic-democracy

One major consequence of the COVID-19 crisis will be the loss of jobs of millions of workers around the world because of the bankruptcy of their employing companies. The main issue to deal with in the short term is the liquidity risk i.e. when a company cannot meet its financial obligations. To address this main issue and according to the circumstances, companies could pay their employees' wage in the form of stocks instead. Of course, such a solution depends on the payment conditions agreed between the workers and the company. A comparable payment method exists for the shareholders when some companies with liquidity issues pay dividends to their shareholders in the form of stock dividends instead of cash. According to the National Center for Employee Ownership[3], employees can buy stock directly, receive it in the form of a bonus, receive stock options, or obtain stock through a profit-sharing plan. So the employees can also contribute to some extent by giving up their bonuses for stocks. Such contributions can complement the public fiscal incentives and the shareholders' losses.

Becoming a Shareholder: really a dream come true?

From a global perspective, the potential of employee ownership can vary a lot from one country to another. For some countries, developing employee ownership is a challenge for two main reasons. First, the lack of a developed capital market and the financial education of the workers. Some multinational corporations had to face these two challenges when they launch their own global employee stock purchase program. The Boost plan[4] was launched by Essilor in 2017 in 57 countries with 55,000 employees in Latin America and Asia or L'Oréal with the Invest Plan in 52 countries[5]. Both companies launched their employee stock purchase plan and they both were awarded the Best employee ownership company award in 2017 and 2018. Even though the capital market is not well developed in some countries where global companies have operations, their employee ownership plan can contribute to developing it by spreading an ownership of financial assets culture.

The shares are usually listed on the home market of the companies. Another

[3] https://www.nceo.org/
[4] For a video presentation of the plan: https://youtu.be/-EbWRHrOR3U. For a presentation of Essilor employee ownership plan: https://www.essilor.com/en/the-group/governance/employee-shareholding/.
[5] The website of the plan is here with videos and materials in several languages: https://invest2018-loreal.com/.

challenge is financial education because holding a financial asset can be very abstract compared to owning a house or a land for instance. For example, Blasi et al (2013) mention that, in the 19th century USA, the main source of capital was the land. They recall that the ownership culture was developed at that time when concerns about inequality led political leaders like Abraham Lincoln to sign the Homestead act. This law allowed to sell 10 % of the total area of the USA to farmers for a very small investment. In a country where capital market is not developed, investment in the employing company has to be well explained as an investment in tangible assets. We interviewed a top executive who managed the worldwide employee stock purchase plan of a leading building materials producing company. According to him, in some countries where stock investment does not exist, investment in the stock purchase plan was presented as buying a piece of the factory the workers were working at. But financial education remains a challenge in many countries, including where the capital markets are well developed.

From the employees' viewpoint, the appeal of gaining a share of equity as part of their overall income depends primarily on the company's prospects and on their own financial situation. For workers in companies that do recover from the crisis, receiving a share of equity as part of overall income means, by definition, that they will receive lower wages. Employees' interest in exchanging a proportion of their wages for equity then depends on their individual liquidity constraints—the option may suit the highest-paid workers but not the lowest paid. Paying workers with equity may also influence individuals' overall wealth, and the level of risk involved will be determined by external events among other things, the same way as shares' value recovery depends on the recovery of the economic sector or industry which firms belong to.

Several economic models predict that investment in employee ownership is in line with the core principles of financial diversification (Aubert et al, 2009, 2018; Markowitz et al, 2010). A paper coauthored by Harry Markowitz, the Nobel prize winner for portfolio theory, suggests that a share of the total wealth of the employees between 10 and 15 % of their overall wealth may be "not too imprudent". For the US where employee ownership is the most developed in the world, Kruse et al (2019) find that very few US households[6]

[6] The authors find that 15.3 % of families with private-sector employees had employer stock in their portfolio, with a median value of $ 6,000 and a median percent of family net worth of 3.1 %. About one in five (19.2 %) of the families with employer stock exceed the 15 % threshold.

have more than 15 % of their wealth invested in company stocks. So, there is room to develop employee ownership even in the country where it is the most popular without putting employees' wealth at too much risk. The conversion of the wage income into stocks may then be adapted according to several factors related to the company and the employees' characteristics: the demography of the workforce (executive vs non-executive with different financial constraints), the risk and the sector of the companies (some companies are more affected than others by the COVID-19 crisis).

But ultimately, the employees have to be convinced that swapping their salary for their employer's stocks is a good strategy. Jessri et al (2020) suggest that employees would decide to participate in corporate venture if they perceive different incentives such as risk environment, independence or entrepreneurial self-efficacy, besides the traditional financial incentive. Hence, paying their regular salaries using equity shares we would improve firms' short-term liquidity, without the need to face a massive loss of jobs. However, increasing the number of shareholders means distributing the power among many participants within the firm, fragmenting the decision-making processes, and embedding these individuals with small slices of presence and participation, promoting the emergence of what Naím (2015) called "micro powers". The emergence of these "micro powers" would progressively threaten the position of hegemony of traditional firms.

The corporate side: share to survive or die through the effort

For employers, paying workers a share of equity as part of their income can help to improve corporate short-term liquidity; instead of cash going out in the form of salaries, companies would issue new stocks to employees. It is the same mechanism when companies pay stock dividends instead of cash dividends to their shareholders. This strategy has been adopted during the Great recession by companies lacking sufficient cash liquidity. In the short term, an important disadvantage of increasing the number of stocks is the dilution of earnings per share, that is, when company profits are divided among more shares of its common stock. The value of each individual stock decreases accordingly. The payment of wages in equity is therefore made at the expense of shareholders' wealth precisely when they experience dividend cuts[7] and sharp stock price decrease.

A potential drawback of this equity for wage strategy is that it leaves the selection process of the employees' stock recipients at the employers' discretion who could apply power relation strategies on it (Agbontaen, 2019). In this situation, a worker oriented decision will transform into a disadvantage for the organizational culture as well as for inequality reduction. On the other hand, leveraging employees' voice and empowerment would drive organizations to a higher level of retention, influencing their decision to stay in the firm (Samah et al, 2019). Under financial crisis circumstances, organizations may decide not to extend to all employees this benefit, but to whom it needs to retain towards a post crisis and recovery scenario, for instance, strategic workers on key value added processes or young professionals with long-run high potential for the company.

In addition to the profit dilution of earnings per share issue, some drawbacks of employee stock ownership have been documented in the academic literature. Developing employee ownership is generally a decision of the owner or the general manager of the company. Financial economics often regards employee ownership as an entrenchment strategy of management to put shares in "friendly hands" (Benartzi et al, 2007) because employees are the managers' "natural allies" against a hostile takeover (Pagano and Volpin, 2005). Another risk expected to arise with collective incentive systems like employee ownership is the freeriding or the 1/N problem. When a worker belonging to a group of N workers benefits from a collective inventive system, he gets the 1/N part of any additional effort like all his or her colleagues. Consequently, no worker has an individual incentive to work more under collective incentives. In economics, this problem condemned employee ownership and profit sharing.

However, in the longer term, most disadvantages of new share issues can be mitigated by the positive and very well-documented outcomes of employee stock ownership. Indeed, the increased workforce motivation of the employee owners leads to improved corporate performance, which increases the value of shares. Extensive academic research of the Institute for the study of employee ownership and profit sharing at Rutgers University shows that

[7] "The great dividend reset: is there a new normal for investors?", Financial Times accessed on 08-22-2020 (https://www.ft.com/content/b0873571-b4f4-4c9e-aa18-318cb7589e7f)

companies can expect better performance by developing and implementing employee stock ownership programs. Most of the empirical evidence on the relation between employee ownership and performance, was reviewed by the meta-analysis of O'Boyle et al (2016). These results plead for employee ownership having positive effects higher than the above mentioned drawbacks. Empirical evidence shows that the 1/N problem can be mitigated by mutual monitoring among workers (Freeman et al, 2010).

Although employee owners voting rights work differently according to the country[8] being a shareholder usually comes with a voting right. This means that the employee owners have a voice in the decision of the company. There is empirical evidence that employee ownership works best coupled with worker's participation and involvement (Kruse et al, 2010). Workers' participation and involvement in decision-making may take many different forms. The European Foundation for the Improvement of Living and Working Conditions[9] (Eurofound, 2020) finds that employees working in a high-involvement organization report a high level of work engagement, are less absent from work, more likely to put in extra effort, prefer a later retirement age, and report higher levels of well-being. High-involvement organization provides more opportunities for both formal and informal skill development.

The risk of democratized organizations is to drive the decisions at a point where operational efficiency and diligence may suffer. According to Naím (2015), distribution of power into several small parts could drive organizational systems to inertia and dangerous delays, due to the lack of consensus or unnecessary bureaucracy. Naím (2015) called this the fragmentation of power due to the emergence of these small new actors "micro powers", which are able to slowly undermine the traditional positions of power and hegemony. For instance, a strengthened labor may influence into firms' payment policies, decreasing dividend payments as well as final profitability (Haw et al, 2018). Moreover, empowered employees can achieve enough power to directly influence organizational policies and collaborate in shaping some of the rules in companies (Budjanovcanin, 2018).

[8] In the US and France where employee ownership is the most developed, stocks hold in the US Employee Stock Ownership Plans (ESOPs) have no voting rights and the voting rights can be exercised indirectly in France through company savings funds.
[9] The data are from the European Working Conditions Survey (EWCS) 2015, collected from a representative sample of employees across the EU Member States, Norway and the United Kingdom.

Moreover, some organizations may promote this democratizing initiative while others may seem strongly reluctant to it. Since Schneider (2013) explained how capitalism is differently deployed by regions, emphasizing how Europe and Asia are using a collaborative capitalism based on trust relations and networks, the United States use a competitive capitalism based on free market perspective and Washington Consensus statements, and finally Latin America has adapted a hierarchical capitalism based on social inequalities and power relationships. The initiative of paying with share equity could be well received or not, depending on the characteristics of the organizational context (DiMaggio and Powell, 1983). According to Useem (1984), local business elites would tend to influence on their business' environments in order to keep their traditional power over time, consolidating a strongly influential upper-class in society. Furthermore, Cordova (2019) found that 16% of corporate network studies related to shared directors' practice had negative outcomes, while 44% of the latter refers specifically to individual interests of the business elite. These individual interests would prevent others to gain access to what this business elite does, and promote an underlying work of influence over the governments' regulatory action as well as on other organizations (Durand, 2019). Hence, we strongly argue that this financial alternative could be a liquidity solution for some firms, but a severe constraint for traditional power to others.

Conclusion

Global scale financial crisis, such as the one caused by the coronavirus outbreak, force organizations to make difficult and painful decisions towards their continuity of operations or even their survival. Several disruptions on processes and generalized decreasing demand drive them to think on reducing their costs and try to increase their financial liquidity. Besides other decisions, an alternative for this is to pay employees' regular salaries using equity shares, understanding its implications in the short-term as well as in the long one.

In the short-term, this measure would increase firms' cashflow and empower employees, improving their satisfaction, which would reflect in organizational performance. However, it may also raise inequalities among employees, creating conflicts of interests regarding selection and retention processes.

In the long-term, this decision would undermine the traditional position of power of the organization, distributing it into small parts, diminishing its hegemony and threatening the decision-making processes with lack of resolve and agility. Furthermore, providing power to employees over the firm would make them able to reshape some functions, misaligning them with firms' strategic goals, or induce additional future risks such as labor strikes.

Organizations would need to decide how to deal with their financial constraints, considering the implications discussed in this paper and their own capabilities and expectations to facing the crisis. Their decisions regarding this financial alternative would also be strongly shaped by the context's patterns and the interests of local business elites.

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