Financial Participation for Sustainable Business Development

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Abstract

The relationship between employees and their corporations are becoming an important issue of discussion on corporate performance. Literature on corporate strategies argues that providing incentives and motivation to employees can encourage efficiency and productivity that can lead to sustainability. While on the other hand, others argue that motivation can fail with a few examples.

This paper discusses such relations in terms of the possibility of mitigating some of the transaction costs caused by improper management of corporate structures and the resulting principal-agent setting. A strategic management approach is applied in which the challenges in corporate performance and employees' motivation are turned into objectives by presenting a framework of financial participation strategy to encourage sustainable business development. Financial participation (FP) is discussed in detail.

Key words: Financial participation, employees, social capital, corporate organisation, sustainable business development

1. Introduction

The value of a corporation can be seen as a pie with a number of different claimants such as stockholders, employees, and even the government vying for a piece of the pie. The different claimants are connected by a web of explicit and implicit contracts and to a certain degree the interest of the different claimants differ and may conflict. Thus the potential agency problem may arise (Win, 2001; Krishnam, 2006; Say, 1824).

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The separation of ownership and employees in corporations cause potential principal- agent problems (Krishnam, 2006; Win, 2001). The owners of the company (shareholders) cannot exercise immediate control over the company's decisions, whether being it operational or strategic; as a result two groups are created: owners of capital and professional managers with little or no financial stake in the company (Win, 2001). A conflict of interest can exist between the two groups. Shareholders wanting to maximize profit and thereby dividend returns, whereas managers on the other hand wish to pursue a number of other objectives such as continuous investments. These objectives come under the umbrella of managerial status and market dominance. Thus, the separation of ownership and operational decision-making (managers) can result in the risk-takers (shareholders) earning less than the maximum achievable (Win, 2001).

Also, this is not the only principle- agent problem. Principal-agent situation in corporations include the relationship between employers and their employees (Krishnam, 2006; Win, 2001). But, owner-employees do not incur any agency costs, as there are no conflicts of interests (Krishnam, 2006; Ned, 1999). This can be justified by Ned (1999), who argues that problems in corporations caused by workers are negligible as compared to that caused by processes. If the problems of organizations are less than that of workers, then workers as owners of their processes cooperate through participation in the development of their organization and also benefit from the resulting profits. This can create innovation to overcome the process related problems and improve organisational settings that are in conflict to process development and sustainability. Many studies on corporate structures can be used to argue on the need to enhance working life in corporations by helping workers to discover better and more interesting ways of doing their jobs, which can be achieved through motivation and incentive schemes (Gary, 1994; Lowitzsch, 2007; Buchko, 1992; Cable and Fitzroy, 1983; Defourney et al., 1985; Whadhwani and Wall, 1990). Therefore, such forms of organizational structures need to be encouraged to enhance corporate sustainability.

However, some corporations have been motivating their workers to encourage efficiency and a typical example is the case of a company, Texas Instruments Malaysia (Greg, 1999).

Nevertheless, motivation can also fail, for instance Steel workers were given a flat US$150 bonus and were guaranteed 3 percent per year wage increase to reward productivity gains, and an escalator clause ensuring that most of any future cost of living increases would be passed on in the form of higher wages. But steel output per labour hour failed to increase at all on average during the seven years, and so the 3 percent annual productivity increase exceeded actual productivity by 3 percent causing essentially inflationary wage cost increases and it accumulated to 23 percent by 1980 (Deily, 1994). This argument shows the need to develop incentive and motivation schemes that would encourage corporate sustainability and performance. Here, the argument is based on the enormous rewards that can be achieved by corporations through financial participation with employees. That is when workers are co- owners of their corporations; they can work hard for its success and benefit from their performance. They would also be acting as a watch-dog for each other, which may reduce the cost of supervision. This can lead to substantial cost reduction in supervision and ensure sustainability since no one will want to lose his/her resources.

Moreover, workers can be trained to be flexible in moving from one department to the other, to take advantage of slack that exist in the organizational operations (flexibility), leading to cost reduction (sustainable investment). If, there is the absence of financial participation or motivation of employees, it might lead to a situation in which the employees are trained to improve the company's performance and after the training they decide to leave the company to be employed by another employer leading to loss of return to investment. Therefore sustainable business development require the most effective and efficient way of organising corporate structures. This will require the application of appropriate corporate strategy to sustain business and overcome its dynamics.

The global economic crises have proven that sustainability is a challenge for corporate management and employment, which can make the concept of financial participation to hold effective grounds. Corporate sustainability comes from the concept of sustainable development, which deals with development that meets the present needs of corporations without compromising the ability of the future generations to continue the growth of corporations (WCED, 1987; UNCED, 1992).

This paper discusses FP and shows that it has a positive impact on the corporate sustainability, but this requires a strong degree of social capital and human resource development for it to hold effective grounds.

2. Financial Participation

In a corporate structure, employee share, ownership and participation are simply independent organizational variables. The European Federation of Employee Share Ownership (EFES, 2001) argues that neither one nor the other of these variables can lead to a significant improvement of corporate performance, but only a combination of them. This can be justified with most economic analysis of wage and employment issues that has been based on marginal productivity of labour and contractual payment of wages (Poutsma et al., 2006). The challenges of contractual labour are numerous, especially those created by rent seeking behaviour in firms and by the moral hazard issue. This traditional view of labour market is worthless; it can only apply in certain circumstances where employment occurs as a market exchange. Therefore Employee Stock Ownership (ESO) is a recent phenomenon that is growing within organizational structure because an employee's relationship to its company is seen as vital for the long term organizational reputation of the company (Zoltan, 1996).

An employees' relationship with its company and ESO has led to the concept of Financial Participation (FP) (EFES, 2001; Poutsma et al., 2006; EC, 1991; EC, 1996). According to the European Federation of Employee Share Ownership (EFES, 2001), FP exists in many countries of the world, but the concept of FP is more common in United States of America (USA) than in Europe, Japan and other countries of the world (Buchko, 1992; Hashi, 2007; Kelso, 1991; Lowitsch, 2007; OECD, 1995; Festing et al., 1999). The concept had its origin and its relevance in the late 1980s and since then practices as well as research has demonstrated the need for more precision of the concept. The success though so far is conditioned on how the practice of ESO can join with participatory management to have an impact on economic and social dynamics of organizations, which can lead to sustainability (EFES, 2001; Whdhwani and Wall, 1990; Lowitzsch, 2007; Kelso, 1991).

Many research initiatives haven been carried out in Europe and around the world on FP, like the PEPPER (Promotion of European Participation in Profit and Enterprise Result) schemes to promote FP schemes and the Benchmark Project on FP, which is a follow up of PEPPER (Lowitzsch, 2007; EC, 1991; EC, 1996; Eurofound, 2007). Various types of schemes on FP exist in the world, for instance profit sharing schemes and options, employment ownership schemes and a combination of both the schemes (Lowitzsch, 2007; Kelso, 1991; Hashi, 2007; EC, 1991; EC, 1996; Eurofound, 2007). Also, there is Employee Stock Ownership Plan (ESOP) scheme in USA and many other countries (Lowitzsch, 2007; Kelso, 1991; EFES, 2001; Poutsma et al., 2006; Eurofound, 2007).

However, there are basically two forms of FP; profit sharing and capital sharing in the form of ESO or other forms of non managerial co-ownership in an enterprise's capital. Profit sharing can be in cash or shares; while ownership can be in shares or stock options (Lowitzsch, 2007; Kelso, 1991; EFES, 2001; Poutsma et al., 2006). ESOPs is a collection of all FP models in a single model, known within the European Union (EU) as a building block approach on FP (Lowitzsch, 2007). Within the building block approach the ownerships are based on investment of employees' bonuses or retirement benefits in their corporation and allow them to have stocks in their company to participate in profit sharing. But, one can argue here that FP should not require investment of employee bonuses and retirement benefits, rather retaining a certain share of their salaries for investment in the business development. This is because no matter how much sustainability strategies have been put in a business, there is still some degree of uncertainty of bankruptcy, which if happened, would leave old people in a bad situation. In addition, it is against many policies on pension schemes in many countries in the world. In developed countries like Germany, there is the constant debate to increase the employees' pension fund savings. Therefore, ESOP cannot be justified with retirement benefits for employees.

2.1 Survey of Financial Participation within the European Union

FP with employees has been actively promoted by a number of western governments, as well as by the EU. This is precisely because it is expected to lead to a number of positive effects. PEPPER 1 to PEPPER 3 and the

Benchmark projects in the EU report on a favourable general attitude within a given national framework (Lowitzsch, 2007; Hashi, 2007; Buchko, 1992, Festing, 1999; OECD, 1995; Würz, 2003; Eurofound, 2007). This has generally led to some supportive legislation on PEPPER, and this has clearly facilitated the spreading of FP schemes in practice within the EU (Thiel, 1991; Peukert, 1992; Herrnfeld, 1995; European Commission Enterprise Directorate-General, 2003). There have been cases where PEPPER schemes have an important phenomenon in some countries, for instance France and the UK (Hashi, 2007; Pendleton et al, 1995; Pérotin and Robinson, 1995). In some countries in the EU, there is active support of FP, while in the other countries there is a general lack of support of FP or was only seen some years back.

Assessment of FP based on comparable indicators in all EU's 27 countries and 2 candidate countries (Croatia and Turkey) from CRANET (survey of companies with 100 + employees on FP), European Working Condition Survey (interview with 30,000 individuals in all European countries with regards to payment schemes and share ownership) for all countries and the preliminary results of the Benchmarking Project (future PEPPER 4) show that FP schemes are present in almost all EU member countries, but all schemes of FP are narrow schemes rather than broad schemes covering majority of employees (Lowitzsch, 2007; Hashi, 2007; Buchko, 1992; Mc Cartney, 2004).

The lack of support for FP in Europe is due to lack of interest or concrete position and limited legislation (Lowitzsch, 2007; Hashi, 2007). In PEPPER 3 report, there are practically very few laws specifically dedicated to FP in EU (Lowitzsch, 2007; Hashi, 2007; Eurofound, 2007). In some countries, the laws enable some form of FP referring almost exclusively to ESO, as there have been a few cases of legislation on profit-sharing (Thiel, 1991; Peukert, 1992; Herrnfeld, 1995; European Commission Enterprise Directorate-General, 2003). This is due to a lack of more general support for FP, which can provide favourable legislations and fiscal incentives.

Moreover, the total absence of interest on the part of social partners is the main reason why FP can not play a major role in Europe. Though, employees in Europe are frequently offered privileged condition for buying shares in their enterprise of employment, which can not be determined by conviction of employees' ownership being an instrument to strength incentives, but this method of privatization was chosen (Lowitzsch, 2007).

A comparative analysis of the general attitude of government and social partners within EU countries show lack of concrete policy measures supporting PEPPER schemes by policy makers and limited interest by both trade unions and employers' organizations. This general lack of support for PEPPER by government, trade unions and employers association, and the corresponding absence of supportive legal framework on PEPPER schemes can explain the reason for little diffusion of PEPPER schemes in many EU countries. But a few years back till now, many trade unions are accepting PEPPER, as it can contribute to better division of value-added to production. However, the concepts of FP are being recently accepted by both Left and Right-wing parties, partly as a new culture in industrial relations based on innovative managerial strategies (Lowitzsch, 2007). It can be an instrument for enriching the social contract and social dialogue and it can increase workers remuneration and power.

2.2 Framework for Financial Participation

The issue of ownership and property rights is important in any organizational setting, whether at the corporate or individual level or an economy as a whole (Zoltan, 1996; Kelso, 1991; Roggemann, 1999). The lack of individual ownership rights is one recurring factor in the failure of many economies (Kelso, 1991; Roggemann, 1999). One can argue that this is because nobody has reasons for doing anything (normative behaviour), which can be explained from the prospective of a sole proprietor, who is likely to put in longer hours in his business than a hired agent (Zoltan, 1996).

Ownership present economic agents with sets of incentives that promote efficiency in a wide variety of settings, eliminates uncertainties and transaction costs by creating stable contractual relationships. Such relationships can be used to insure against various losses that can occur in organizational settings caused by employees. For instance in the 1990, many corporations like Microsoft Corporation were created because they found market as inefficient and wanted to eliminate uncertainty and transactions cost caused by employees. They created patterns that led to networks, value-adding partnerships and virtual corporations (Zoltan, 1996). These organisational structures when combined with FP have the potential of enhancing corporate sustainability. Figure 1 below illustrates the relationship within an organizational structure and employee's participation in building equity. This form of participation provide them with ownership rights in which they can also participate in the profit sharing of their organization based on their contribution (length of employment) and join the shareholder groups when they go on retirement.

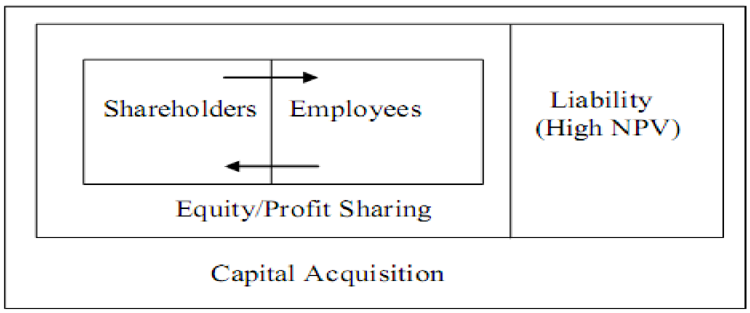

Figure 1 Financial Participation for organisational Sustainability

The development of these relationships within organisational structure would lead to capital formation for corporate investment, which consists of equity from both shareholders and employees, and liability capital from financial institutions as loan, when there is a high NPV (Net Present Value) investment with short payback time. Therefore, the capital acquisition of corporate investment would comprise of all the contributions. Thus, all the contributors to the corporate fund like the employees and the other shareholders will participate in profit sharing and decision making of the company.

Nevertheless, for FP to have an impact on organizational structure and performance some conditions are necessary, which are explained as follows:

1. FP needs to include all employees not only managers or senior staff as it is the case in many countries in the EU. This can reduce the normative and rent seeking behaviours. Therefore, everybody needs to cooperate

and work together effectively and efficiently, knowing that they would jointly benefit from the fruit of their labour. This can bring the supervision cost to zero, leading to reduction of cost and increase in profitability, which are strategies towards sustainability

2. Employees need to be involved in the board of management, since the employees know best, who have the potential to lead their corporation, so that they can achieve a higher performance, productivity and cost reduction, than depending on leaders who are only politically appointed, but can not provide the ability needed in increasing productivity and earnings, due to lack of the appropriate capacity

3. Employees need to have a majority vote in the right to choose the board of management in their corporation, while the voting of the board of directors can depend on the number of shareholders and issued shares. This is necessary so that they can have an impact on the corporate and its decision making as they understand the corporation better than the other shareholders

4. Profit sharing should depend on the total number of shares that exist at the time of profit sharing. The participation of employees in profit sharing schemes should depend on the total amount of their contribution both from salaries, earnings and benefits. This means that the longer an employee has worked for the company, the greater the proportion of the profit that he will receive or re- invest in the corporation.

However, any economic system is not static in itself because of internal and external driving forces that influence them, for example, human dynamics with drives such as transculturality, especially in multi-national corporate organisations. Therefore for FP to be achieved, the level of social capital (trust, connectedness etc.) that exist within organisational structure needs to be high, which requires motivation, norms, rules and in the worse case sanctions.

3. Analysis of Social Capital for Financial Participation

Social capital is a feature of social organisations such as networks, norms, and social trust that facilitates coordination and cooperation for mutual benefits. Putman (2002) defined social capital as "features of social life or networks, norms, and trust that enable participants to act together more effectively to pursue shared objectives, and the social connections and the norms and trust" that can be sustained.

Some forms of capital are easy to evaluate while others are not. For example, one can know the worth of a house or car but human welfare or social capital is difficult to evaluate. Nevertheless, social capital is vital for human welfare and economic growth, and reduces the cost of working together (Coenen, 1998). The economic function of social capital is to reduce costs associated with formal coordination mechanism like contracts, hierarchies, and bureaucracy (Fukuyama, 1999a). It can presumably reduce the cost of monitoring, negotiating, litigating and enforcing formal agreements. Many complex services are very costly to monitor and are better controlled through internalised professional standard than through formal monitoring mechanisms. Procurement is often more efficient when left to be the judgment of an experienced procurement officer, rather than being done "by books" as in the case of a good deal of government procurement. A number of empirical studies Annale (1994), give numerous examples of informal intellectual property exchange in Silicon Valley. They suggest that Hi-Tech Resource and Development (R&D) often depend on the informal exchange of intellectual property rights. This is simply because formal exchange would entail excessive costs and slow down the speed of interchange. Even in non Hi-Tech environments, social capital often leads to greater efficiency than purely formal coordination techniques (Annalee, 1994).

Also, a highly centralised and bureaucratic system, create many inefficiencies as decisions are delayed and information distorted while moving up and down hierarchical chains of command. In many manufacturing facilities, flatter management structures have been used, which in effect push responsibility down to the factory floor itself. Workers who are much closer to the sources of local knowledge are authorised to make decisions on their own, rather than referring them up to a managerial hierarchy (Womack, 1991). This often leads to great gains in efficiency, but it totally depends on the social capital of the workforce. If there is distrust between workers and management, then the delegation of authority required in a typical “lean” organization leads to instant paralysis. This is in effect what happened to General Motors during the strike of 1991 and 1998, when a single dissident local (angry in the first instance, over the outsourcing of brake parts) was able to shut down the company’s entire North American operation (Fukuyama, 1999b). Therefore, social capital has to be organised to give benefits to both the organization and the employees. Figure 2 below provides a framework of organisational structure for financial participation for enhancing the sustainability of corporations.

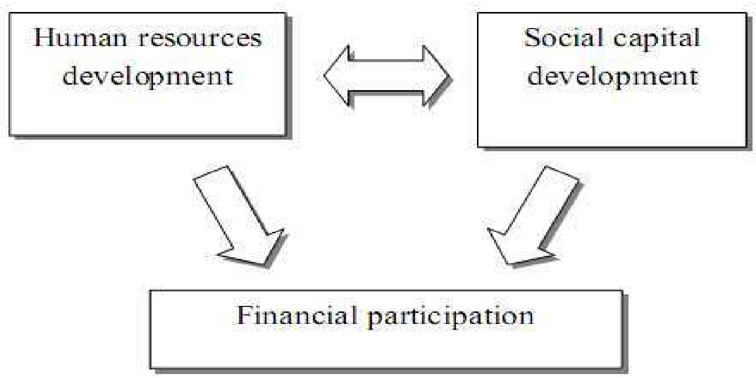

Figure 2 Scheme of Organization Management for Financial Participation

It shows that the development of social capital, which is trust and commitment to the organisation, can lead to a cooperative team of employees, who are ready to work hard to develop their corporation. The corporation on the other hand can invest on human resource development with the confidence that human resource is its social capital. But social capital can be achieved when there are incentives and motivations giving ground for the development of FP. Therefore FP can be seen as an innovation and sustainability approach in giving incentives and generation of motivation among employees. Incentive and motivation of people can be justified on the understanding of the reason why people prefer to join one group and not the other or why people like to live in one community and not the other, and why people prefer to work in one industry and not the other. The simple answer is because of opportunities and benefits that exist. This means, strategies towards sustainability of corporations should focus on enhancement of opportunities and benefits to their employees, which can be achieved through FP.

4. Discussion

FP can provide workers with incomes that are more directly linked with the enterprise performance, hence leading to greater commitment, investment in the firm- specific human capital and reduction in intra- firm conflicts. Also, it can enhance teamwork and provide a cooperative spirit, thereby facilitating the improvement of the working of an organisation and the adaptation of the work force to new technologies that can increase performance. This can encourage future employees to join the company, while employees already working in the company are encouraged to remain working.

Nevertheless one can argue that individual incentives provided by FP can be diluted by free rider effects, particularly in large organisations. This is because gains from increase in productivity generated by one employee are shared among all employees, who participate in the profit-sharing or stock ownership. Therefore the positive productivity effects of FP would be wiped out in big organisations, but it can remain a bit in smaller organisations. However, literature and empirical studies by the Benchmark Project argue that these negative aspects are more than offset by the enhancement of corporate behaviour and social capital development.

Moreover, collective FP can provide an incentive to overcome rivalry problems and tend to encourage collaboration between individuals with a view to increase effort and productivity, which is the case of many corporations like Microsoft Corporation. Therefore the implementation of FP can lead to reduction of transaction costs, for instance cost of monitoring, since everyone would be a watch dog for the other.

In addition, there is the opportunity that FP can reduce poverty by making both the rich and the poor grow richer, especially in a free market economy (Kelso, 1991). Even though, there are some threats with the implementation of FP like the dual risk that employees and stakeholders can lose both their jobs and value of their shares in the event of bankruptcy; the benefits are greater than the risk. This is due to the potential cost and benefits sharing that can mitigate free rider effects. Therefore it can be a strategy towards attainment of sustainability and risk avoidance.

Also their are obstacles to the growth of FP within organisational structures regarding the legal system, in the areas of taxation law (possibility of double taxation), social security and labour law, especially trans-national corporations. These can be mitigated if FP is generally accepted and the level of social capital in organisational structure increase to ensure that certain actions would not be taken by some individuals. This could also encourage the improvement of the legal system in favour of FP.

Furthermore, in Small and Medium size Enterprises (SMEs) both cost and administrative problems might be considered prohibitive also to FP. For instance, the fiscal system may entail substantial administrative cost for enterprises introducing multi-national FP schemes and cultural presumptions regarding social partnership that vary widely within countries. Therefore, FP requires a strategic planning by organizations. Strategic Planning is a complex process that determines how the resources available to the firm can be allocated to best conduct the economic activity of the firm (Zoltan, 1996).

5. Conclusion

A framework of organisational structure for FP has been presented in this paper to provide arguments for its potential adaptation in participation approach to enhance strategies towards corporate sustainability. It exists in many parts of the world, but in practice is still limited, that is why it is not supported on a broader scale even though it can provide enormous benefits to corporations and organizational structures.

However, good strategic decision making require knowledge about how the operations within an organisational set up actually work and reflects the capability of organising its resources to meet its needs. This has not been clarified within FP frameworks to show how its practical implementation can have an impact on corporate dynamics. Therefore, there is need for more research on strategic planning on FP within the framework of organisational dynamics.

Also, there is the need for more studies on its implementation and practices to show the corporate world and organisations more appropriate ways of implementing FP. This can encourage planning strategies towards sustainable business development.

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