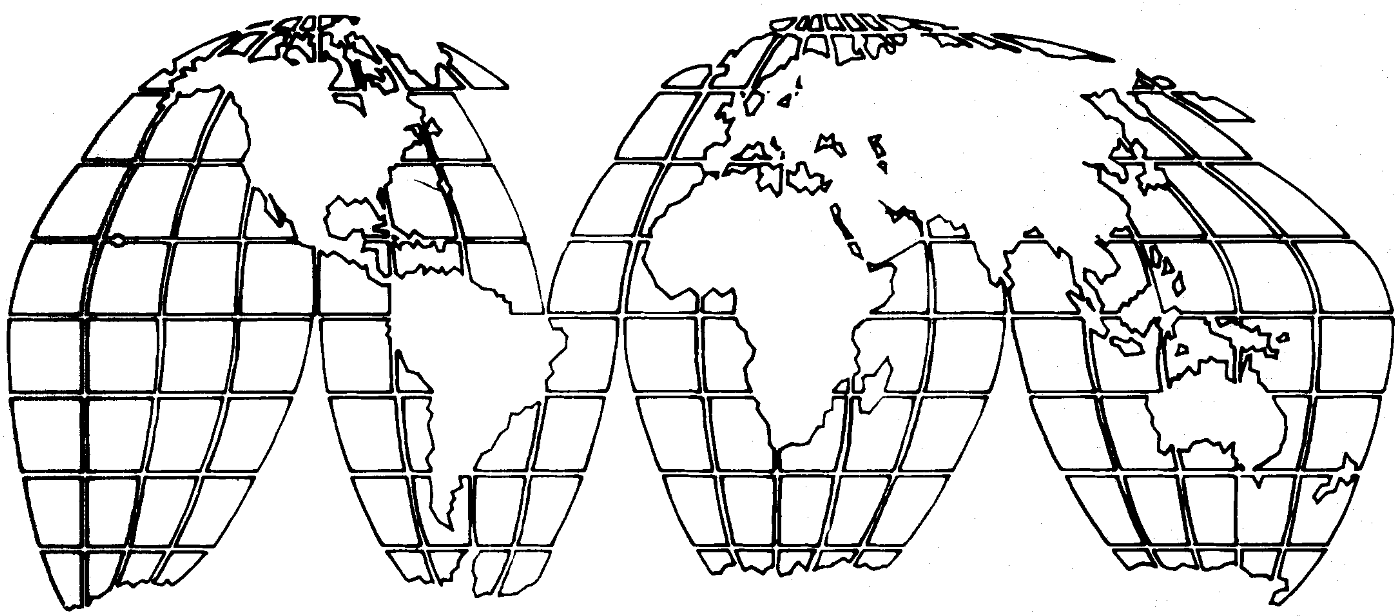
A.I.D. Evaluation Special Study No. 19

CAPITALIZING WORKERS: The Impact of Employee Stock Ownership Plans in Selected Developing Countries



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CAPITALIZING WORKERS: The Impact of Employee Stock Ownership Plans in Selected Developing Countries

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PREFACE

This study of employee stock ownership plans (ESOPs) in developing countries was conducted for the U.S. Agency for International Development as part of the Office of Evaluation's (PPC/E) review of potential private sector initiatives. Preliminary results were presented at the conference on "LDC Experience with Private Sector Development" (October 12-15, 1982), sponsored by AID.

The study team was composed of four staff members and associates of Development Alternatives, Inc. (DAI), who were assisted by two consultants from Equity Expansion International. Susan Goldmark and Alan Roth visited four companies with ESOPs in Zimbabwe and Thailand, while Donald Jackson and Joseph Recinos visited two companies in Costa Rica and one in the United States. Joseph Recinos and Susan Goldmark analyzed the second U.S. company.

The team developed and pretested questionnaires prior to the fieldwork. Team members collected data for about 10 days in each developing country and then met with Norman Kurland and Larry Cooley of Equity Expansion International and Richard Blue of PPC/E to discuss their findings.

Susan Goldmark and Alan Roth took primary responsibility for writing the report. Norman Kurland and Joseph Recinos provided much useful information on the theoretical framework behind broad-based capital ownership (Chapter Two) and U.S. legislation to promote ESOPs (Annex C). All of the team members wrote selected developing country profiles and case studies (Annexes C through F).

Special thanks go to the company managers and workers who generously donated valuable time to discuss their ESOPs with us. Their hospitality and patience in describing unique ESOP plans invaluably assisted the team. Our appreciation also goes to Molly Hageboeck of PPC/E, whose curiosity about this possible AID development assistance strategy laid the groundwork for this report. Her suggestions, as well as those of Richard Blue, were very useful in producing the final report.

Susan Goldmark
Team Leader

EXECUTIVE SUMMARY

BACKGROUND

In 1981, the U.S. Agency for International Development began a major private enterprise intiative. Its objective is to stimulate economic growth in developing countries by encouraging the expansion of indigenous private enterprise. Of particular interest to AID are private enterprise development strategies that benefit its traditional target group -- the poor majority.

AID commissioned Development Alternatives, Inc. (DAI) to examine how one such strategy has fared. Worker ownership plans, of which the best known variant is an employee stock ownership plan (ESOP), provide equity to a firm's employees. Workers are thereby transformed from wage earners to business owners, and share in the firm's benefits and losses accordingly.

ESOPs, in theory, also have other attractive uses and benefits. If the current owners of a company wish to transfer their ownership, the ESOP mechanism could:

- Assist the company in changing from public to private ownership;
- Enable a company (for example, a multinational in a developing country) to divest itself of a subsidiary;
- Provide a market for privately held stock that otherwise would be difficult to sell; or
- Protect a company from a corporate takeover.

ESOPs can be a means of spreading private capital ownership to those in the lower economic classes. Even providing employees with only a minority position may improve worker-management relations and create a politically powerful ally in favor of private ownership, thereby reducing the threat of nationalization. Participating companies may benefit not only through the tax and capital advantages sometimes offered, but also from improved employee productivity. In addition, companies can gain a competitive edge if wages are lowered and supplemented with distributed earnings, thereby tying employee incomes to the company's financial position. This also provides greater flexibility to the company and more job security to employees.

STUDY OBJECTIVES AND LIMITATIONS

This study was commissioned to examine the impact of ESOPs in developing countries and to determine whether this concept merits AID assistance as part of its private enterprise development strategy. Although ESOPs are theoretically a very attractive means of assisting private employers and employees, little is known about their number and actual effect, particularly in developing countries.

The study team adopted a case study approach because few ESOPs were identified in developing countries of AID interest, and little in-depth information on the plans was available. Team members visited six fairly large companies with ESOPs in Zimbabwe, Thailand, and Costa Rica. For purposes of comparison, they also visited two companies in the United States that were considered models.

The study attempted to determine whether:

- These programs have been successful in providing ownership benefits to substantial numbers of lower-level employees;
- The companies and pre-ESOP shareholders benefited from these programs;
- Internal and external incentives and constraints can be identified; and
- Strategies are indicated that might lead to a development assistance program to motivate and support new efforts in these fields.

The small size of the sample and diversity of ESOP experiences, however, require that all conclusions be regarded as extremely tentative.

STUDY FINDINGS

Actual ESOP benefits are determined by conditions both within and outside a company's control. They depend, for example, on the ESOP's design; yet they also depend on the national, political, economic, and legal environment. Companies that are well-managed, financially successful, and concerned with employee welfare can benefit from these plans. The likely effects of ESOPs on companies without these characteristics are less clear.

All of the companies examined for this study were financially successful. This success, however, cannot be linked definitely to their ESOPs because:

- The company's financial success and good worker-management relations predated the ESOP; and/or

- The ESOP was part of a complete reorganization that had many components contributing to future success; and/or

- The ESOP involved a relatively small amount of company stock; and/or

- Not enough time had elapsed upon which to judge the ESOP's effect.

Nevertheless, intensive study of the eight cases and the four countries in which they were based resulted in certain findings:

- The United States provided the most favorable tax environment to encourage ESOP growth. Special U.S. tax laws permit companies to deduct as a pre-tax expense both principal and interest of a loan used for an ESOP. The examined U.S. companies thereby received an inexpensive infusion of capital that was used to purchase stock from previous owners; employees received stock at no personal cost.

- None of the developing countries studied provided tax benefits or low-cost credit to encourage ESOPs. All plans thus were instituted at some cost to the company or stockholders. Three companies contributed post-tax earnings to purchase newly issued stock on behalf of employees. Two companies provided interest-free loans for an employees' trust to purchase company stock. Only one overseas company decided to use an outside loan to purchase shares for employees; dividends repaid the principal, while the company absorbed the interest charges.

- All but one of the eight companies sampled were extremely pleased with their ESOPs and thought that they had fulfilled expectations.

- Employees' gains among the companies varied considerably. In some companies, employees secured a substantial second income from dividends (or share of profits), increased their retirement security, and received the psychological benefits of feeling like part owners of the company. In other companies, employees had not yet received any financial benefits from their ESOP.

- Only one company gave the employees' trust a controlling interest in the firm. Managers of the other seven companies said they did not think that the present owners would allow the company to become worker controlled. In some cases, however, employees increased their participation in management issues directly related to employee welfare.

RECOMMENDATIONS

Despite the lack of conclusive evidence found in this study regarding the financial benefits of ESOPs to companies and employees, sufficient indications exist that this concept is worthy of further examination and selective promotion. More information on the applicability of ESOPs to companies in developing countries is required before any substantial program begins.

Thus, the study team recommends that AID develop an experimental program to promote ESOPs and to evaluate carefully their impact in developing countries. This program should first be tested in countries whose government and business community are receptive to the idea, and where the national socioeconomic and legal environment is most conducive to ESOP development. AID private sector officers should assess conditions in their countries, using criteria outlined in this report, to determine whether it would be worthwhile to participate in the program.

Since AID cannot shoulder the costs of ESOPs in all developing countries, the program's objective should be to demonstrate the potential of ESOPs so that others can build upon this experience and take appropriate steps without direct U.S. assistance. Alternative programs to achieve the same objectives should be explored to provide a basis for comparison of the costs and benefits of ESOPs. Any ESOP program should be coordinated with and complement efforts of other multinational and bilateral assistance agencies.

The ESOP program might include the following elements:

Financial Assistance

- Foreign exchange loans to local financial institutions to leverage ESOP stock purchases for qualifying plans. These loans might be tied to the purchase of U.S. raw materials, spare parts, or equipment by private companies. Current commodity loans should be modified to give priority to companies that initiate or already have ESOPs;

- Low-cost local currency loans channeled through domestic financial institutions for companies seeking to begin an ESOP;

Technical Assistance

- Seminars for corporate managers and host country government officials to explain ESOPs and the AID program;
- Assistance to host-government finance agencies to examine the costs, benefits, and nature of tax and credit incentives for ESOPs;
- An examination of ESOPs as a mechanism to denationalize specific state-owned enterprises;
- Feasibility studies to assess the financial impact of different ESOP designs upon interested companies;
- Management assistance to help introduce the plans within companies; and
- Seminars with U.S. corporations that have subsidiaries in developing countries to discuss their concerns and determine whether and how the public and private sectors might cooperate to create more incentives for the adoption of ESOPs.

ESOPs must be tailored to fit specific situations. The array of potential constraints and ESOP design options suggests that AID should not attempt to develop a detailed, uniform model for application across countries and companies.

CHAPTER ONE

INTRODUCTION

OVERVIEW

One of the principal objectives of U.S. development assistance is to improve the standard of living of the poor in developing countries. Most foreign assistance programs are channeled through the public sector and are intended to increase the capability of the more disadvantaged to become productive members of their country's economy. The gap between the rich and the poor, however, is most often the result of concentration of private capital in the hands of relatively few Past and present assistance programs have not substantially affected this concentration of ownership.

In 1981, the U.S. Agency for International Development began a major private enterprise initiative. Its objective is to stimulate economic growth in developing countries by encouraging the expansion of indigenous private enterprise. AID is, however, trying to ensure that lower income individuals also benefit from its private sector programs. Thus, of particular interest to AID at this time are private enterprise development strategies and project ideas that benefit its traditional target group.

This study examines a potential AID strategy that might strengthen the private sector through the extension of capital ownership to economically disenfranchised groups. One possible means of spreading ownership of private capital to more individuals, especially to those in lower economic classes, is through employee ownership of company stock. In both the United States and Western Europe, employee stock ownership plans (ESOPs) have become a popular means to supplement employee benefits while providing such benefits to the companies as capital formation, access to new credit sources, tax breaks, and gains in productivity. These ESOPs can take many forms and are initiated for a variety of reasons.

To date, most of the ESOP studies have been done on companies in the United States and Western Europe. Little attention, however, has been paid to ongoing ESOPs in developing countries. Yet it is there that the benefits to the workers from these programs could be the greatest. The idea and the experience of broad capital ownership (aside from that of cooperatives, which differ from employee ownership) [1] are rare and relatively new in most developing countries where many of the workers are more disadvantaged than in the industrialized West. Not only could these workers improve their income and retirement security, but companies can also benefit. In addition, a multinational corporation might want to divest or create a constituency to prevent nationalization, or a company might need to enhance its equity position, borrow money, or improve its worker-management relationships. Governments can also use ESOPs to shift a company from the public to the private sector.

With the potential for so many benefits to be gained from ESOPs in developing countries, an effective approach to development may be found in encouraging and assisting the creation of these programs. Yet little is known about what has already been tried and how well these efforts have succeeded. This study was commissioned by AID to enhance its knowledge on the experience of selected ESOPs in developing countries and to advise whether future promotion activities are merited.

SCOPE AND METHODOLOGY

The intent of this study is to examine cases in developing countries where companies have allowed and assisted employees to purchase company stock, and to determine whether:

- These programs have been successful in providing ownership benefits to substantial numbers of lower level employees;
- The companies and pre-ESOP shareholders benefited from these programs;
- Internal and external incentives and constraints can be identified; and
- Strategies are indicated that might lead to a development assistance program to motivate and support new efforts in this field.

The study team adopted a case study approach because few ESOPs were identified in the developing countries that AID assists. The team first compiled a list of all known companies with employee stock plans. Although over 5,000 ESOP companies exist in the United States, and several hundred in Costa Rica, few companies were identified in other countries currently assisted by AID programs.[2]

Although conditions in developing countries differ, the team chose the ESOP cases that might exhibit some common factors that could provide guidance for future efforts. Two of the eight examined cases were in the United States to serve as a means of comparison with those in the developing countries. Two cases were chosen in each of three developing countries: Costa Rica, Thailand, and Zimbabwe. Each ESOP studied by the team varied in terms off financing, stock distribution, and benefits. Their only common characteristic, and the main criterion for their inclusion, was that they appeared to be offering ownership benefits to all levels of employees. Also, by studying two cases per country, the team was able to cover more cases within the budget ceiling of the study.

All of the examined companies in developing countries were fairly large. Small companies often avoid taxation through manipulation of their financial records and therefore do not have reliable accounting books upon which to value stock and distribute earnings for ESOP owners. Thus, the small-scale firm was not included in the sample and may not be appropriate for ESOP introduction.

Team members examined these companies and their environments in depth to determine the ESOP's effect on both the company and its employees. Past studies have not conclusively linked changes in company or employee performance to ESOPs. This is because the studies have not rigorously examined the company's pre-ESOP status or because they have failed to compare this performance with similar firms that do not have ESOPs.[3] This study attempted to avoid this methodological pitfall; however, since only eight cases were examined, all conclusions must be regarded as extremely tentative.

To understand and assess the performance of the eight ESOPs, the team developed three questionnaires to cover the following areas of inquiry[4]:

- The national economic and political environments;
- The companies' range of operations and markets;
- The companies' financial condition (past and present) and performance compared with those of their industry and the economy;
- ESOP development and strategy;
- Employee-management relations;
- Wages, salaries, and non-ESOP benefits;
- ESOP benefits (past, present, and potential);
- Worker and management views of the ESOP and its benefits; and
- The impact of the ESOP on company performance.

This report first presents the theoretical framework behind ESOPs. Chapter Two describes a variety of methods that could be used to broaden the ownership of corporate stock to lower-income individuals. The focus then shifts to the mechanism examined in this report -- employee stock ownership plans -- and explains the model ESOP adherents regard as ideal, as well as its potential benefits.

Chapter Three compares the ESOP adherents' model with characteristics of the eight cases. It also summarizes the impact of ESOPs upon the eight companies and their employees. Chapter Four concludes the report with policy recommendations for AID suggesting the nature of a future ESOP strategy.

Annexes A and B provide detailed information on the factors behind the adoption of ESOPs and their impact on the national and company level. Annexes C through F contain selected developing country profiles and case studies.

NOTES

1 Cooperatives usually do not include employees as members. In addition, they apportion voting rights on a one-person, one-vote basis instead of by amount of stock owned.

2 ESOPs were identified in Saudi Arabia, Malta, Singapore, Chile, and China. The study team did not visit these countries since they had no AID missions. Additional ESOP companies may exist, but were unknown to the institutions, commercial attaches, and journalists tracking such developments that the study team contacted. Since Costa Rica has a thriving ESOP movement, the team also tried to find companies in other developing countries so that the effect of their environments could be analyzed.

3 See Jerry Jenkins's analysis of the quality of these studies in "Broadening Capital Ownership: An Initiative for Private Sector Production and Politics."

4 These questionnaires may be obtained from PPC/E.

CHAPTER TWO

THEORETICAL FRAMEWORK FOR EMPLOYEE STOCK OWNERSHIP PLANS

TYPES OF BROAD-BASED CAPITAL OWNERSHIP

Proponents of spreading capital ownership from the hands of the few to the many see a variety of ways by which this may be accomplished. This study focuses exclusively upon ESOPs, since none of the other broad-based capital ownership plans have yet been tested in the United States. Because some of these other mechanisms might be particularly relevant to developing countries, however, they are described in this chapter.

al ownership theory adherents have identified four primary financing mechanisms:

- Employee Stock Ownership Plan: a financing mechanism to allow employees to earn and accumulate tax-free shares in their company without salary deductions or use of their personal savings. Loans to purchase stock on behalf of employees are secured and repaid from future pre-tax company profits.

- Consumer Stock Ownership Plan: a technique designed to provide stock to customers of public utilities, mass transit systems, and highly capital-intensive businesses. Tax-deductible dividends and refunds based on patronage would be used to repay loans used to purchase stock on behalf of consumers.

- General Stock Ownership Corporation: this mechanism would enable residents living within specific geographic areas to gain access to capital credit to establish professionally managed land development corporations for urban and rural development.

- Individual Stock Ownership Plan: this adaptation of the U.S. Individual Retirement Account would permit government employees and professional and other groups designated by the government to gain access to credit to purchase "qualified" shares in new and growing publicly traded companies. Eventually, this plan would be made available to all citizens as a supplement to Social Security.

Although producer and consumer cooperatives exist in the United States, they are not considered broad capital ownership plans since they do not enjoy the tax and financing advantages of ESOPs. Developing countries may find some variations, such as the consumer stock ownership plan, more in line with their needs than the ESOP, since employees in corporations form an extremely small and relatively privileged segment of the general population. As another example, at planting time a Zimbabwe brewery establishes a fixed price for barley grown by local farmers; if the market price at harvest time is higher, the difference is paid to the farmers in company stock. The appropriateness of these types of broad-based capital ownership plans might be considered in any future programs seeking to promote the private sector through this concept.

THE EMPLOYEE STOCK OWNERSHIP PLAN MODEL

The ESOP and other broadened ownership mechanisms described above are derivatives of the Kelso-Adler theory of political economy.[1] Its goal is to enable all persons to become shareholders of industrial capital, with their dividends providing an income that allows them to be self-sufficient. Employees would thus be transformed into company shareholders. As a result, the barriers that have historically divided laborers and owners of capital should be lessened.

The following summary of the model advocated by ESOP adherents provides a frame of reference throughout this text against which to compare the sample of eight ESOP cases. To achieve the maximum benefits from an ESOP, adherents argue that it should approximate their model as closely as possible. Although differences exist among the adherents, this section presents an overview of the key features of the general model.

This model operates at two levels: it assumes a legal, economic, and social environment conducive to equity and ESOP growth; it then states characteristics of the ideal plan that a company should adopt within that environment. The national environment most conducive to the promotion of ESOPs with maximum benefits to employees and, ultimately, society includes the following characteristics:

- Absence of a corporate income tax: to allow shareholders to derive the full monetary benefits from ownership. Corporate taxable income would be eliminated by treating dividend payouts, like ESOP payments, as deductible business expenses;

- Prohibiting corporations from retaining earnings to finance new growth without the consent of minority stockholders: this protects the ownership rights of minority stockholders and forces companies to finance growth through new equity issuances under an ESOP or other broadened ownership mechanisms. By eliminating government corporate taxes and the practice of retained earnings, owners would receive 100 percent of company profits in dividends;

- Availability of low-cost capital credit to finance ESOPs: to lower the cost of financing an ESOP and enable employees to acquire a significant amount of company stock;

- Availability of capital diffusion insurance: to insure ESOP lenders against loan defaults and protect employees' equity accumulations against company bankruptcy; and

- Limited personal income taxes: individuals would not pay personal income taxes until their net worth was sufficient to generate a stream of income capable of supporting a modest standard of living.

The type of company that would provide an ideal setting for the successful introduction of an ESOP, according to its proponents, would have the following characteristics:

- Pro-employee philosophy. The ideal firm would consider employee ownership participation as essential to employee dignity, and adopt the corporate objective of maximizing employee ownership opportunities. This philosophy would be reflected in the legal charter of the enterprise and its planning and investment strategies;

- <u>Market-based wages</u>. Wages should be maintained at modest levels sufficient to meet minimum subsistence needs during business declines. This income would be supplemented by monthly and annual cash bonuses tied to a formula based on profits and productivity. (ESOP stock accumulations and dividends would complement this income after the adoption of the ESOP.) The ideal firm would also minimize basic wage differences between employees; the differential should be sufficient to encourage individuals to excel, but not so wide that top management loses the ability to relate to lower-level employees. All owners should know the salaries, bonuses, and perquisites of top employees; and

- <u>Employee participation in management</u>. Employees should actively participate in the firm's management so that professional managers have considerable autonomy to make daily operational decisions, but are accountable to a democratically elected board of directors, who serve on a staggered term basis.

  -- Joint ownership councils, consisting of executive and elected non-management representatives, would have access to sensitive financial and policy data that might jeopardize the firm's competitive position if publicly disclosed.

  -- Employees should be fully informed of other important problems and decisions as they arise.

  -- Quality control circles and ongoing programs to encourage the involvement of employees in decisions affecting their work place should be encouraged, so that such decisions are made from the bottom up.

  -- Union officials should not be represented on the company's board of directors, to avoid a conflict of interest between the union, which represents workers' interests, and the owners. In no case should the union have the right to hire and fire management.

The ideal ESOP design would have the following characteristics:

- <u>Leveraged stock acquisitions</u>. To increase the immediate equity opportunities of employees, the ESOP would have the power to use leveraged financing to acquire large blocks of stock repayable with future company profits;

- Fully employee owned. The above leveraging mechanism would be used until employees owned 100 percent of all company stock; this provides maximum incentives for those actively involved in production while compensating previous shareholders. (Highly capital-intensive firms are exempt from this rule, since individual workers would accumulate excess income through an ESOP. See section on broad capital ownership options for a discussion of consumer stock ownership plans.);

- Dividend pass-throughs. The ESOP should specifically require that dividends on employee-held stock be paid out as second incomes to supplement wage and retirement incomes. Ideally, all dividends would be distributed to shareholders. (This condition reinforces the national legal requirements cited above.);

- Stock allocated according to relative rewards. The formula for dividing annual ESOP benefits should be based on the relative contributions of the participants to the company's success, but cut-off levels should be determined by the wage differentials the company has established. All employees should begin to earn ownership rights upon entering the firm to minimize group conflicts and provide incentives to employees;

- Market for shares. Employees should be guaranteed a market (the public stock exchange, the company, or the employee stock ownership trust) to sell their shares at fair market value at any time after vesting;

- Full voting rights. Employees should enjoy the same voting rights as other shareholders based on their stock accumulation within the ESOP. This would enable employees to vote for representatives on the board and on major corporate policies to protect their property accumulations through the ESOP; and

- Continuing ownership education for employees. The company and any labor organization should provide continuing education on the rights, responsibilities, and benefits of stock ownership to encourage constructive employee participation in the company.

POTENTIAL BENEFITS FROM EMPLOYEE STOCK OWNERSHIP PLANS

Ideally, the adoption of an ESOP allows everyone involved to benefit. According to the theory, companies, previous shareholders, employees, and the government reap both financial and social rewards. This list of benefits serves as an ideal. Although all may not be achieved in the real world, some may be possible even without adopting all components of the model. Thus, the list of benefits served as a check list against which the team compared the companies studied in the field.

The company receives some financial benefits if capital credit, investment capital, and tax-savings that otherwise would not have been available are provided through the ESOP mechanism. In this case an ESOP might enable a company to:

- Secure low-cost capital credit;
- Obtain new infusions of capital; and/or
- Increase cash flow through lower taxes.

If the company wished to transfer current ownership, the ESOP might:

- Assist the company in changing from public to private ownership;
- Enable a company to divest itself of a subsidiary;
- Provide a market for privately held stock that otherwise would be difficult to sell; or
- Protect a company from a corporate takeover.

The heightened morale of employees that is supposed to follow the introduction of the ESOP may benefit the company by:

- Increasing worker productivity;
- Improving product quality;
- Reducing waste rates; and/or
- Lowering employee absenteeism and turnover.

ESOPs also have the potential to improve relations between different classes of employees and with the government. Some of these less quantifiable benefits include:

- Improved worker-management relations;
- Easier recruitment;
- Diminished vulnerability to nationalization; and
- A good public image.

Pre-ESOP shareholders benefit through the company's increased profitability, which is supposed to result from ESOP adoption. The price of shares and amount of dividends are supposed to rise for those who retain their stock. Thus, even if new shares are issued, previous shareholders will ideally not suffer a reduction in the value of their stock. Their political control of the company may well be lessened, however, as employees gain shares and voting rights. Yet stockholders who choose to sell their stock to the ESOP are supposed to receive a fair price for it. This is a particularly appealing offer for multinational corporations in developing countries whose likely alternative is government expropriation.

An ESOP's potential benefits to employees range from strictly monetary rewards to the psychological effects created by greater control of the work place. The financial rewards may include:

- Increased gross income resulting from the regular distribution of dividends; and
- Increased retirement income when the stock is sold.

The psychological benefits of worker ownership and increased participation in company decisions may include increased:

- Job security;
- Job satisfaction;
- Retirement security;
- Interest in company progress; and
- Cooperation among employees.

Just as no existing environment, company, or ESOP plan fulfills all the requirements of the model, the benefits stemming from the adoption of an ESOP also vary in practice. Rather than argue the theoretical reasons why such an ideal has never been established, this report will examine the specific situations that led the examined companies to adopt the plans they did, how these plans differ from this ideal, and what their impact has been.

NOTES

1 For further information on this theory, consult the works by Louis Kelso cited in the bibliography.

CHAPTER THREE

CASE STUDY FINDINGS

DIFFERENCES BETWEEN THE COMPANIES STUDIED, THEIR ESOPS, AND THE MODEL

None of the companies the team studied has yet adopted all the components of the ESOP model. This is because either the country's environment is not conducive to such ESOPs, or the company's particular circumstances dictate adopting a different type of plan. These cases provide a diversity of experiences that team members did not anticipate prior to their fieldwork. The examined cases indicate that a single ESOP model cannot fulfill the needs of all companies in all places; instead, each company must be carefully studied to determine whether an ESOP can improve its position and, if so, how the plan should be designed to best meet the needs of all concerned.

The characteristics of the countries the team visited and of the ESOPs it studied are presented using the ESOP adherents' model as a framework for comparison. The chief differences between the field cases and the ESOP model are explained in this section to gain a fuller appreciation of how ESOP adoption in practice varies from the theory. These cases may provide more relevant models for other developing countries than the ideal type.

Figure 1 summarizes the business activities of companies studied.[1]

Figure 1: Business Activities of the Companies Studied

COUNTRY	COMPANY	BUSINESS ACTIVITY
United States	Allied Plywood	Distributor of plywood building materials
	E-Systems	Aviation and electronics research and manufacturing
Zimbabwe	Art Printers	Paper, plastic, and metal products manufacture
	Dunlop	Industrial rubber products, furniture, engineering, and sports equipment
Thailand	Bangkok Bank	Private financial institution
	Saha Union	Textile and garment maufacturing
Costa Rica	La Gloria	Department store chain
	Coopemontecillos	Cattle marketing, animal slaughtering, meat processing, tanning, and sales

Country Environment

Figure 2 compares the national tax and investment characteristics of the ESOP model with those of countries visited for this study.

Of the countries sampled, the United States provides the most tax incentives for the adoption of ESOPs. This explains why the United States also has the most ESOPs of any country in the world. (See Annex A for a more complete discussion of incentives the U.S. government has given to promote ESOPs.) Costa Rica, however, provides a conducive social environment, with its emphasis on worker participation and the distribution of wealth (see Annex F). Zimbabwe's foreign exchange remittance and tax policies, which serve as a disincentive to adopt an ESOP, are mitigated by a potentially explosive political atmosphere that propels private companies to adopt policies in favor of workers (see Annex D). Thailand is providing incentives for private companies to become public, but does not wish to erode its already small tax base by offering tax breaks for ESOPs (see Annex E).

ESOP Company Characteristics

Companies that are concerned with employee welfare are the best candidates for the introduction of ESOPs. These companies would be most receptive to ESOP adoption and more likely to design plans that benefit employees. As Figure 3 shows, however, this criterion would also exclude some of the companies the study team examined. ESOP adherents argue that if ulterior motives are behind an ESOP's initiation then the plan can be distorted and fail to deliver its potential benefits.[2] Although the wish to

Figure 2: Summary of Examined Countries' Tax and Investment Laws

MODEL	UNITED STATES	ZIMBABWE	THAILAND	COSTA RICA
• Absence of corporate income taxes.	• Principal and interest on a loan used to establish an ESOP is repaid from corporate pre-tax earnings.	• Approximately 50% corporate income tax.	• Registered companies are taxed at a 30% rate; unregistered companies pay a 40%. income tax.	• Cooperatives are exempt from payment of any income taxes.
• Prohibition of retained corporate earnings without unanimous stockholder consent.	• Individuals with controlling interest in a company who sell a majority block of stock are taxed at a capital gains rate. Individuals who sell a minority block but still retain controlling interest, however, must treat this as dividend income unless this sale is made to an ESOP, in which case, the income is taxed at the lower capital gains rate.	• 20% individual income tax; 30% tax on capital gains.	• No capital gains tax in stock sold through the stock exchange.	• Low corporate income tax.
• Availability of low-cost capital credit to finance ESOPs.		• Severe foreign exchange restrictions.		• No tax on dividends.
• Availability of capital diffusion insurance.		• Up to 9% of the wage bill may be contributed to a pension fund from pre-tax earnings.		
• Absence of personal income taxes until net worth is sufficient to generate stream of income capable of supporting modest standard of living.				

improve employees' well-being was an important reason behind the adoption of many ESOPs, clear political and financial benefits were just as strong in other cases. If humanitarian goals were the only reason to adopt an ESOP, few owners would have been interested.

Figure 3 also shows that, not surprisingly, most companies maintained a wide disparity between salaries of top management and workers. Allied Plywood and the two Costa Rican cases had the narrowest gap in real income to employees. Although E-Systems had an extremely wide gap, employees said that they were not interested in what top management earned as long as they secured union-level wages. Salary differentials in Zimbabwe and Thailand were extremely large, reflecting the relative scarcity of skilled workers and management staff capable of directing those companies to penetrate the world market.

Prior to ESOP adoption, all companies had established some kind of mechanism by which to receive feedback from employees. These included quality control circles, worker committees, and elected representatives to management committees. Most of these forums provided an opportunity to discuss ways in which production and working conditions could be improved rather than to discuss company investment decisions. Nevertheless, almost all company managers emphatically declared that the traditional separation between management and ownership must be maintained for the financial health of their companies. Some managers said that employee participation in management was not a practical matter. They thought that too much time would be required to provide the information that employees would need to make informed decisions, which often had to be made quickly in an undemocratic fashion.

Figure 3: ESOP Company Characteristics

Name of Firm/ Business Activity	Company Philosophy/Chief Reason for ESOP Adoption	Employee Salaries and Benefits	Employee Participation in Management
MODEL	Pro-employee philosophy.	• Base salary determined by the market. • Cash productivity bonuses frequently distributed. • Salaries and benefits of most highly paid employee should be no more than five times the lowest paid. • All employees should know salaries, bonuses, and perquisites of top executives.	Quarterly meetings in which corporate officers and board members disclose and account for their decisions to employees. All important decisions should be discussed with employee representatives.
UNITED STATES			
Allied Plywood	Owners wished to sell their company, incurring the lowest tax rate possible while maintaining the job security of employees.	• Base salaries are 30% lower than competitors. • Monthly + annual bonus plan. • Base salaries + benefits are 30% higher than competitors.	Informal meetings between management and employees.
E-Systems	Management wished to attract and hold employees for life; ESOP mechanism was chosen because of its finanical benefits to the company.	• Competitive salaries. • Annual bonuses provided only to top management. • Salary and bonuses of highest paid employee is 100 times those of lowest paid.	Informal groups of plant managers and workers meet each month to discuss all but labor union problems and individual grievances. Strategic finanical decisions not discussed.
ZIMBABWE			
Art Printers	• To avoid nationalization. • To promote good public relations; and • To improve employee benefits.	• Employee wages above minimum wage. • Relatively generous benefit package. • Large difference between highest and lowest paid.	Four employees are represented on the boards of each of Art Printers' five subsidiary companies. Worker councils elected by employees meet with management each month to discuss a limited range of issues.
Dunlop	• To avoid nationalization; • To promote good public relations; and • To improve employee benefits.	• Employee wages above minimum wage. • Relatively generous benefit package. • Large difference between highest and lowest paid.	Worker councils meet with management each month but have little say in corporate decisions.

Figure 3. (continued)

Name of Firm/ Business Activity	Company Philosophy/Chief Reason for ESOP Adoption	Employee Salaries and Benefits	Employee Participation in Management
THAILAND			
Bangkok Bank	• To improve employee benefits. • To increase employees' identification with the company.	• Competitive base wage. • Extremely comprehensive benefit package. • Large gap between highest and lowest paid.	Quality control groups are being established, but key decisions are family controlled.
Saha Union	• To improve employee benefits. • To increase employees' identification with the company.	• Competitive base wages. • Extremely comprehensive benefit package. • Large gap between highest and lowest paid.	Employees elect representatives to manage their benefit programs and have quality control circles, but workers have little influence on corporate financial decisions.
COSTA RICA			
La Gloria	• To improve employee welfare.	• Sales persons work on salary plus commissions. • Highest paid employee earns four times that of lowest paid.	Employee representatives are encouraged to make suggestions.
Coopemontecillos	ESOP was part of complete reorganization to save the company; employee guarantees that were required to receive a bank loan were given in exchange for stock.	• No bonus plan. • Highest paid employee earns 10 times that of lowest paid.	Employee representatives are encouraged to make suggestions.

ESOP Design Characteristics

Figure 4 shows that the ESOPs adopted by the examined companies varied considerably. Since the U.S. companies were chosen because their design closely approximated that advocated by ESOP advocates, they exhibit the most characteristics in common. The ESOP designs of companies in a particular developing country, however, varied as much as those in companies located on different continents.

Method of Providing Stock to Employees. Tax incentives caused both U.S. companies to transfer stock to employees at no direct cost to them through a financing mechanism. Dunlop Zimbabwe was the only foreign case to obtain a loan to purchase stock on behalf of employees. Most companies simply contributed funds from either pre- or post-tax earnings, depending on the tax advantages. Two companies allowed their employees to purchase stock from their post-tax salaries (in one case, employees could purchase stock at an attractive par value), thereby minimizing the cost of the ESOP to the company.

Percentage of Company Stock Owned by Employees. Less than 10 percent of ESOP companies in the United States and none of the examined overseas cases were majority worker owned. Managers of almost all the examined cases said they did not believe that their company would ever become worker controlled. The one exception was Allied Plywood, in which the owner expressly wished to sell his entire company to employees prior to his retirement.

Distribution of Company Profits. A key element of the ESOP model is that all profits are distributed to owners, and borrowing is used to finance all expansion. Allied Plywood came closest to distributing almost all profits; enough were retained so that stock would appreciate by 10 percent each year, thereby enabling employees who had purchased stock on their own to earn a return on their investment. Although the Thai and Costa Rican firms had relatively high payout ratios, all firms retained earnings to finance future growth.

Method of Stock Allocation. The model proposes that stock be allocated by salary and bonuses since the latter is supposed to help close the income gap between employees. Since bonuses did not serve this function in any examined companies, this criterion becomes irrelevant. Allied Plywood does distribute stock according to salaries and bonuses with the opposite

Figure 4: Examined Companies' Employee Stock Ownership Plan Characteristics

Name of Firm/ Business Activity	Method of Providing Stock to Employees	Percentage of Company Stock Owned by Employees	Distribution of Company Profits	Method of Stock Allocation to Employees	Employees Ability to Sell Stock	Employee Stock-holders Voting Rights	Stock Ownership Information
MODEL	Trust is established to borrow funds to purchase stock; the corporation repays this loan from pre-tax earnings and dividends on employee stock.	100% employee owned.	All profits should be distributed to shareholders.	According to salary and bonuses with cut-offs if large wage differentials exist.	Employees should be allowed to sell their shares at any time after they are vested.	Passed through the employee stock ownership trust to employees.	Existence of program to publicize and explain the employee stock ownership plan and the rights and responsibilities or stock ownership.
UNITED STATES							
Allied Plywood	Pre-tax company contributions purchased 44% of employees' stock; 40% of stock purchased through a leveraged ESOP as decribed in the model.	84% held by the ESOP trust; 16% owned by individual employees.	Retain enough to enable 10% annual stock appreciation.	According to salary and bonuses.	Employees may sell stock only upon leaving the firm.	Employees do not have voting rights; company president and treasurer appointed to manage the trust.	Comprehensive information program.
E-Systems	Exactly same as model.	20% of stock is held by the employee trust.	Approximately 30% of net earnings paid out.	According to salary and bonuses.	Employees may sell stock only upon leaving the firm.	Employees who are 100% vested may vote.	Comprehensive information program.
ZIMBABWE							
Art Printers	Annual contribution made from distributed profit.	15% will be owned by employee trust in about 10 years (currently 1.7% employee owned).	About 45% of net profits distributed during past three years.	• Stock held in common trust. • Not yet determined whether shares will ever be distributed to employees.	Individual employees do not own shares; compensation not yet determined.	Employees indirectly elect trustees who vote at stockholders' meetings.	Comprehensive information program geared to lower-level employees.

Figure 4. (continued)

Name of Firm/ Business Activity	Method of Providing Stock to Employees	Percentage o Company Stock Owned by Employees	Distribution of Company Profits	Method of Stock Allocation to Employees	Employees Ability to Sell Stock	Employee Stock-holders Voting Rights	Stock Ownership Information
Dunlop	Trust was established to borrow funds to purchase stock; Dunlop repays interest while post-tax dividends repay principal.	About 4% of stock is allocated to employees.	About 65% of net profits distributed during past two years.	By length of service.	Employees may sell stock only upon leaving the firm.	Employees may vote their paid-up shares at the annual stockholders' meeting.	Little publicity or explanation of program to employees.
THAILAND							
Bangkok Bank	Post-tax company contribution.	Almost 10% of stock is owned by employees.	About 40-50% of net profit is distributed.	Dependent upon salary alone.	Employees may sell stock only upon leaving the firm.	Employees vote their shares at the annual stockholders' meeting.	No information program considered necessary.
Saha Union	Through payroll deduction.	About 5% of stock is owned by employees.	About 65-80% of net profit has been distributed during the past eight years.	Dependent upon salary alone.	Employees may sell stock only upon leaving the firm.	Employees vote their shares at the annual stockholders' meeting.	No information program considered necessary.
COSTA RICA							
La Gloria	Trust was established to use severance pay obligation monies to purchase company stock that is never passed to employees.	35% of a La Gloria subsidiary (GLYSA) is owned by the employee association of both La Gloria and the subsidiary.	Not available.	Dependent upon salary alone.	Employees may sell stock only upon leaving the firm.	Elected representatives of the employee association vote employee stock as a block.	Comprehensive explanation of ESOP for new employees.
Coopemontecillos	The cooperative bought stock for employees from company profits; employees could also individually purchase stock.	20% of shares are employee owned.	11% of earnings must be retained by cooperative.	Dependent upon salary alone.	Employees may sell stock only upon leaving the firm.	One person: one vote; delegates are elected to the general assembly, which is the main policy-making body.	Comprehensive explanation of program to employees.

effect intended, since bonuses widen the gap between employees. Dunlop was the only company that used length of service as the sole method of stock allocation; this is because management wanted to gear the plan to rewarding longer-term, lower-level employees. This method actually comes closest to promoting the ESOP adherents' goal of reducing disparities between employees' real incomes.

Employees' Ability to Sell Stock. No examined case permitted employees to sell stock prior to leaving the company. Managers indicated that this would defeat the basic purpose of the ESOP, that is, binding employees to the company's financial performance to spur productivity. Some companies did allow employees to use the stock as collateral when taking out loans. This practice, however, is illegal in the United States.

Employee Stockholders' Voting Rights. In some cases, employees were allowed to vote their stock; more frequently they had an indirect vote through a trust or other representatives. Conforming to cooperative law, members of the Coopemontecillos cooperative each had one vote, irrespective of the number of shares owned.

Stock Ownership Information Programs. All except one company had extensive information programs to explain the concept of stock ownership to employees. Since this was an alien concept to most lower-level employees in the developing countries, they will need more time to understand the concept fully.

When team members described the elements of the ESOP model to managers of the companies they studied, most explained why they had chosen a different model. These reasons must be taken into account when designing an ESOP assistance project, or anticipating its impact. All companies, of course, were strongly in favor of government assistance to the program, but none advocated corresponding structural changes, such as the distribution of all profits, within their own companies. It would be convenient to show a strong causal relationship between the degree to which the country, company, and ESOP design conformed to the ESOP model and the level of positive impact. Unfortunately, many external and internal company-specific characteristics eliminate the possibility of such a facile generalization.

IMPACT OF ESOPs ON COMPANIES STUDIED

All of the companies the team studied were successful relative to their competition or environment. It is extremely difficult to link this success with their ESOPs because:

- The company's financial success and good worker-management relations pre-dated the ESOP; and/or
- The ESOP was part of a complete reorganization that had many components contributing to future success; and/or
- The ESOP involved a relatively small amount of compnay stock; and/or
- Not enough time had elapsed upon which to judge the ESOP's effect.

Financial Benefits to Companies and Pre-ESOP Shareholders

The U.S. tax system provides financial benefits to companies that adopt ESOPs. Companies may repay both the principal and interest on loans received to purchase stock for employees from pre-tax earnings. And income received by a majority stockholder who sells a small block of shares to employees, still retaining majority control, is also taxed at a lower rate.

Figure 5 summarizes the financial impact of ESOPs upon examined companies using the potential benefits listed in Chapter Two as a guide. Both E-Systems and Allied Plywood received loans to purchase company stock on behalf of employees. These loans were fully repaid from pre-tax profits. Allied's previous owners paid lower taxes on the income they received from selling their stock to their employees. (See the description of the Allied Plywood case in Annex C for more information.) Thus, in the

Figure 5: ESOP's Financial Impact on Companies and Pre-ESOP Shareholders

	COMPANY	PRE-ESOP SHAREHOLDERS
MODEL	• Secure low-cost capital credit. • Obtain new infusions of capital. • Increase cash flow through lower taxes. • Increase profits.	• Broadened ownership of the company. • Decline in influence of pre-ESOP owners.
ALLIED PLYWOOD	• Market conditions, profit-sharing plan, and annual bonuses responsible for increased profits.	• Ownership completely transferred to employees. • Lower capital gains tax rate paid by previous owner on income received from stock sales to ESOP.
E-SYSTEMS	• Increased profits.	• Minority block of stock sold by previous owners to ESOP at market price.
ART PRINTERS	• Earnings that would have been distributed are reinvested in the company, thereby improving cash flow.	• Lower dividends to shareholders until ESOP stock fully purchased. • Broadened ownership of company but still family controlled.
DUNLOP	• Expenses increased since company pays interest charges on loan to purchase stock from previous owner; no additional revenues generated by this expense.	• Dunlop International not permitted to repatriate earnings generated through stock sales.

Figure 5. (continued)

	COMPANY	PRE-ESOP SHAREHOLDERS
BANGKOK BANK	• Post-tax earnings returned to company in form of new stock purchases.	• Broadened ownership of company but still family controlled.
SAHA UNION	• Interest-free loan is expense to company with no perceivable effect on revenues.	• Same as above.
LA GLORIA/GLYSA	• Decrease in La Gloria's working capital.	• New company created.
COOPEMONTECILLOS	• Improvement in financial status due to complete reorganization of company of which ESOP was component.	• Broadened ownership of company. • Decline in influence of previous owners.

United States, ESOPs did provide tax savings for companies and previous owners. The short-term cash flow position of these companies, nevertheless, would have been better if outsiders, rather than the company, had bought this stock or if loans had been used to purchase newly issued shares on behalf of employees.

The three developing countries did not offer tax advantages, such as those found in the United States, for ESOPs. Without any special tax breaks to promote ESOPs, all of these companies had to sacrifice financially to develop their plans. Three companies contributed post-tax earnings to purchase newly issued stock on behalf of employees (Art Printers, Bangkok Bank, and Coopemontecillos; the first two cases purchased these shares with post-tax earnings, whereas Coopemontecillos, a tax-exempt cooperative, used its net profits.) In these cases, their contribution came right back to the company as new capital. Thus, the contribution served the same function as retained earnings. The opportunity cost of this transaction to the two publicly traded companies (Art Printers and Bangkok Bank), however, is that this newly issued stock would have commanded a higher price and generated greater income for the company if it were sold on the open market (given past and current market conditions).

The major effect of these transactions was on previous stockholders. Their dividends were lower than they otherwise would have been, and the percentage of total shares under their control has decreased. The price of their shares was not directly affected.

The one overseas case that financed the purchase of shares from previous owners (Dunlop) had no additional revenues generated through this debt expense. The company is locked into paying for shares at the original cost, which have now declined to just over one-third their former value. Although the ESOP has hurt the financial position of the company, its relatively small size has limited the damage. Since the parent company, Dunlop International, was not allowed to repatriate these stock sale earnings, it also suffered.

Rather than paying for employee shares through an outside loan, two companies, La Gloria and Saha Union, each provided an interest-free loan to a trust to purchase shares on behalf of employees. Since these funds flowed back into the company, the main financial cost was the dilution of the value of existing shares that occurred when new equity was sold at par without generating new capital. This cost diminishes as stock is paid for by employees over time. One of these cases, Saha Union, allowed employees to purchase shares from salary deductions over a one-year period without interest. Thus, the real price to employees was in effect lower than stated. The company may have also forgone income through this transaction to the extent that the shares could have commanded a higher price on the open market. In Saha Union's case, employees purchased shares at par value when market price was significantly higher.

Nevertheless, all companies except Dunlop were enthusiastic about their ESOPs. Since most overseas companies did not receive an immediate financial benefit from their ESOPs, other factors were providing satisfaction to company management. Some thought the ESOP would yield long-term financial benefits, while others said that it had fulfilled their basically altruistic objectives.

Qualitative Benefits to the Company

Only one company's management thought that the ESOP had increased worker productivity, improved product quality, and improved worker-management relations. All companies had an impressive employee benefit program that either preceded the ESOP or was part of a complete company reorganization. In either case, the ESOP's effect could not be separated from these factors. Most managers and employees stated that other benefit and worker participation programs had already alleviated any past worker-management problems. Thus, they did not expect the ESOP to generate any changes in these areas. The Thai and La Gloria companies, therefore, primarily adopted ESOPs for philosophical, humanitarian reasons.

Factors such as the introduction of an ESOP, good worker-management relations, high productivity, and financial success may all stem from good management. An ESOP is no substitute for such management. Thus, if turnover is a problem at higher levels, the plan should be structured to attract and retain those at the top as well as those on the bottom.

In Zimbabwe and Thailand, ESOPs did not provide sufficient incentives to retain middle and top management. At E-Systems, however, the ESOP has helped to retain the highly skilled workers who are critical to that company's success. The overseas companies, however, may have little power to reduce this turnover, regardless of what ESOP strategy is adopted. Zimbabwe's political and economic situation far outweighs the ESOP's power to attract upper-level employees; highly trained managers in Thailand often prefer to be employed by international companies that offer higher salaries, albeit with comparatively fewer fringe benefits.

All firms the team studied had relatively low worker turnover, even prior to the ESOP. The high unemployment rate among unskilled workers was considered a stronger factor behind the low turnover of these employees than the ESOP.

All ESOPs fostered good public relations. Political conditions in some countries made this an urgent necessity rather than an option. Although Dunlop's ESOP was motivated by fear of nationalization, the Zimbabwe government has yet to take any serious action in this direction. Art Printers was also responding to similar pressure when it decided to begin an ESOP. Perhaps these measures will prove to be politically advantageous in the long run.

IMPACT OF ESOPS ON EMPLOYEES OF COMPANIES STUDIED

Financial Impact

The financial impact of ESOPs on employees in the cases studied was dependent upon the degree of:

- Distribution of dividends; and
- Stock appreciation.

In cases such as Dunlop in which dividends were being used to repay a loan taken to purchase company stock, the ESOP had no effect on the stream of earnings to employees. In 5-10 years when the Dunlop loan is repaid, the dividends could significantly supplement the income of lower-level, long-term employees, since stock was allocated according to length of service. Companies, such as Saha Union, that had employees purchase small amounts of stock through salary withholdings also generated relatively insignificant earnings for lower level-workers.

The Costa Rican companies' ESOPs significantly affected employees' annual income since dividends are large and untaxed. And although dividends are subject to double taxation in Thailand, Bangkok Bank employees received a 52 percent return on their investment in 1981 alone (dividend of 52 baht on stock purchased at par of 100 baht). Since the Bangkok Bank ESOP has been operating for 18 years, and employees with long service have accumulated relatively large stock holdings, the plan does contribute significantly to those employees' earnings.

An important financial benefit to employees accrues through the appreciation of their stock. Because this additional income is earned only upon retirement or leaving the firm, this benefit was more important for older employees in all companies than for the younger ones. Younger employees wanted larger dividends, whereas older ones wanted their stock to appreciate through retained earnings. In all cases, employees had not realized the value of this cushion until a few of their colleagues had left the firm and cashed in their stock. In cases in which this situation has not yet occurred, the ESOP remains a theoretical abstraction rather than a dependable future source of income. In some cases, such as Saha Union, employees are permitted to use their stock as collateral for loans and so may not have this cushion when they need it. Yet in all cases, the ESOP would eventually provide some income benefits to employees who had worked with the firm until they were vested.

The degree of this benefit, of course, depends upon the price of the stock when it is sold. Stock price may not necessarily be a reflection of the company's financial performance but rather investors' general expectations for the market. Thus, although Dunlop is performing reasonably well in comparison with the market, its stock has dropped to about one-third its original price. This drop has caused management and employees to regard the plan as a failure in the short run.

In cases in which the ESOP provides the only source of retirement income, the employees' well-being is inextricably tied with the company's life. Chilean workers, in a case not closely examined for this report, who used their pension funds to purchase stock in their companies in the mid-1970s are now destitute because these companies have gone into bankruptcy. These cases indicate that employees concerned with a secure retirement should opt for a diversified ESOP that also includes the company's stock within its portfolio.

Qualitiative Benefits to Employees

When employees become part owners of their company through an ESOP, they may receive other benefits as well. One of these is the psychological benefit of employees seeing themselves as a part owners. They should feel more closely associated with the company and take increased pride in its operations. Thus the heightened morale of ESOP company employees must be counted as an important potential benefit. The impact of ESOPs on the mental health of U.S. employees is currently being carefully studied by the National Center on Employee Ownership.

This study examined these aspects, but found that conclusions regarding qualitative benefits are difficult to reach because:

- Qualitative benefits are hard to measure;
- The expressed positive feelings of the employees could result from the many benefits they receive and not necessarily the ESOP; and
- The short amount of time spent by the team with employees and the environment in which interviews were conducted (at the request of management) limited employees' candor.

Employees in companies that have either launched an advertising campaign to promote their plans or distributed significant dividends received the greatest psychological benefits from the ESOP. The benefits resulting from a publicity campaign will be transitory, however, if expectations are not fulfilled in the long run.

In essence, the more successful the company, the higher its stock will appreciate and/or its level of dividends, thereby creating a successful ESOP. An unsuccessful company similarly will generate, in the long run, negligible benefits through its ESOP. What still remains to be proved is whether an ESOP alone can turn an unsuccessful company into a successful one.

NOTES

1 More in-depth information on these companies and the countries in which they are located may be found in Annex B.

2 See Norman Kurland's "Tips from the Pros" in the January 1982 Newsletter of the Employee Stock Ownership Association. He argues that if the ESOP is viewed as a "tax-gimmick, or as a token gesture of corporate benevolence, or even as a last ditch desperation move to save a dying corporation, everyone involved may wish they never heard of the ESOP. It can magnify hidden problems and weaknesses in a company."

CHAPTER FOUR

POLICY RECOMMENDATIONS

The data from this study suggest that the concept of worker ownership is compatible with AID's current private enterprise development policy. Although the study did not find conclusive evidence regarding the financial benefits of ESOPs to companies and employees, the study team thinks that the idea is worthy of further examination and selective promotion. More information on the applicability of ESOPs to developing countries' companies is required before any substantial program begins. Thus, the team recon [illegible] D develop an experimental program to promote ESOPs [illegible] evaluate their impact in developing countries. The team bases this recommendation on the findings that are presented in detail in Annexes A and B.

This program should first be tested in countries whose governments are receptive to the idea and where the national socioeconomic and legal environment is conducive to ESOP development. This would include countries that:

- Provide tax incentives for employee benefit programs and/or private sector expansion;
- Protect private stock ownership;
- Wish to transfer or sell nationalized companies to the private sector;
- Wish to nationalize or transfer ownership of foreign companies into local hands;
- Wish to improve employee welfare;
- Wish to reduce substantial labor unrest;
- Wish to create a public stock market; and/or
- Have a U.S. project that provides foreign exchange for use by the private sector.

Not all conditions must be met by all countries; AID private sector officers should make a rough assessment of conditions in their country to determine whether it should participate in this pilot program.

Companies that would be the best targets for U.S. assistance are those that:

- Have good managers concerned with employee welfare;
- Think their political risk would be reduced through ESOP adoption;
- Think worker productivity, the company's financial performance, or both could be enhanced through an employee benefit program;
- Wish to establish some retirement security for employees; and
- Keep accurate financial records.

The AID ESOP development program could provide financial and/or technical assistance to selected countries and companies. Since AID cannot shoulder the costs of ESOPs in all developing countries, the objectives of the program should be to demonstrate its potential so that others can build upon this experience and take appropriate steps without U.S. assistance. Alternative programs to achieve the same objectives should be explored so that the costs and benefits of ESOPs could be compared. Thus, the effect of whatever assistance is provided must be carefully monitored and evaluated so that it may instruct other donor agencies, governments, and companies. To the extent possible, this program should be coordinated with and complement efforts of other multilateral and bilateral assistance agencies.

The program might provide the following financial assistance:

- Foreign exchange loans to local financial institutions to leverage ESOP stock purchases for qualifying plans. These loans might be tied to the purchase of U.S. raw materials, spare parts, or equipment, and repaid to a local currency fund that is earmarked for future development policies. Current commodity loans could be modified to give priority to companies that initiate or already have ESOPs. Foreign exchange should be made available only to developing countries with serious shortages;

- Low-cost local currency loans channeled through domestic financial institutions for companies seeking to begin or enlarge an ESOP; and

- A loan guarantee corporation to guarantee these loans.

The financial institution disbursing AID funds should conduct feasibility studies to determine the financial impact of any loans used to establish ESOPs. If funds are being used to buy out existing owners, then the firm must present evidence to ensure that competent management will be retained.

Technical assistance could be used to complement financial assistance or be provided separately. Elements of the technical assistance package might include:

- Seminars for corporate managers and host country government officials to explain ESOPs and the AID program;

- Assistance to host-government financial agencies to examine the cost, benefits, and nature of tax incentives for ESOPs;

- Examination of ESOPs as a mechanism to denationalize specific state-owned enterprises;

- Feasibility studies to assess the financial impact of different ESOP designs upon interested companies before they apply for financial assistance;

- Management assistance to help introduce the plans within companies; and

- Seminars with U.S. corporations that have subsidiaries in developing countries to discuss their concerns and determine whether and how the public and private sectors might cooperate to create more incentives for ESOP adoption.

One potential mechanism might be to help establish subsidiaries of companies wishing to invest in countries with difficult political environments. Low-cost loans could be used to match the parent company's investment. This subsidiary would, within an agreed time frame, pass majority control to its employees. The parent company, to ensure high quality and protect its investment, would provide management assistance and an assured market. Employees would have a vested interest in increasing profits, since employee-held stock would be bought with these earnings.

ESOPs must be tailored to fit specific situations. Thus it is impossible to dictate a model to which all companies seeking assistance must conform. Any plan should be designed to meet both AID and company objectives. An ESOP program that AID might implement to improve employee welfare and promote private sector development, using financial and technical assistance, should include the following elements:

- The company should not require employees to purchase stock through salary withholdings; stock should be purchased by using an outside loan or through a pre-tax company contribution;

- All employees should be eligible to participate in the plan; in cases in which no pension fund or social security system is present, the ESOP should be large enough to provide "a safety net" for lower-level employees; employees should be prohibited from selling stock until retirement or upon leaving the firm so that this income is available at this time;

- A publicity program should accompany the introduction of an ESOP so that all employees understand the rights and responsibilities of stock ownership;

- Employees should participate in trust management to the extent possible, without discouraging management from establishing an ESOP; and

- The company should be required to monitor the financial and qualitative effects of the ESOP, to the extent possible. Any promotion program for an ESOP should have an outside midterm and final evaluation to determine whether it merits further support or requires any changes.

These guidelines still leave each company considerable freedom to design the plan that best meets its needs. Following the above guidelines may, however, help avoid some of the problems experienced by the companies the team studied. More detailed recommendations can be found in Annexes A and B.

ANNEX A

NATIONAL FACTORS AFFECTING ESOP ADOPTION: FINDINGS FROM CASE STUDIES, IMPLICATIONS, AND RECOMMENDATIONS

ANNEX A

NATIONAL FACTORS AFFECTING ESOP ADOPTION: FINDINGS FROM CASE STUDIES, IMPLICATIONS, AND RECOMMENDATIONS

INTRODUCTION

Although the ESOP concept is attractive as a tool for broadening capital ownership and providing new benefits for workers in developing countries, its adoption and utility is conditioned by many factors.

In the countries the study team visited, little has been done by the governments to facilitate and motivate the adoption of ESOPs. Yet the legal, political, and economic environments in some of these countries are receptive to ESOPs. This annex exa[illegible] factors that help identify which countries might be [illegible]argets for initiating ESOP programs and what ass[illegible] be applied at the national level. These factors reflect only the most important issues the study team identified during visits to three developing countries; they are not a complete list.

The most important legal factors the study team identified in the countries it visited were the existence of:

- Tax incentives for companies adopting employee benefit plans; and
- Stock ownership rights.

The political orientation of some countries makes ESOPs a potentially useful tool to achieve their goals as well as aid past and future investors. These countries include those that wish to:

- Transfer or sell nationalized companies to the private sector;
- Transfer ownership of foreign companies into local hands;
- Improve employees' welfare; and/or
- Reduce substantial labor unrest.

Two economic factors the team identified were:

- The existence of a relatively stable stock market; and
- The country's need for foreign exchange.

These issues are analyzed by case study and, on occasion, by examples from other cases known to the study team. Since the team studied only a few cases and some factors were evident in only a subset of those examined, any conclusions must be considered tentative.

LEGAL ISSUES

EXISTENCE OF TAX INCENTIVES FOR COMPANIES ADOPTING EMPLOYEE BENEFIT PLANS

COUNTRY	FINDINGS
Zimbabwe	Company contributions to purchase stock on behalf of employees are not tax deductible. Art Printers, for example, contributes 15 percent of distributed earnings to purchase stock for employees. Loans to finance stock purchases for employees are treated like any other business loans. The Dunlop plan, therefore, is designed so that the company repays the loan's interest, while dividends on employee stock repay the principal. No capital gains tax on stock held by employees is expected (normally 30 percent), although this is not yet official policy. There is a 20 percent tax on stock dividends, unless dividends flow to another company; thus, dividends going to the Dunlop Employee Trust are taxed whereas those going to the separate trust the company established on behalf of employees are not taxed until they are distributed to employees. Foreign companies that sell stock to Zimbabwe nationals must reinvest their earnings in Zimbabwe; if these funds are placed in a blocked account, the company may repatriate 9 percent of the principal each year; if they are reinvested then it can repatriate 19 percent of pre-tax earnings. Thus, there are no financial incentives for foreign companies to sell stock to nationals and little financial incentive for foreign companies to invest in Zimbabwe.
Thailand	The government has not provided any tax incentives to encourage the development of ESOPs. Money contributed to such plans must come from after-tax profits or from salaries that are subject to income tax. Dividends are taxed as regular income. Appreciation of stock is subject to a 10 percent capital gains tax but exempted when stock is sold through the stock exchange (then, however, it is subject to a brokerage fee). There are no restrictions on distribution of profit/retained earnings ratios. Newly issued stock can be sold to

employees and existing shareholders at par with no limits. New tax laws are being prepared for 1983, but there has been no sign that employee stock ownership is being considered.

Costa Rica

The present tax and labor code provides a trade-off between tax deductions and the use of working capital. If employers place severance pay obligations into a blind account or an employee association, they may receive a tax deduction. Or, if they choose to make the required accounting entries in the company's books, they do not receive this deduction until an employee leaves. In this case, however, the company's working capital is increased. An employer can keep his working capital and receive a tax deduction if the severance pay obligation is paid to an existing employee association and the association decides to purchase company stock from the company.

This situation is due to change, however, when the tax and labor code is revised in early 1983. The current debate does not yet indicate the course the changes will take.

Guatemala

Tax laws permit the deduction of contributions to a pension fund with government approval on a case by case basis. Pension fund regulations, however, especially as applied to purchase of contributor company stock, have not been developed. Given the recent political changes in Guatemala and a greater concern by government officials for growth with equity, AID might consider providing ESOP-related technical assistance to both government and selected private companies.

The Latin American Area

Tax and trust laws are similar to those in Guatemala and provide an opportunity for AID technical assistance if the target government and private multinational and local companies are interested.

COMMENTS AND CONCLUSIONS: Of the developing countries covered in this study, none had developed tax incentives to promote ESOPs. The tax laws differed considerably among these countries, and there was also a significant difference in the way in which the companies structured their plans to best handle the tax problems. Because of unfavorable tax laws, however, the company in most cases was unable to gain much immediate financial benefit. In the United States, in contrast, the tax incentives allow for more of a balance between company benefit and employee benefit. The companies in developing countries decided to initiate ESOPs because of their interest in benefiting their employees and gaining either a more content work force, political advantages, or both. In the long term, this was an expected benefit, but the linkages were less clear and less sure than if the company could obtain some immediate financial benefit as well.

RECOMMENDATIONS: It is likely that few countries will have already established tax incentives specifically for ESOPs. Some elements in various tax systems may provide some benefits to ESOPs, but considerable expertise and time could be required to ferret these out. More important is the general attitude of government to use tax laws as a means to promote employee welfare and private sector expansion. AID should provide technical assistance to such governments to develop tax laws that would provide an incentive to ESOPs and also meet private sector development objectives.

STOCK OWNERSHIP RIGHTS

COUNTRY	FINDINGS
Zimbababwe	Art Printers had to obtain special permission from the stock exchange to contribute newly issued stock at par to the trust. The stock exchange did not want this stock to be traded publicly but finally agreed to the plan when Art Printers said it would limit sale of the stock outside the trust. (It also threatended to delist if the stock exchange did not approve the plan.)
Thailand	Stock ownership includes voting rights. Stock can be sold both publicly and privately by stockholders without restriction.
Costa Rica	Same as Thailand.

COMMENTS AND CONCLUSIONS: The benefits that individual employees will gain from participation in an ESOP will depend to some degree on the freedom they have to sell their shares. The company may use the ESOP as a form of pension plan whereby the employees can obtain full ownership rights only at retirement or job termination. If there are restrictions on how and where the employee can then sell his shares, however, these impinge on ownership rights and can limit the potential benefit. The only government limitation on ownership rights found in the case studies was the unwillingness of the Zimbabwe stock exchange to allow shares bought by the Art Printers trust at par to be sold on the open market. This condition may limit the benefits of stock appreciation that could accrue to the employees if stock were distributed; it also dampens any move by the trust to allocate stock.

RECOMMENDATIONS: Stock ownership rights are not necessarily an important factor in the selection of countries because most of the rights are determined at the company level and the lack of public market for stock can be offset by internal trading within the company. The major criterion for AID to look for is the right of private ownership of stock.

POLITICAL ISSUES

DESIRE TO TRANSFER OR SELL NATIONALIZED COMPANIES TO THE PRIVATE SECTOR

COUNTRY	FINDINGS
Zimbabwe	It is currently not government policy.
Thailand	The country has a number of state enterprises that consultants from the World Bank and AID have suggested be sold or otherwise eliminated because these firms are a fiscal burden and need not be controlled by the government. Vested bureaucratic, political, and labor interests, however, have resisted such moves.
Costa Rica	The country is currently actively pursuing this philosophy. Specific companies in the sugar, cement, and shrimp industries are being considered for denationalization to worker groups in the private sector.

Examples From Secondary Sources

Saudi Arabia	The government recently transferred ownership of a state-owned, profitable fertilizer factory to the company's employees.
Malta	The shipbuilding and repair industry had been a state-owned enterprise that has a long history of financial loss and remained a burden to the government. In the later 1970s, the government transferred ownership to the workers. This transfer has been studied and documented, but no follow-up study has been done to assess the results.
Mexico	The Mexican government has said it wishes to return subsidiary companies owned by recently nationalized private banks to the private sector. In September 1982, prominent Mexican union and congressional leaders expressed an interest in having workers purchase the firms totally or in partnership with private investors. Given the present critical situation in

the country, its proximity to the United States, and its on going negotiations with the U.S. government, World Bank, and International Monetary Fund, Mexico, although not an AID country, might benefit from initiatives taken to assist it and its workers to denationalize many of these firms.

El Salvador

In 1979, the government of El Salvador nationalized all private banks owned by Salvadoran nationals. The decree also recommended at least 25 percent of the banks' equity be sold to bank employees within a reasonable time. This clause, however, has not been invoked. A new right-of-center coalition has just come to power in El Salvador. It may be an appropriate time for AID to assist the new government to establish an ESOP within the bank sector.

COMMENTS AND CONCLUSIONS: The desire to transfer or sell nationalized companies can be a criterion in AID's selection of countries to offer ESOP assistance. A number of countries may be interested in using ESOPs as a means to denationalize companies or subsidiaries of nationalized companies. There is little evidence available to indicate whether denationalization using ESOPs results in a long-term benefit to the employees or transfers a financial burden of the government to the employees who may not be able to turn the company around. The potential for ESOPs to assist efforts at denationalization is considerable, but many possible pitfalls and difficulties exist in any implementation program.

RECOMMENDATIONS: AID should begin to identify countries whose public companies need not remain in government control, where the government appears willing to denationalize one or more of these companies, and where the compaines have a chance of succeeding in the private sector. The best candidates among the companies would be those that are not doing well because of the inefficiency of public ownership and not because of inadequate markets, high costs of raw materials, or outdated equipment. Since many interested parties who might follow suit will watch the first attempts at transferring ownership, these candidates should be examined carefully to see whether they have the potential for success. A feasibiliity study to assess the potential for productivity gains and eventual profit should be undertaken. In addition, the availability of qualified management and the ability of the company to attract and support such management should be considered.

WISH TO NATIONALIZE OR TRANSFER OWNERSHIP OF FOREIGN COMPANIES INTO LOCAL HANDS

COUNTRY	FINDINGS
Zimbabwe	After independence, the government told multinationals to transfer ownership of their subsidiaries to the Zimababwe public. This prompted Dunlop International to sell 21 percent of its shares to the Zimbabwe public and 4 percent to its employees. The government has also stated its intention of buying control of strategic industries, but currently lacks sufficient funds to achieve this objective.
Thailand	The government established state enterprises after World War II. Since the 1950s, however, government's policy has been to support the private sector, and there has been no interest in nationalizing private companies. The government encourages foreign investment but limits the types of business activities that are open to foreign investors.
Costa Rica	There has been no recent history of nationalization and no plans to nationalize in the future. Instead, the reverse is true.

Examples from Secondary Sources

Guatemala	There is no current threat to nationalize large land holdings under the new government. The critical land tenure situation, however, could force a future more radicalized government to take such action. In July 1982, high-level government and military leaders, including the minister of economy and the president of the National Committee for Reconstruction, formed a working commission with owners of a large privately held estate. The commission's purpose was to promote, as one possible model, a private enterprise approach to land reform. The model will involve both landowners and workers in co-ownership of the estate. AID might consider working with the government and selected private landowners to replicate this approach.

COMMENTS AND CONCLUSIONS: While Zimbabwe may be an extreme case where the government must deal with a high level of foreign ownership under a socialist ideology, many countries insist on local ownership to some degree for foreign investments. They also encourage transfer of ownership into local hands. For governments that do not have sufficient capital to nationalize a company and cannot interest local investors in purchasing the shares, an ESOP becomes an attractive alternative. If the government wants the political gains that can be attained by showing concern for the welfare of workers, an ESOP may be the most attractive option. There is no evidence, however, to indicate how governments will respond to the ESOP option.

RECOMMENDATIONS: AID should begin to identify countries whose policy is to reduce the control of multinational corporations over the local economy and force them (and other foreign investors) to share equity with nationals. In addition, it should also identify countries whose policy is to nationalize companies or industries. AID should then suggest to these governments the option of using ESOPs to achieve their objectives. AID should also promote the ESOP idea among multinational corporations as a means to divest where nationalization threatens them or where the they no longer wish to operate. They may also be interested in partial divesture using ESOPs for political gain to forestall a more expensive loss by nationalization.

EMPLOYEE WELFARE ENVIRONMENT

COUNTRY	FINDINGS
Zimbabwe	The government is committed to improving working conditions. It introduced a minimum wage (still below poverty level for family of six in urban areas); a freeze on salaries above $26,667; workers' councils, which meet with management representatives to discuss issues each month; and industry boards to examine working conditions and wages with management and worker representatives. Each year, these boards must grant approval to companies to continue operations. There is no social security system. Contributions to pension funds may be deducted from pre-tax earnings. There is also a mandatory housing allowance of $6 for employees at minimum wage.
Thailand	Large companies in the Bangkok area adhere to the minimum wage set by the government, but the minimum wage is ignored by small firms and companies outside of Bangkok where the minimum wage is lower but still above the level most companies are willing to pay. Annual increases in the minimum wage are expected. For the next year, however, the government has decided to freeze the minimum wage, and unions are contesting the decision. Contributions to pension funds can be considered a pre-tax expense up to 9 percent of salary, and the pension fund must be administered outside the company. The Revenue Department is suing Bangkok Bank for taxes on its Pension Fund I because it is administered within the company. A wide range of benefits (including housing, low-cost loans, and automobiles) can be taken by the company as pre-tax expenses. The general view of government, however, is that it looks more favorably on business than on worker welfare. Many small companies are known to exploit their workers, and some of the large companies offer few benefits. There is no social security system.

Costa Rica	Costa Rica provides well for its people in both the public and private sectors. Government programs and legislation provide for worker welfare and protection. The private sector has a large number of enlightened managers and entrepreneurs who look after their workers. There is no social security system.

COMMENTS AND CONCLUSIONS: The attitude of a government toward its workers will be a factor in its interest in promoting ESOPs. Of the three Third World countries the team studied, only Thailand showed a relative lack of interest in the welfare of its workers.

RECOMMENDATIONS: AID should consider this criterion to be important in identifying countries in which to promote ESOPs.

SUBSTANTIAL LABOR UNREST

COUNTRY	FINDINGS
Zimbabwe	After independence, the government sanctioned strikes and encouraged the growth of labor unions. Now it is trying to promote better worker-management relations and discourage strikes to stimulate economic growth.
Thailand	Unions have not been successful in Thailand. Workers see them as being interested in the welfare of union leaders and not helping the rank and file. In some companies they have minor influence, but in many others they have low membership or have been rejected.
Costa Rica	Union activity in Costa Rica is strong and relatively well organized. The only sector that experiences substantial labor unrest is the banana industry, where unions are said to be guided by communist organizers. It is of particular interest to note that the companies that have been involved in ESOP-type activities over the last 30 years (70 companies) have had only one strike. Neither of the two companies interviewed had unions, nor did the workers interviewed think that one was necessary.

COMMENTS AND CONCLUSIONS: In the United States, ESOPs have a reputation for creating an environment in which the workers see the point of view of managers and owners (since the workers are also owners). As a result, the workers are less likely to strike and endanger their own profits. There is a tendency for communication between labor and management in ESOP companies and therefore more likelihood that problems can be resolved before they reach crisis proportions. An ESOP therefore becomes an attractive tool to governments that want to reduce labor unrest and to companies that want to improve worker-management relations. In the countries the team studied, labor unrest was not a major problem, and the direct effect of ESOPs on labor problems could not be observed. The companies studied had a reputation for less labor unrest than other companies in their respective industries and environments. Most of them had a reputation for benevolence to employees, with the ESOPs being only one small benefit.

RECOMMENDATIONS: AID should begin to identify countries whose government is interested in finding a means to quell labor unrest. It should then hold discussions with appropriate government officials to develop strategies for using ESOPs to achieve government objectives.

ECONOMIC ISSUES

STOCK MARKET EXISTENCE AND STABILITY

COUNTRY	FINDINGS
Zimbabwe	The country has a small, volatile stock market, which has been extremely depressed during the past year. The price of Dunlop stock, for example, is currently at one-third its 1980 value.
Thailand	The Securities Exchange of Thailand was established in 1974 under the control of the Ministry of Finance. The exchange grew rapidly through 1978 but then went into decline in early 1979. That same year, new regulations were imposed to control the behavior of finance companies in exchange activities. The Capital Market Development Fund was also established under the management of the Industrial Finance Corporation of Thailand to buy stocks to support prices and motivate other investors. The exchange is still subject to substantial fluctuation.
Costa Rica	Costa Rica has a small stock market. Almost all stock transfers are handled privately through legal representatives. Stability of stock prices and value should be a major concern, however, in these bleak economic times.

COMMENTS AND CONCLUSIONS: Unstable stock markets can cause stock prices to drop sharply at periods when employees want to sell their shares for retirement. When the ESOP is used as a pension plan, unstable stock markets can diminish the security of the plan. Not many Third World countries have stock markets, but those that do generally have unstable markets. As in the Dunlop case where the price of stock was critical to the plan's operation, a sharp drop in the market as a whole (despite Dunlop's continued good performance) put the Dunlop stock price so low that the sale of stock to employees had to be abandoned. Stock market volatility may not be a problem for plans whose stock is offered at par and held for a long period of time, the objective being income rather than appreciation. Moreover, plans whose stock is not publicly traded but rather repurchased by the trust or the company on a formula basis avoid the pitfalls of the stock market.

RECOMMENDATIONS: A strong, stable stock market is an added benefit for any country selected for an ESOP program. Since most developing countries will not have well-established stock markets, however, the ESOP program should be oriented more toward private stock trading. ESOPs may provide a mechanism by which countries may promote a stock market. Companies may first establish ESOPs to broaden capital ownership and then begin trading stock among these companies. This would be a preliminary step toward larger trading activities.

NEED FOR FOREIGN EXCHANGE

COUNTRY	FINDINGS
Zimbabwe	As a result of a drop in exports and mineral prices, Zimbabwe has a critical shortage of foreign exchange. The government has imposed severe foreign exchange restrictions and quotas on imports. As a result, manufacturing companies lack imported raw materials, spare parts, and capital equipment. Thus, both the government and the private sector are very receptive to assistance programs that provide foreign exchange and imported goods.
Thailand	Historically, Thailand has never had a critical foreign exchange shortage. From 1978 to 1981, however, the public external debt increased an average of 50 percent each year, and balance of trade steeply declined. In 1981, the baht was devalued, and some mild steps the government took to stop the downslide seemed to have worked. Therefore, neither the government nor the private sector will likely make accommodations to obtain foreign exchange assistance.
Costa Rica	Costa Rica has experienced a 650 percent devaluation in the past 18 months. This has led to a critical foreign exchange shortage.

COMMENTS AND CONCLUSIONS: The government and the private sector of countries facing severe foreign exchange shortages may be receptive to ESOP program development, especially if tied to the infusion of foreign exchange.

Foreign exchange may be used by companies to purchase imported raw materials, spare parts, and capital equipment. It may also be exported for foreign investment. If a foreign exchange loan is used to purchase stock on behalf of employees and tied to the purchase of productive equipment, then, assuming that such assets were the critical constraint inhibiting growth, sales should increase, and profits rise. In addition, the value of shares should reflect this improved performance. If dividends rise in response to increased earnings, then employees would receive short-term gains (faster loan pay-off or increased income) as well as see the value of their shares appreciate. If the company generates foreign exchange through exports of its products or saves foreign exchange through import substitution, then the country would be in a better position to repay the loan in foreign currency.

If, however, the loan is used to enable employees to buy shares in a company that reinvests abroad, then the infusion of foreign exchange will not have positive influence on the company's financial performance. In fact, if the company's management leaves with these earnings, the company can be expected to decline unless its employees have been well trained to assume these responsibilities. In this case, if the financial condition of the company deteriorates, it is likely that the employees will default on their loan, the value of their shares will decline, and employees' income will decline as dividends disappear. The transfer of ownership without the retention of good management will end in failure for all concerned.

RECOMMENDATIONS: In countries where AID already has a program to provide foreign exchange loans for use by the private sector, AID might consider tying those loans to enabling employees to purchase stock in the companies involved. In Zimbabwe, for example, AID is providing $50 million each year over three years to permit private firms to purchase U.S. equipment and parts. These firms then repay the loans to the government in local currency that is earmarked for development projects. If the promotion of ESOPs were seen as a priority by the government and AID, then a stipulation might be made either (1) giving preference to firms with ESOPs, and/or (2) indicating that these loans should be used to purchase newly issued stock on behalf of employees and the capital still used to purchase U.S. equipment and goods. Method of loan repayment, preferential tax treatment, and other specific aspects of such a plan would, of course, require further in-depth examination.

ANNEX B

COMPANY-SPECIFIC FACTORS THAT AFFECT ESOP INTRODUCTION AND IMPACT

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INTRODUCTION

The companies the team studied shared certain characteristics that made them receptive to ESOP adoption. These factors might therefore be a useful starting point from which to identify future ESOP companies in developing countries. The key factors were the companies':

- Reasons for establishing an ESOP;
- Employee welfare ethic ;
- Retirement security program; and
- Size.

Other company-related factors that have been mentioned in the discussion of the ESOP model were not found to be critical factors in these cases. A larger sample would undoubtedly reveal a longer list of factors that were critical to ESOP introduction within companies.

In addition, the team identified the influence of some key design issues that influenced the ESOP's impact. The second section of this chapter explores the relationship of certain ESOP design characteristics and their impact and offers recommendations based on these conclusions. This section includes many of the issues mentioned in Chapter Three and adds some new ones that the study team identified. These ESOP design issues include:

- Method of providing stock to employees:

  -- Through a loan from an outside financial institution,
  -- Through a loan from the company to an employee trust, or
  -- Through a company contribution.

- Percentage of total shares owned by employees;
- Profit distribution policy;
- Method of stock allocation to employees:

  - -- Proportional to salary,
  - -- According to length of service, or
  - -- According to salary and length of service;

- Employee stock ownership rights;

- Employee participation in trust management;

- Using the ESOP as collateral for loans; and

- Communication about the plan.

The findings discussed in this chapter often involve considerable technical detail since they are directed at those interested in specific issues rather than a broad overview. It is to be hoped that a fuller understanding of the reasons behind the team's recommendations will be gained as well as an appreciation for the complexity of the issues involved.

COMPANY-SPECIFIC FACTORS THAT AFFECT ESOP ADOPTION

COMPANY REASONS FOR INTRODUCING AN ESOP

COMPANY	FINDINGS
Bangkok Bank	The bank has created a second pension fund, Provident Fund II, which could not earn tax-free interest (unlike the first pension fund). The bank's management allowed stock to be purchased at par from this fund as a means to earn income on that savings. In addition, the bank's management wanted the employees to feel like they were part owners and more closely linked to the company. The original objectives, therefore, were a combination of increasing employee benefits and developing better employee-management relations.
Saha Union	The company's intention in setting up the ESOP was to have a more supportive work force. The company's president and originator of the ESOP was quoted as saying that a house standing on 11,000 bamboo poles is stronger than a house standing on only one pole. The company would obtain this support by sharing ownership with its employees.
Art Printers	The main reason for the ESOP is political. The company is under pressure from the government to show more concern for the welfare of its workers. As a result of the socialist ideology espoused by the government, the company took steps to mollify the government before change was forced upon it. The company already had a reputation for treating its workers well, and the ESOP could be an additional benefit.
Dunlop	Dunlop, a totally British-owned company at independence, established its ESOP with 4 percent of its shares and sold 21 percent to the Zimbabwe public in an attempt to avoid nationalization.
Coopemontecillos	To resolve this cooperative's financial crisis by obtaining a loan, its employees had to

	pledge their salaries as collatoral. In return, they demanded that stock be allocated to them.
La Gloria/GLYSA	The owners of La Gloria were part of a movement called the Solidarity Union that fostered employee ownership programs. They found that the government's severence pay requirements could be met by using a fund that could purchase company stock. The ESOP, therefore, was a means to enhance employee benefit by providing income and appreciation to severence pay funds.
Allied Plywood	The owners set up the ESOP to sell the company to the employees. They did this to maintain the job security of the employees and to gain a substantial tax advantage from the sale.
E-Systems	Management wanted to be able to attract quality employees and be able to hold onto these people for their professional lives. They felt that the ESOP would accomplish this because of the benefits the employees would gain from ownership. Management was interested in the tax benefits that could be gained from leveraged financing through the ESOP; the purchase of a large block of stock on the public market for employees made the company less vulnerable to a corporate takeover.

COMMENTS AND CONCLUSIONS: Most of the companies the consultants studied were interested in increasing benefits to their employees as a major ESOP objective. Although the companies saw this as a means to achieve a closer relationship between employees and the company, smoother worker-management relations, and lower staff turnover, they rarely mentioned increased productivity or how the ESOP will affect profits. Three of the ESOPs had financing as one of the motives and two of the companies had political motives.

RECOMMENDATIONS: There can be many reasons why a company would want to set up an ESOP. AID advisers should look for companies that might have financial needs or see political gain from an ESOP. For some companies, the ESOP may provide an important improvement in worker-management relations. The only common pattern among the cases was an interest in employee welfare, which could be a factor to look for in selecting initial participants in an ESOP assistance program.

COMPANY EMPLOYEE WELFARE ETHIC

COMPANY	FINDINGS
Dunlop	Since benefits to employees have traditionally been good, management did not expect the stock plan to have any effect on worker productivity or worker-management relations. Management hoped it would reduce turnover, which had traditionally been low, but turnover among the artisans and management staff had dramatically increased as a result of the political-economic environment.
Art Printers	The company has a reputation for taking good care of its employees. Wage levels are high; extra benefits include subsidized housing, free canteens, a pension plan, and two bonus systems. The ESOP fits into a company pattern of concern over employee welfare.
Bangkok Bank	The bank provides a wide range of benefits including high bonuses, pension plans, medical care, and financial assistance for housing and other personal needs. For a new employee, the ESOP is just one more benefit among the many. For employees with longer service, however, their ESOP accounts have grown large enough to become noteworthy.
La Gloria and Coopemontecillos	Both of the Costa Rican cases represent organizations that are members of the Costa Rican Solidarity Union. For the past 30 years, the union has strongly advocated the close and necessary collaboration among workers, management, and owners, as well as a just distribution of profits among these groups. Furthermore, both groups have had, and continue to have, excellent employee benefit programs in addition to their broadened ownership programs.
Allied Plywood and E-Systems	Both companies have shown concern for their employees' welfare. The owners of Allied Plywood especially were worried about employees losing their jobs or cash bonuses if the company were sold to a major conglomerate.

COMMENTS AND CONCLUSIONS: All of the companies studied had a reputation for taking good care of their workers before initiating the ESOP. In all of the cases, the non-ESOP benefits are so strong and so varied that it was not possible to isolate the effect of the ESOP on employee productivity. Surprisingly, in some of the cases management commented that benefits were already so good that it was unlikely the ESOP would further improve productivity. Yet the company still wanted to initiate an ESOP program. Increased productivity was therefore not the guiding principal for the companies. Many of the management people interviewed explained the plan as being directed toward employee welfare and not necessarily company welfare.

RECOMMENDATIONS: AID should begin its program with companies that already demonstrate their interest in employee welfare. The productivity gains from an ESOP may be less in these companies, due to the productivity level already achieved from other benefits, but it will be helpful to have strong management support for the initial introduction of ESOPs in a country.

USING AN ESOP AS A PENSION PLAN

COMPANY	FINDINGS
Bangkok Bank	The financing for the ESOP came from the Bank's Provident Fund II, which is a pension fund, although a secondary one compared to Provident Fund I. The bank views the primary fund as a secure source of retirement income for its employees and does not use the money in that fund for anything but straight savings for 10 percent tax-free interest.
Saha Union	The company does not have a regular pension fund but uses the ESOP as a means to provide some retirement benefits to employees. The contributions to the ESOP come from salary deductions that are used to purchase stock at par. Employees can sell their shares only upon retirement or termination of employment.
Art Printers	The company contributes a sum equal to 7 1/2 percent of salary or wages to the pension fund, which is separate from the ESOP.
Dunlop	The company has a pension plan, which is separate from the ESOP.
Coopemontecillos and La Gloria/GLYSA	Neither company has a pension fund for employees; thus, in effect the ESOP may serve this function.
Allied Plywood	The company does not have a pension fund because the owner did not believe in such funds and refused to set one up. The ESOP serves as a form of pension fund because the stock cannot be sold until an employee retires or leaves the firm.
E-Systems	Although E-Systems has a cash retirement plan, employees view the ESOP as their principal retirement asset. Since the inception of the ESOP, there has been an annual 10 percent stock dividend, and three splits of 60, 33.3, and 100 percent. Thus, the stock value has greatly appreciated over the years. In 1973,

for example, 100 shares were worth $900, at $9.00 per share; in 1982, those same 100 shares have become 470 shares with the per share value being $38.00, a full 20-fold increase.

COMMENTS AND CONCLUSIONS: ESOPs often have restrictions on stock sale whereby the employee can market his shares only upon retirement or termination of employment. Thus, the ESOP represents one kind of pension fund. However, in a number of countries, for a fund to qualify as a pension fund and gain some of the tax benefits that are accorded to pension funds, the money cannot be used for speculative purposes. Furthermore, in some cases it must be managed by a third party. In Thailand, for example, tax breaks are available for company contributions to pension funds up to 9 percent of an employee's salary, but the fund must be managed by an independent company. Bangkok Bank was managing its own pension fund and was therefore being sued by the Revenue Department of the government. In the United States, special tax breaks are also available for the ESOP, and unlike the pension funds, the ESOP contributions go right back into the company as new capital. Although the company can gain, the loser can be the employees whose retirement income is more at risk than it would be under a pension plan. In the United States, pension plans are insured by the government's Pension Benefit Guaranty Corporation. In other countries, however, pension plans may be administered by third parties but may still be risky. Many countries do little to encourage pension plans and their absence may make an ESOP particularly attractive.

RECOMMENDATIONS: AID technical assistance should be sensitive to the need in some Third World countries for special retirement security systems. If there is no prospect for establishing a legitimate and secure pension fund, an ESOP represents a good alternative. An ESOP, however, should not be used to replace pension funds that provide adequate security; company stock might be added to other pension fund investments to reduce the employees' risks but provide them with a stake in their own company. In any case, the risks and benefits associated with ESOPs should always be carefully compared with other means of providing employees' retirement security.

COMPANY SIZE

COMPANY	FINDINGS
Bangkok Bank	This company is the largest commerical bank in Thailand and ranks 221st among the world's commercial banks. It has 17,200 employees.
Saha Union	One of the largest textile manufacturers in Southeast Asia, Saha Union also manufacturers related products such as buttons, tape, rubber and shoes. In the total family of Saha Union companies (all participate in the ESOP using the stock of the holding company), there are a total of 11,000 employees.
Art Printers	The company has five subsidiaries (all in manufacturing) and is, itself, a subsidiary of the Nedlaw Group. The total number of employees in the five Art Printers' subsidiaries is 1,342.
Dunlop	This company has a monopoly on tire manufacturing in Zimbabwe and also produces sports and other consumer products. It has a total of 1,350 employees.
La Gloria/GLYSA	This combined company is the largest department store chain in Costa Rica. The total number of employees for the two companies is 467.
Coopemontecillos	The cooperative is the largest meat exporter in Costa Rica. It has 1,125 cattlemen and 826 employees; 1,950 members in all.
E-Systems	The company specializes in electronics and has a major role in the U.S. electronic warfare industry. Sales this year may reach $750 million. The number of employees is 12,000.
Allied Plywood	Although this company has only 20 employees, its sales in 1981 totaled $7.8 milion.

COMMENTS AND CONCLUSIONS: All of the companies the study team visited in the Third World are large and play dominant roles in their respective industries. In the United States, one company, Allied, was small, although its sales were high in proportion to the number of employees. Four of the Third World companies' stock was traded on the stock market, and their bookkeeping follows government regulations.

Private companies in Third World countries, in general, will likely make an effort to avoid taxation and not have clear records for tax collectors to observe. In the opinion of many business people interviewed in this study, the smaller the company and the fewer the owners, the more likely this will happen. Even if the books are well kept, they may not be open to outsiders, non-owners, or even the employee stock ownership trust of a small private company. At La Gloria, owned by two brothers, little is known about the internal financial situation. Although the La Gloria employees own GLYSA and GLYSA profits are known, certain cash flow transactions between GLYSA and La Gloria are not reported to the employees.

The prospects for ESOP support by the employees will be greater if they can be informed about the company's financial situation and have confidence in the information they receive. Large public companies will be more likely to have such information available.

RECOMMENDATIONS: AID ESOP advisers should avoid companies where there is a possibility that proper financial information will not be available to employees. Some small companies may qualify as good ESOP candidates in this regard, but large, public companies may be the more likely candidates.

ESOP DESIGN CHARACTERISTICS THAT AFFECT ESOP IMPACT

METHODS OF PROVIDING STOCK TO EMPLOYEES

Loan From Outside Financial Institutions

COMPANY	FINDINGS
Dunlop	The Employees Trust received a loan to purchase shares on behalf of employees. Post-tax dividends on stock repay the principal while Dunlop covers the trust's administrative expenses and interest charges, which are deductible as a pre-tax expense. The three-year loan has a rollover provision and can be easily adjusted if dividends do not cover payment charges. Employees receive no dividends until the loan is fully repaid -- perhaps as long as 10 years in this case. Thus, they have little interest in the stock ownership plan until they receive tangible financial benefits.
E-Systems	The original purchase of 500,000 shares of E-Systems stock was made possible through this first U.S. leveraged ESOP. The Employee Stock Ownership Trust requested and received a loan of $7 million from a commercial bank for the purchase of stock. The company guaranteed the loan, and the stock itself became the collateral. This loan was fully paid off in seven years through yearly company contributions of 2 percent of total salaries to the trust, which then paid the bank.
Allied Plywood	From 1976 until June 1982, Allied has used a non-leveraged ESOP. The company contributed an average of $130,000, equivalent to approximately 10-25 percent of annual payroll (a government regulation sets 25 percent as the maximum annual contribution), but there was no set formula determining employer contributions. The ESOP trust purchased stock each year from the principal owners at its equivalent market value (based on real asset value). Until June 18, 1982, the ESOP had

acquired 44 percent of Allied common stock. In June, the trust secured a loan from a local bank to purchase the remaining 40 percent from the owners. The trust will pay off the loan with annual pre-tax contributions from the company. The remaining 16 percent is held by individual employees outside the trust.

COMMENTS AND CONCLUSIONS: In the United States, special tax laws to support ESOPs allow companies to borrow money and repay interest and principal as a pre-tax expense. As a result, leveraged financing has become a very popular means to finance an ESOP. In the countries the study team visited, governments had not yet developed tax incentives to support ESOPs. Without any special advantages to the company to borrow money for stock purchases, only one company, Dunlop, chose to use loan financing.

RECOMMENDATIONS: AID could provide technical assistance. U.S. tax specialists could assist governments to restructure their tax laws to promote leveraged financing for ESOPs. Leveraging allows for much larger blocks of shares to be purchased for employees, but the tax breaks need to be sufficient for the companies to obtain direct financial benefit from the leveraged ESOP. This would be the case if principal payments could be deducted from pre-tax income. AID could also provide tax specialists to work with trade associations or consortiums of companies in selected countries to develop tax strategies that these groups could then suggest to their governments.

AID could also provide financial assistance. Through governments or local banks, it could provide low-cost loan capital to companies in need of capital and willing to channel the funds through an ESOP. This could be done in countries where the prospects for changing tax laws are bleak and where the low-cost loans would serve as a carrot rather than the tax break on a normal loan. The amount of discount of the loans would depend on the availability of loans through normal channels and the degree of resistance of companies to set up leveraged ESOPs without any special discounts or tax breaks on the loans.

Financial assistance would also be attractive to countries and companies whose foreign exchange is scarce. The U.S. loans could be made available for purchase of U.S. commodities but tied to the creation of an ESOP. For commodity loans not in the ESOP program, one of the selection criteria for offering the loans could be the existence of an ESOP.

Loan From the Company to the Employee Trust

COMPANY	FINDINGS
Saha Union	Saha Union's financial investment company gave an interest-free loan of $300,000 to enable the Employee Trust to purchase stock at par value. Employees repaid the company through deductions from their salaries. This method provided no financial benefit to the company.
La Gloria	The original 35 percent of GLYSA stock was lent interest free to the Employee Association to be repaid, within 7 years, out of profits made from the investment of severance pay monies allocated by La Gloria/GLYSA to the association. Voting and dividend rights were passed through before the loan was repaid.

COMMENTS AND CONCLUSIONS: In the two examples of company financing for the ESOP, the loans were made at the expense of the company on an interest-free basis. The trust or Employee Association was thus able to purchase a sizable number of shares without having the cash at hand. When the shares are newly issued, the money lent by the company to the trust is quickly returned to the company upon the purchase of the shares. The company has thereby created new shareholders with its own capital. This dilutes the shares of existing shareholders without adding new capital to the company until the loan starts to be repaid. The cost of the loan is the decrease in dividends per previously existing share and possible decrease in value of these shares until the loan is repaid (and the new capital employed).

To the extent that the loan is repaid with money the employees (or their trust or association) would receive from the company regardless of the existence of the ESOP, the ESOP provides a means of chaneling these funds back into the company as new capital. If the loan is repaid with money the employees receive as an added contribution from the company specifically for the ESOP, the loan is just a mechanism for the company to speed up the purchase and then pay out the contributions over time using its cash flow.

RECOMMENDATIONS: Since an internal loan (company to trust) represents one possible mechanism to facilitate the purchase of stock in certain circumstances, any technical assistance offered by AID should include consideration of this option for specific companies.

Company Contribution

COMPANY	FINDINGS
Art Printers	The company contributes 15 percent of distributed profits to the trust each year until the total number of shares purchased by the contributions equals 15 percent of total issued shares. Since the contribution is from distributed profits, it is directly at the expense of the company's shareholders, who have approved the plan. The contribution goes back into the company as new capital.
Bangkok Bank	The bank makes a monthly contribution for each employee to its Provident Fund I (a pension fund). The contribution is equal to 10 percent of the employee's post-tax salary but is a pre-tax expense to the company and is not taxed to the employee. The money in the pension fund earns tax-free interest of 10 percent per year compounded annually. At the end of five years, an additional contribution to the employee is made of a sum equal to 50 percent of the total amount accumulated in the pension fund. This additional contribution, deposited into Provident Fund II, comes from the bank's after-tax earnings. The contribution is not taxable to the employee and does not earn interest. At the bank's next issue of stock, the Provident Fund II is swept clean to purchase the available shares, and the bank makes certain that there are always enough shares available to do this. When an excess of shares are available, employees with more than 10 years of service can purchase the remainder from their replenished accounts in Provident Fund II or from personal savings. The amount of the remaining shares that each employee can purchase is limited by a ratio of one share to a predetermined number of shares he already owns. Provident Fund II is replenished at the end of 10 years of service, again by a contribution equal to one-half of the amount accumulated in Provident Fund I. This contribution is more than twice as large as the first contribution since salary levels will have increased during the period, and therefore the monthly pension

fund contributions will also have increased. Although the second contribution to the Provident Fund II is much larger, however, and also does not earn interest, only a small portion can be used to purchase shares since fewer shares are made available.

Coopemontecillos

The cooperative will distribute profit as dividends in some years while in others it will retain profits and issue new stock as dividends instead of cash. It thereby finances the issuance of new stock through retained earnings.

E-Systems

After the original loan was repaid, the company continued to contribute an amount equivalent to 2 percent of annual payroll to the Employees Trust. The trust purchases company stock on the open market to be allocated to the individual employee accounts.

Allied Plywood

Allied began its ESOP through annual company contributions, but applied outside financing and a leveraged repayment to purchase the remainder of stock owned by Allied's original owners.

COMMENTS AND CONCLUSIONS: In all of the above cases, the company's contribution to the plan for the purchase of shares is returned to the company as new capital. In effect, the contribution increases retained earnings if the profit used to make it would have otherwise been distributed and not returned. The cost of the contribution is the dilution of existing shareholders' equity since the overall capital in the company remains the same, but the equity (and profits) must be distributed over a greater number of shares. This loss to existing shareholders may be balanced by such positive effects of the ESOP as increased employee productivity, political gains, and better worker-management relations.

RECOMMENDATIONS: Since the cost of the company's contributions is to the existing shareholders, they must see the potential for benefits in increased dividends or stock appreciation before giving their approval. AID technical assistance could recommend tax incentives (such as the 1 percent tax credit in the United States) for company contributions to an ESOP. AID could also seek to demonstrate an ESOP's potential to generate greater employee productivity and other positive results.

PERCENTAGE OF TOTAL SHARES OWNED BY EMPLOYEES

COMPANY	FINDINGS
La Gloria/GLYSA	La Gloria is totally owned by two brothers. GLYSA is also owned by them as well as outside investors and the Employee Association of the combined work force of La Gloria and GLYSA. Thirty-five percent of GLYSA stock is owned by the association. This will not change unless the company requires additional capital.
Coopemontecillos	The employees own 20 percent of total shares in the cooperative. Since stock is voted on a one-person, one-vote basis, the employees actually control 42 percent of the votes. Changes in this percentage will only occur if there is a change in the relative bargaining power between cattlemen and employees, or in the case that more employees are hired and decide to purchase additional shares at a rate greater than the cattlemen.
Dunlop	Dunlop Zimbabwe was a wholly owned subsidiary of Dunlop Holding Company (United Kingdom) until 1980 when 25 percent of the Dunlop Zimbabwe stock was sold on the local Zimbabwe market. Of the stock available, the subsidiary bought, at market price, 900,000 shares for its employees. This stock is allocated to the employees on a formula basis, with dividends from allocated shares or voluntary salary contributions used to pay for the shares over time. When and if the 900,000 shares become fully owned by the employees, their percent of total shares will be 4 percent. Currently, the employees own about 1 percent; it represents so small an amount compared with wages and other benefits that the employees have little interest in the plan.
Art Printers	The objective of the ESOP is to have the trust own 15 percent of total shares. To realize that goal, the company contributes 15 percent of distributed profit to the trust each year until the objective is reached. The company has made only the first year's contribution, which amounts to about 1.7 percent of total shares. The employees see that it will take a long time (nine years or longer at current profit levels) to reach the 15 percent level.

Bangkok Bank	Because the plan has already been operating for 18 years, the employees have built up their ownership level to about 9.6 percent of total shares. Of this amount, the older employees have the larger holdings. The dividends they receive and the value of their stock at retirement are substantial enough to create considerable enthusiasm about the plan.
Allied Plywood	All of the stock is employee owned. Eighty-four percent is held by the ESOP trust and 16 percent by two employees outside the trust.
E-Systems	About 2.6 million out of a total 13.0 million shares are owned by the Employee Trust. This is presently 20 percent and will grow at a rate that depends on E-Systems' profitability and contributions to the trust.

COMMENTS AND CONCLUSIONS: In none of the companies studied in the Third World was ownership by employees great enough to give them a controlling interest. La Gloria/GLYSA's employees held the largest percentage of company stock among overseas cases. The percentages owned by employees in the Zimbabwe and Thailand companies are quite low (maximum of 9.6 percent currently in Bangkok Bank); although the percentages are slowly climbing each year, employee control does not look probable for any of them.

Despite the low percentages, individual employees in some of these companies are reaping what they see as big rewards. In the Costa Rican companies, for example, the employees were pleased with their percentage of ownership. In Bangkok Bank, the employees with lengthy service were pleased with the return on their stock, and in Dunlop the length of service criterion for stock distribution concentrated the best benefits in the hands of the lower level, long-service employees. In Art Printers, the plan was too new for employees to see any direct financial benefits, but the communications program and election process for the trustees contributed to the employees' interest in the plan.

While the effect of the plans on productivity cannot be measured in this set of case studies, one can assume that a prerequisite for increased productivity would be interest in the plan from the employees and that the plan was an additional benefit. This was clearly the case in the Costa Rican companies, Art Printers, Bangkok Bank, and to a much less degree in Saha Union and Dunlop. These factors correlate with the percentage of stock owned by or promised to the employees.

RECOMMENDATIONS: AID technical assistance should be oriented to long-term results. Third World workers have little experience with stock ownership and often will start believing in the plan only when they can actually see the flow of benefits. This may take considerable time to achieve, depending on whether there is leveraged financing and whether profit levels and stock prices allow for adequate financial returns. The percentage of stock owned by the workers will be less important than the improvement the ESOP makes in their income and/or retirement security. A small percentage of stock in a company with a high capital/labor ratio and ESOP benefits oriented to the lower level employees may have a more dramatic effect than a higher percentage of stock in a company with a lower capital/labor ratio and stock distributed by salary. As a general rule, however, AID should try to maximize the percentage of stock and to see that it is acquired as rapidly as possible. There should be no minimum percent of shares required for an AID-supported ESOP.

PROFIT DISTRIBUTION POLICY

COMPANY	FINDINGS
Art Printers	The company's contribution to the trust of 15 percent of distributed profit (each year until the trust owns 15 percent of total issued shares) is a direct, immediate loss of dividends to shareholders. The company had been distributing a major share of its earnings, but the level of retained earnings has increased over the last few years. This can be attributed to the need for capital for the new tissue plant and would not reflect a change in long-term policy.
Bangkok Bank	In spite of the rapid expansion of bank operations and the added cost of its new headquarters in Bangkok, dividends have been high (9 percent of the share price and 34 percent of par in 1980, 16 percent of the share price and 52 percent of par in 1981). Distributed profit has traditionally been 40-50 percent of net profit but went up to 59 percent in 1980 and 95 percent in 1981. Distribution is not expected to continue at such a high level.
Coopemontecillos	There is no set policy. Some years all profits are distributed. Other years they are retained and, instead, new stock is given to shareholders as a form of dividend.

COMMENTS AND CONCLUSIONS: There is no clear pattern of profit distribution among the companies studied although all of the plans stress the importance of dividend income to employees. The more income the employees receive from their stock, the more interest they have in the ESOP. A high level of retained earnings may increase the value of their shares, but they will not see this profit until they leave the company.

RECOMMENDATIONS: If the object of the ESOP is to improve worker-management relations, then dividends will increase its impact. If AID sees a need to stress retirement security, however, retained earnings can remain high without adversely affecting retirement security. AID should also be sensitive to the company's needs for capital expansion through retained earnings. No single policy or strategy regarding profit distribution will fit all ESOP situations.

METHOD OF ALLOCATION TO EMPLOYEES

Stock Allocation Proportional to Salary

COMPANY	FINDINGS
Saha Union	On a monthly basis, 5 percent of the post-tax earnings of salaried employees or one day's wages of daily laborers was deducted to buy newly issued company stock at par value (100 baht) although market value was significantly higher (currently 156 baht). A total of 24 million baht worth of shares was transferred to workers, representing 6 percent of outstanding stock, in three new issues in 1978, 1980, and 1981. Since a wide gap in salaries exists, lower paid employees receive minimal benefits from the ESOP but top executives receive significant financial advantages. Thus, a blue collar employee with Saha Union for seven years received 16 shares that earned 320 baht (approximately 4 days wages) in dividends in 1982 -- and has a market value of 2,500 baht.)
La Gloria	Stock benefits per employee are based on salary levels, which in turn are based on education, work experience, and tenure.
Coopemontecillos	Seventy-eight percent of the cooperative's yearly profits are distributed to the cattle producers, who receive shares and dividends based on the number of head marketed through the organization. Twenty-two percent of the yearly profits is distributed to the workers, who receive shares and dividends based on their salaries.
Allied Plywood	Corporate cash contributions to the ESOP are equal to 10-25 percent of annual payroll (a government regulation sets 25 percent as the maximum annual contribution), but there is no set formula. Stock purchased with these contributions is allocated to each employee based on total employee compensation, which includes cash bonus benefits and salary. Seniority is not considered except as reflected in higher cash bonuses and wages to older employees.

COMMENTS AND CONCLUSIONS: When stock is allocated according to salary levels, those at the bottom will receive relatively insignificant benefits and the gap between the lowest and highest paid employees will remain the same. This method of allocation may be most appropriate for companies with relatively uniform salaries or those wishing to offer incentives to middle and top management.

RECOMMENDATIONS: If AID wishes to target ESOP benefits to lower paid employees, then it should not encourage plans that allocate stock in proportion to salary. Exceptions to this rule include plans that allocate significant numbers of shares to those at the lowest salary levels or to firms with relatively homogeneous salaries. Another option would be to use formulas based on salaries that allocate greater amounts of stock to target groups. Stock, for example, might be allocated proportionate to salary and benefits only until a certain ceiling is reached.

Stock Allocation According to Length of Company Service

COMPANY	FINDINGS
Dunlop	All employees who had worked with Dunlop for at least one year as of November 1980 had 40 shares allocated to their accounts for each year of service. Each employee could also purchase an additional 20 shares per year of service through a payroll deduction over one year. Each year, employees completing one additional year of service may purchase 40 shares on a cash basis. Shares available to employees through these company plans cost $2.40 (1980 original price) whereas the actual market price has declined to $0.90. Once dividends on shares have repaid the loan required to purchase them (in about 1990), then dividends could account for a significant portion of long-term blue-collar workers' wages and provide a significant windfall at retirement. This plan, however, provides insufficient incentive for higher salaried, long-term employees to remain with the company.
Bangkok Bank	Employees receive their first block of shares at the first issue of new stock after the end of their fifth year of service. The bank finances additional purchases of stock after the end of the tenth year. The employee turnover rate is less than 1 percent per year, but causality is difficult to assess given the number of other benefits available as well as less clear social and economic factors.

COMMENTS AND CONCLUSIONS: When stock is allocated strictly according to length of service, the plan has a high potential for providing important benefits to lower paid workers. Depending on the amount of stock offered, dividends could become a significant source of outside income and, upon retirement or leaving the firm after many years of service, a windfall (in comparison with a worker's annual salary). This type of plan would be less attractive to highly paid employees and thus would have to be supplemented with other benefits if turnover among middle or top management is a problem.

RECOMMENDATIONS: Since equity is likely to be a major AID objective in an ESOP program, with the emphasis being on greater distribution of stock to the more needy, length of service is an attractive criterion for stock allocation. AID should promote this approach when the company also benefits from low employee turnover. Otherwise, stock could just as well be allocated equally to all employees, including those just hired. In an industry experiencing rapid growth, where the work force consists of many new workers who could benefit from an ESOP, linking allocation to length of service might exempt too many workers.

Stock Allocation According to Salary and Length of Service With the Company

COMPANY	FINDINGS
Bangkok Bank	Stock allocation is keyed to length of service and salary level. First distribution of stock occurs after five years of service, with the employee buying discounted shares (par) based on number of shares already owned. At the end of 10 years of service, the employee receives more financial assistance from bank for stock purchases. The size of the company's contribution is proportional to amount of net salary. The results of this system are difficult to assess because employee turnover is low. The highest turnover is in senior management as smaller banks make attractive offers to these employees. Since the stock plan provides the most benefits at the end of five years and again after 10 years and none after that, there are many weak periods when the plan's hold on employees would be minimal.
Allied Plywood	Stock is allocated according to each employee's salary and bonuses; a vesting schedule is used to determine stock ownership rights. Employees are 30 percent vested after three years and earn 10 percent for each additional year of service.
E-Systems	Each year the Board of Directors votes to allocate a percentage of total salaries (to date, 2 percent) to the Employee Stock Ownership Trust. The trust in turn purchases company stock with these monies and proportionally allocates the stock to each employee's account according to base salary levels. Employees are vested at a rate of 10 percent per year of employment.

COMMENTS AND CONCLUSIONS: By combining both salary and length of service in determining stock distribution, a company can create incentives for employees to stay with it. These incentives would be equally valid for all salary levels. However, if the company were interested in retaining employees at specific levels, rather than all levels, the distribution formula could still be based on salary but not necessarily increasing with salary. If the objective is to hold onto senior level employees in companies where there is a wide variation between lower level and senior level salaries, the amount of stock required to keep the senior people may be so great as to distort the plan into one benefiting the senior people at the expense of those at the lower levels. At Bangkok Bank, the plan based on salary and length of service was not sufficient to retain its senior staff.

RECOMMENDATIONS: Because this method of stock allocation favors more highly paid, tenured employees, it would not be an efficient way for AID to benefit the most needy employees. However, since it may be the best method to meet a company's needs, it should not be eliminated as a possible option.

EMPLOYEE STOCK OWNERSHIP RIGHTS

COMPANY	FINDINGS
Thai Farmers' Bank*	The bank allowed employees to purchase shares at par ($5 per share) according to length of service, and it imposed no restrictions on selling the stock. More than 80 percent of the employee stockholders immediately sold the stock at its market price of $20 per share. Employees derived a windfall profit, while the bank received no long-term benefit. The plan was thus a one-time bonus.
E-Systems	Voting and dividend rights are unrestricted once the employee is fully vested (10 years, 10 percent per year). The right to sell the stock, however, passes to the employee only when he quits, retires, or dies. There is no requirement to sell the stock, however, once the employee departs the firm.
Allied Plywood	Voting rights are not passed through to employees. Employees may sell stock only when leaving the firm. They may take either their vested stock or a cash equivelant when they leave the company. Tax laws in the United States, however, require a capital gains tax to be paid on immediate distribution of stock to the beneficiary. This forces employees to sell their stock immediately. Since Allied Plywood stock is not publicly traded, the only market for employees is either the compnay or the trust.
Art Printers	The trustees have not yet decided on how stock will be distributed. However, unless the shareholders, by a special resolution, vote to allow shares to be sold outside the trust, employees, if they receive any stock at all,

* Although this was not one of the in-depth cases, Thai Farmers' Bank management was interviewed because this plan was the only example that provided full stock ownership rights to employees.

will have to sell their stock back to the trust rather than on the market. Whether the trust would hold it for them on request if they retire is a question far removed from current thinking. It appears that the trust will not distribute stock but will hold it for the employees collectively.

La Gloria — Stock is owned by the Employee Association and not by individual employees. When employees leave the company, they receive only the original company cash contributions to the association and their own savings. (Interest is paid out periodically). All capital appreciation on invested stock accrues to the association although the company is considering a change in policy. If approved, employees in the future will be paid out of the capital gains on association investments over a period of time.

Coopemontecillos — Employees must sell their stock back to their company upon leaving the firm, retirement, death, or dismissal. Employees are, however, paid capital gains on their stock.

E-Systems — Employees have the option to take their vested stock or a cash equivalent. Since the same capital gains tax applies as it does with Allied Plywood, however, most employees take a cash equivalent even though E-Systems stock is publicly traded.

COMMENTS AND CONCLUSIONS: Except for Thai Farmers' Bank, all of the cases examined had restrictions on ownership ranging from when the stock could be sold (usually at retirement or upon leaving the company) to whether the employee was even allocated specific shares. In some of the companies where the plans were new and few employees had seen a retiring employee actually receive his shares or money, the employees expressed doubt that the shares really existed and that employees would receive them. The more ownership rights that are passed to the employees, the more the employees will appreciate the plan. The companies wanted the employees to feel like part owners, however, and this element would be lost if employees could sell their stock as soon as it was allocated to them. In addition, some of the companies see the ESOP as a supplement to the pension fund (at Saha Union it was the pension fund).

In some cases the stock is not or cannot be publicly traded and the trust fund holds the stock for the employees and pays them its fair value when they retire or leave. Full ownership rights cannot be exercised when no outside market for the stock exists. The trust fund can create the market, thereby providing a useful service. In some companies, voting rights are passed on before the stock is fully vested or fully paid for. More often, however, voting rights are withheld until the stock is vested and paid for. In some cases, voting rights are not passed on until the employee retires or leaves. In these cases, management sees the ESOP as a way to offer financial incentives to workers but does not think the workers should thereby influence management decisions.

RECOMMENDATIONS: AID's emphasis is likely to be on the benefits to lower-level employees. These employees will be less likely to hold onto stock to build equity and more likely to sell it as soon as possible. Full ownership rights would allow them to do this. They see their needs in the short term and want to use the cash. AID may well be interested in the long term benefits of stock ownership. As worker equity builds, the flow of profits to employees increases, employee-management relations improve, and retirement security increases.

THE ESOP AS COLLATORAL FOR LOANS

COMPANY	FINDINGS
Bangkok Bank	The bank offers housing loans to employees based on their salary level. Loans can be up to 80 times an employee's monthly salary. The ESOP fund does not have a role in these loans.
Saha Union	The company allows employees to borrow money from the credit union using their stock as collatoral. Employees can also use the stock of other employees as collatoral for additional loan money if they have signed approval of it.
Art Printers	The company does not offer housing loans but will guarantee mortgages for its employees. The trust is considering using stock dividends to make loans to company employees.
Coopemontecillos	Employee members may borrow up to 10 times their share value, or two months salary. They need two other members as co-signer and are charged an average of 20 percent.
La Gloria/GLYSA	Employees may borrow up to 10 times the value of their accounts in the Employee Association. GLYSA stock is owned by the association, not individual employees, but may be used as collateral for loans made to the association if the majority of employee members so desire.
E-Systems and Allied Plywood	The 1974 ERISA legislation prohibits U.S. ESOPs from using ESOP stock as collatoral for loans.

COMMENTS AND CONCLUSIONS: Stock ownership represents an employee asset that can be used as collatoral for loans. However, since stock values continually change and may be volatile in developing countries, valuation for purposes of collatoral is difficult and may be low. If one objective of the ESOP is to provide retirement security to employees, and if they use the stock as collatoral and borrow heavily, their retirement security is lost. If the company chooses not to make loans on this basis, it is possible that employees will be able to use their stock as collatoral on the public loan market outside of company control.

RECOMMENDATIONS: If a company receiving AID assistance wishes to use the ESOP for employees' retirement security, it should not set up a loan program using the stock as collatoral. AID should not encourage this practice.

EMPLOYEE PARTICIPATION IN TRUST MANAGEMENT

COMPANY	FINDINGS
Art Printers	The company appoints three Professional Trustees (a judge, a lawyer, and an accountant). Employees elect three Employee Trustees, who are elected by an Election Committee whose members are elected by the employees. In the only election held to date, Employee Trustees elected were an accounts clerk, a welder, and the general manager of one of the subsidiaries. At the time of this study, there had only been one meeting of the trustees, and no important decisions were made. The trust has been given the role of deciding how the dividends will be distributed or otherwise used and whether stock ownership should go to individual employees (and if so, then how this should be done). Interviews with the welder and the general manager indicated that the views of lower-level employees might not be well represented on the Board of Trustees. Employees have been told that they will have a participatory role in trust decisions, but their control and influence over decisions seems weak, indirect, and tenuous. If the board makes decisions the employees do not like, it will risk widespread dissatisfaction with the stock plan. The initial election activity was exciting to the employees and sparked their interest although they will not see much money from the trust for a long time (if ever). The overall result of their participation could be very positive if the board reflects their views.
E-Systems	The trust has three directors appointed by the company's Board of Directors from top management. This is the only formal employee input, although the trust management, in general, is open to employee suggestions and inputs.

La Gloria	The trust is the Employee Association, which is comprised of elected employee representatives. There appears to be a good deal of turnover on a yearly basis. The association itself also chooses three employee representatives to the Board of Directors, and management chooses one more employee to the board. (Employees therefore have four seats on 10-member Board of Directors.)
Allied Plywood	In June 1982, the former owners, before selling the remainder of their stock, appointed a new president and treasurer. The former owners also chose the same two people to represent employees as ESOP trustees on a board of four members. The other two seats are occupied by the former owners themselves. The new president is also a major stockholder of the 16 percent of stock held outside the trust. All voting decisions are made by the Trust Committee. The result is that there is very little formal employee participation in trust management.

COMMENTS AND CONCLUSIONS: In two of the cases, there is considerable flexibility on how the money in the trust fund (or Employee Association) will be used. In one of the two cases, La Gloria, the employees have full control over these decisions. In the other case, Art Printers, their level of control is tenuous at best. It is questionable whether the Art Printers' management should have left flexibility in the plan if it was not ready to hand control to the employees. In other plans where management decided how the stock and dividends would be distributed and used, employees expressed no interest in those decisions and apparently accepted any restrictions as being the right of the company to impose. The employees in most of the cases were not aware, however, of any other ESOPs and therefore did not know that other options might exist or be applicable to their situation.

Employee participation appears to increase employee enthusiasm about the plan, but management sees the need to balance this participation with restrictions that allow the plan to benefit the company as well as the employees. It may be that employees, once they are also owners, will have an interest in company welfare (as opposed to worker welfare) and therefore find common ground with management. Before this can happen, however, management will be wary of worker participation and less willing to start an ESOP if it fears worker influence over its decisions.

RECOMMENDATIONS: AID technical assistance should promote employee participation to the extent possible without discouraging management from establishing ESOPs. Even without full participation, workers can obtain substantial benefits from an ESOP. ESOP advisers should be sensitive to concerns of management in suggesting level of employee participation.

COMMUNICATION ABOUT THE PLAN

COMPANY	FINDINGS
Dunlop	Management has been disappointed with the plan and has failed to publicize it to employees. Employee representatives understand neither the concept of stock ownership nor the plan's potential financial benefits. Management prepared a one-page, formal document to explain the plan and translated it into two African languages; however, the language is too technical for the semi-literate workers to understand.
Art Printers	When the plan was initiated, the company made a major communications effort to inform employees about how it was to work. Groups of 20-30 employees were shown a 20-minute videotape, which was followed by 90 minutes of questions and answers. The company printed literature describing the plan in simple terms in English and two tribal languages and distributed it to all employees. In addition, the employees were asked to elect trustees, thus creating an environment of activity that further highlighted the plan. The result was interest by employees in the plan and also expectation that they had an important role in its management. This may not to be the case, given the characteristics of the trustees. Thus, if the employees' expectations are not met, the communications effort may have been a mistake. Morever, in the initial communications program, the projected growth of the trust fund was based on 1981 profits, but that was a peak year and 1982 profits are already dropping. The success of the Art Printers plan will therefore depend on profit levels over the next decade and the trustees responsiveness to employee demands.
Bangkok Bank	The bank makes no formal communications effort, but the plan has been in existence for 18 years and most employees understand how it works. The higher level of education of employees in the banking business reduces the

need for detailed explanation. When the plan started, there were many fewer employees to communicate with and less formal means of communication were possible.

E-Systems	Upon joining the firm, an employee learns about the ESOP through an exhaustive barrage of written and visual information that is written in layman's language. In addition, a quarterly company news magazine often discusses the virtues of the ESOP. Each January every employee receives a personal balance sheet with stock and dividend information.
La Gloria and Coopemontecillos	Upon entering the company, an employee receives an informational blitz. In addition, the Employee Association periodically publishes a newsletter, and the employee receives a yearly personal balance sheet.
Allied Plywood	Corporate information is communicated to employees informally. Both the former owners and their successors keep a monthly diary of Allied's quarterly financial reports, and it is open to employees. Management staff members are available to explain any of the data to employees, thinking that although employees do not really participate in financial decisions they should be kept informed.
	Each year the employees receive a report that shows the value of their individual accounts. The company also issues to each employee a report on its operations.
	Company communications have been extremely effective. Employees are content with the plan, have a general understanding of the ESOP, but some difficulty with its technical aspects.

COMMENTS AND CONCLUSIONS: The evidence indicates that communications is an important feature of an ESOP. In Third World countries, the workers are often not familiar with the concept of stock ownership and need to be educated. Since the workers have a stake in the profitability of company operations, they need to be kept informed about the company's financial situation. If their stock account is being taken care of by a trust, they need to regularly know the status of their individual accounts. Art Printers followed its communications blitz at the plan's outset with an election of trustees. Even though the employees may not see any financial rewards from the plan for many years, the election process sharply increased employee interest (but also employee expectations that they would control trust decisions).

The company took a risk in communicating projections and suggesting a level of employee participation that may, in practice, turn out to be lower than anticipated. If this occurs, the employees may view the results negatively even though the plan is still giving them more than they otherwise would have and with which they might have otherwise been content.

While communications are very important, projecting more benefit than can be assured is risky. The employees should also be made aware of the potential pitfalls of the plan.

RECOMMENDATIONS: AID technical assistance to support the development of ESOPs should include recommendations to set up adequate communications so that employees fully understand how the plan works, its benefits and pitfalls, how well the company is operating (especially from a financial view), and how their individual ESOP accounts are faring. The initial communications to employees should not set up targets that may not be met. The wording of these communications should take into consideration the employees' literacy level and experience with financial concepts and terms.

ANNEX C

U.S. BACKGROUND AND ESOP CASE STUDIES

ANNEX C

U.S. BACKGROUND AND CASE STUDIES

U.S. BACKGROUND

Legislative Background

The preliminary legal framework for U.S. ESOPs was laid through federal legislation and rule making: the 1921 Revenue Act and a 1953 Internal Revenue Service (IRS) tax ruling. The 1921 act first granted tax favored status to stock bonus and profit-sharing plans as a means for U.S. companies to attract and retain qualified employees. Although the ESOP is legally similar to defined benefit-type pension funds, its primary purpose has not been to provide for retirement. Instead, it has served as a method for employees to earn an ownership interest in the company for whic [illegible] In 1953, a ruling by the IRS, allowing the leveragi loans by a stock bonus plan, laid the groundwc [illegible] st ESOP. Prior to 1953, this forerunner of the ESOP trust was simply a tax-exempt receptacle for corporate stock contributed as an alternative to deferred monetary compensation.

ESOP did not come into vogue, however, until the early 1970s when congressional leaders enacted a series of laws and tax benefits to support this technique of corporate finance and new type of employee benefit. Among the major laws passed by Congress are:

- Employee Retirement and Income Security Act of 1975. This law made ESOPs part of the Internal Revenue Code. The law provided ESOPs with the unique authority among employee benefit plans to borrow money (and not be subject to a case by case determination by the IRS) for investing primarily in employer securities. Because they are defined as "qualified employee benefit plans," contributions to them are also tax deductible, if the plans meet certain conditions of stock allocation, vesting, and other ERISA rules.

- Trade Act of 1974: This act allowed the Department of Commerce to make certain kinds of economic assistance available for companies suffering from adverse impacts of foreign trade. Under a loan and loan guarantee program, a preference is given to firms when an ESOP owns at least 25 percent of the firm's common stock.

- Tax Reduction Act of 1975: It allowed a company to receive an additional 1 percent credit over and above the

10 percent investment tax credit (ITC) if at least 1 percent of the qualifying investment under the ITC was contributed to an ESOP. (This is the principal reason why many large corporations in the United States adopted ESOPs, technically called TRASOP under this bill.)

- Revenue Act of 1978: Voting rights were made part of ESOP law. In publicly traded companies, voting rights must be passed through on all issues; in closely held firms, voting rights must be passed through on issues that by state law or corporate charter require more than a majority vote.

- Small Business Employee Ownership Act of 1979: This act included for the first time specific language mandating the Small Business Administration to provide financing for ESOP companies and for employee organizations seeking to acquire an ownership interest in their place of employment.

- Chrysler Loan Guarantee Act of 1980: As part of the government's loan guarantee to Chrysler, Congress required that employees rceive $162.5 million (about 15 percent) of Chrysler stock, distributed over four years.

- Economic Recovery Tax Act of 1981: TRASOPs were changed so that the tax credit is now based on payroll -- 0.5 percent of payroll for 1983-1984 and 0.75 percent 1985-1988. The limits on the amount that can be deducted for contributions to a leveraged ESOP were also significantly raised.

Federal assistance to ESOP companies over the past seven years has included loans and loan guarantees from a variety of federal agencies including the Economic Development Administration, the Farmers Home Administration, the Department of Housing and Urban Development, and the Small Business Administration.

Five states, Delaware, Maryland, Michigan, Minnesota, and New Jersey, have also passed laws promoting the ESOP concept. Delaware passed the most comprehensive ESOP legislation in June 1982. The bill says that the state's policy is to encourage employee ownership and that each agency involved in economic development or regulation must report annually on what it has done to promote employee ownership. If it has done nothing, it must explain its lack of action. The law makes it clear that agencies are expected to take positive action. Similar bills are now pending in California, Massachusetts, Ohio, and Virginia.

ESOP Description

More than 5,000 U.S. corporations have adopted ESOPs, including many of the country's largest corporations, such as American Telephone and Telegraph, General Motors, Exxon, and Dow Chemical. Most of these plans give workers only a minority interest in their firm. A growing number of ESOPs, however, such as those of Pan American World Airways, Hallmark Cards, Lowe's Companies, E-Systems Inc., Allied Plywood, and Rath Meat Packing give employees a substantial ownership interest in the company. Such companies as the Milwaukee Journal and Hyatt-Clark Ball Bearing are also among the approximately 500 majority employee-owned firms in the United States. The first company to attempt an ESOP was Penninsula Newspapers, when in 1956 employees took over the chain, which was threatened with a takeover.

Technically, an ESOP is a stock bonus plan that invests primarily in employer company stock. The ESOP may also use borrowed funds repaid with fully tax deductible corporate contributions through the mechanism of an ESOP Trust. As a result, the employer may deduct the principal portion of the loan repayments as well as interest. This is not presently permitted under conventional debt financing.

Conventional corporate financing ensures that all new assets will be owned by the same small percentage of people who own all the existing capital. Debt and internal financing, for example, ensure that the present owners of the corporation will be entitled to all future capital; financing through the sale of new equity ensures that only those who already have savings will become owners.

An ESOP enables the corporation to finance expansion, working capital, ownership transfers, or other business activities with pre-tax earnings while transferring equity or beneficial ownership of these financial assets to its own employees. A loan that ordinarily would be made directly to the corporation is made to the ESOP trust, which the corporation either establishes for that purpose or adapts from a conventional stock bonus, profit-sharing, or pension trust. The ESOP trust uses the loan's proceeds to purchase stock from the corporation, and the corporation obligates itself to make sufficient payments to the trust allowing it to repay the loan.

The merits of ESOP as a financing instrument can best be appreciated by contrasting it with conventional financing. Conventional debt financing requires the debt interest to be repaid with pre-tax earnings, whereas the principal must be repaid with after-tax earnings. Under the current tax structure, this means that the corporation must repay the pre-tax equivalent of almost twice the principal amount in addition to interest. Conventional equity financing, while avoiding the tax consequences of principal repayment, involves the often greater expense of selling the new securities. Where there is little public market for the securities, this is often impossible. ESOP financing combines aspects of both these conventional methods. The corporation, through the ESOP, receives the proceeds of a conventional loan, but the loan principal (as well as the interest) is repaid in pre-tax dollars through deductible contributions to the ESOP and the debt is automatically converted into equity. In addition, the ESOP provides a ready market for the new corporate stock.

While ESOPs, and to a lesser degree worker cooperatives, are by far the most common broad capital ownership plans in the United States today, other employee ownership devices are also used. In some cases, for example, employees buy stock directly. While this is a far simpler operation, it requires the use of employees' after-tax savings, whereas in an ESOP, the company buys the stock for employees with pre-tax corporate earnings. Direct purchase of stock, however, almost evitably leads to skewed ownership with most of the stock bought by top executives.

Other variations include stock purchased or contributed from profit-sharing plans, stock bonus plans, (where a company contributes stock directly to employee accounts), and stock savings or option plan where stock is offered at discounts but usually only to key employees. Each of these may have advantages to stock holders or certain employees, but none is commonly used to transfer any significant amount of stock to a large number of company employees.

Labor union leaders have had mixed, but increasingly favorable reactions to these concepts. Some fear that worker ownership will obsure the traditional adversary relationship between management and labor. Others, including the late Walter Reuther, Shannon Wall of the National Maritime Union (NMU), and leaders of the railway unions, take a different approach. The NMU, for example, offered to cut manning requirements and relax work rules to reduce labor costs by 60 percent in return for a worker ownership interest in two American passenger vessels.

U.S CASE STUDIES

ALLIED PLYWOOD COMPANY

Company Description

In July 1982 Allied Plywood became a 100 percent employee-owned company. Founded in 1951 by Ed and Phyllis Sanders, the company distributes plywood building materials in the northern Virginia area.

The company has experienced rapid growth since its inception. Sales increased from $3.3 million in 1973 to $8.3 million in 1979 despite a mild downturn in 1974-1975 in response to a decline in the housing industry. After sales dropped in 1980 to $7 million, the firm began to concentrate on new markets. Furniture replaced home builders as clients, thereby enabling Allied to increase sales to $7.8 million in 1981. This performance is good in an industry plagued with bankruptcy and lay-offs.

Allied has 20 employees, about half of whom are in management and sales. The remainder work in the warehouse or deliver orders. Employee turnover is extremely low, and most workers have been with the company about 10 years. While its competitors have laid off 20-30 percent of their work force, Allied has not cut back its labor force since 1973. Management says the company has been able to survive because of its wage and benefit policies toward employees despite enormous pressures on the industry.

Company Benefit Plan

The base wage for all employees, irrespective of rank and length of service, is fairly even and about 30 percent lower than the company's competitors. The company also has a profit-sharing plan, however, that distributes earnings on an equal basis to all employees who have been with the company at least 18 months. Each month employees as a group receive $150 for every $500 of sales above monthly expenses. The 15 employees eligible to participate receive about $1,200 each month through this profit-sharing plan.

In addition, the company awards a large annual cash bonus to all employees on the basis of performance, responsibilities, length of service, and absenteeism. This bonus enables higher level and more senior employees to earn more than new, lower level workers. Nevertheless, top management, even with all the benefit plans, still earns only about three times that of relatively unskilled workers. On average, 63 percent of employees' income is derived from bonuses, profit-sharing, and dividends. After these benefits are added to wages, the Allied employees' income is about 30-40 percent higher than that of the company's competitors, Thus, remunerations to employees are tied to company performance rather than fixed at high levels that would force layoffs when sales decline. The company has never missed distributing a monthly bonus.

The company has no pension plan since the owners believed that employees should receive the maximum short-term gains possible rather than setting aside funds for their retirement. The monthly and annual bonus plan, introduced in 1968, has helped increase employee productivity, sales, profits, and quality of work. Since Allied has so few employees, everyone can see the monetary effect of one person's efforts. Peer pressure has been used effectively to raise the productivity of recalcitrant workers. The owners also believed that profit-sharing encourages employees to communicate information and to work as a team.

Reasons for the Introduction of the ESOP

After managing Allied Plywood for about 25 years, Mr. and Mrs. Sanders wanted to retire or start another small business. They did not wish to sell the company to outsiders, who might eliminate their profit-sharing system or fire loyal employees. They feared that a conglomerate would be interested solely in increasing the company's net worth and not in maintaining employee benefits that increase morale and productivity.

In addition, the Sanders wished to reduce their participation in the company gradually. However, they learned that while they retained majority control the income derived from the sales of any small blocks of stock would be taxed as dividend income. Thus, they faced paying 70 percent tax on these stock sales. The other alternative of trading shares with a conglomerate would have allowed the Sanders a tax-free rollover of stock that, if the stock were publicly traded, would have allowed them to sell it in increments at a lower tax rate. Their concern about their employees' welfare caused them to reject this method.

Mr. Sanders learned about ESOPs reading a letter to the editor in the Washington Post. The Sanders could sell small blocks of stock to an ESOP, retain majority control, and have this income taxed at the lower capital gains tax rate, then 28 percent. Thus, the ESOP had the advantage of maintaining the job security of employees while allowing the owners to withdraw capital from the company slowly at comparatively low rates.

Description of the ESOP

From 1978 until 1982, the company contributed about $130,000 each year from pre-tax earnings to purchase stock on behalf of employees. No set formula determined the amount to be contributed aside from the government regulation limiting contributions to no more than 25 percent of the company's annual payroll. By July 1982, employees owned 60 percent of the company's $1.3 million in stock. In July, the Sanders arranged for the Employees Trust to purchase the remaining shares with a loan obtained through the company's commercial bank. Since Allied may subtract both the principal and interest payments on the loan as an expense, the company's tax burden is lowered.

Stock vesting begins after three years of employment with the company. Employees are entitled to 30 percent of the shares allocated in their names at that time, with an additional 10 percent added each year thereafter. Shares are allocated in proportion to salary and cash benefits. Since there is not a wide range in income to employees, there also is no great discrepancy in the number of shares owned.

Although employees are entitled to keep their vested stock when they leave the company, the three employees who have left chose to sell their stock. The company has the right of first refusal on repurchase of any stock employees wish to sell, and the trust has the second right. The company, however, must buy back any shares that employees leaving the firm wish to sell during two 60-day periods following distribution. Except in emergency cases, employees are not allowed to sell their shares while working with Allied. The value of stock has appreciated from $96 per share in 1970 to $313 per share in 1981, or an average annual compounded rate of 11 percent. The company's policy of paying high bonuses and profit-sharing has prevented stock from appreciating at a higher rate. The price of this privately traded stock is determined by an assessment of the value of inventories minus current liabilities divided by the number of outstanding shares.

The allocated and vested employee stock is in a trust originally controlled by Allied's former owners as an internal corporate trust. This mechanism was developed after the company's commercial bank turned down an offer to act as the trustee for the plan. In July 1982, Allied's new president and treasurer replaced the Sanders as the trust's sole board members. They have sole authority to vote employee stock. Indeed, current and former top management agree that employees should not be involved in the management of the company and thus should not have voting rights passed through with their stock. They reason that an enormous amount of time and money would be required to inform all employees about management issues; resources that would be more productively used in generating sales. Most employees seem to agree that they are primarily, if not exclusively, concerned with the company's short-term profit and less interested in all but the most important management issues.

Because Allied is a small company, still retaining the atmosphere of a family operation, information travels quickly. Informal meetings are held frequently. Although the past owners took great efforts to communicate the rights and responsibilities of stock ownership to employees, the plan's value was not appreciated until an employee decided to leave the firm, cashed in his stock, and received about $10,000. Then the annual ESOP reports given to each employee stating the amount of allocated versus vested stock began to have new meaning.

ESOP Benefits to the Company and Employees

Although the profit-sharing and bonus plans have been behind the past gains in productivity and profits, the ESOP has helped improve morale even further and has given employees a heightened sense of job security. When Mr. Sanders first mentioned the idea of establishing an ESOP to employees, most responded that they would prefer higher cash bonuses rather than stock. They changed their minds only when it became clear that they were in danger of losing their jobs if new management took over. Older employees said they regarded the ESOP as an effective pension plan, while younger workers were less concerned with its long-term advantages and stressed the importance of immediate payout of profits. The company has adopted a policy of retaining enough profit to enable stock to appreciate by about 10 percent each year, thereby satisfying both groups.

Another tangible benefit to the company is its corporate image. Many customers have told employees that they believe employee ownership has improved the quality of service they receive from the company. And although service has been good, employees admit that they receive more job satisfaction and take more pride in their work now that customers know that they own the company.

E-SYSTEMS

Company Description

E-Systems is a large, publicly owned corporation encompassing the fields of aviation and electronics. A high technology company with headquarters in Dallas, Texas, E-Systems operates engineering centers, laboratories, test facilities, manufacturing plants, and maintenance organizations at several locations in Texas as well as in Virginia, Florida, Utah, Indiana, and Taiwan. In addition, the company maintains operational and sales offices throughout the world. The firm does most of its work for the U.S. Department of Defense and for foreign governments in the areas of electronic reconnaissance and surveillance.

The firm, on the forefront of technological advancement in a highly competitive field, has experienced rapid sustained growth over the past decade. These factors, as well as management's enlightened outlook, have created a corporate philosophy that considers the needs and desires of the firm's labor force to be primary among all other corporate assets. This attitude is necessary to attract and keep the type of staff that the firm needs for corporate success.

E-Systems became a completely independent company in 1973 when it separated from LTV Corporation. Since then, the number of its employees has increased from 6,000 persons to 12,000 worldwide. During that same period, net sales grew from $166 million to more than $572 million with total assets increasing from $98 million to over $280 million.

The firm's work force is highly skilled and educated, even by industry standards. Out of 12,000 employees in 1982, 4,200 are engineers, scientists, or other highly skilled technicians; 3,800 are hourly employees. Many women are in supervisory or management positions and comprise more than two-thirds of the work force.

Aside from union representation for all non-salaried personnel (various United Auto Workers locals), E-systems management also actively encourages "Communications Councils." Although informal, these councils are permanent representative organizations of employees established to exchange information between workers and managers. They are essentially discussion groups where problems are dealt with and suggestions received by managers. Drawn along functional lines, there are commonly seven to eight councils per plant. Each council has between 8 and 20 members, who are selected by management and rotate every six months. Union representatives, salaried employees, and management all thought that the councils improved both worker-management relations and the overall working environment of the company.

E-Systems Group Benefit Plan History

E-Systems is in a highly competitive industry that has experienced sustained growth over the last decade. The competitive nature of the industry dictated the need for an extensive employee benefit program.

In addition to the ESOP, employees enjoy a long list of extras. The company, however, does not have a corporate profit-sharing plan. According to management, E-Systems had attempted one several years ago but eventually replaced it with an ESOP. The firm's net profit was normally too small (2-3 percent of sales) and unpredictable to make a corporate profit-sharing plan an attractive employee benefit.

Management attempts to monitor the changing aspirations of the employees and to adapt the benefit program to accommodate them. This attitude is reflected in the gradual change in emphasis from immediate benefits to long-term security. This was a key reason behind ESOP adoption.

The principal benefits offered to employees are a cash retirement plan, a full health and life insurance program, a payroll savings plan, reimbursement for educational expenses, and a credit union. In addition, top management is involved in a bonus program.

Reasons for the Introduction of the ESOP

Prior to the 1973 reorganization and spin-off from LTV, E-Systems offered an employee savings plan to its workers. Under the plan, the company matched employee savings, and benefits were paid out upon retirement. Only 15 percent of workers took advantage of this plan, however, and the company eventually terminated it. In its place, the company offered what it thought was an innovative approach to making E-Systems both different and attractive to its work force. In an attempt to combine the goals of traditional profit-sharing and employee savings plans, an ESOP was instituted. Management thought that this type of plan would offer the employee the joint advantage of cash dividends and stock appreciation, while providing a feeling of increased security in retirement and participation in the company's activities.

Buying publicly held stock for employees also helped protect the company from any hostile corporate takeovers. Since the loan used to purchase this stock could be repaid from pre-tax earnings, the ESOP provided a financially attractive means to achieve this objective.

Description of the Plan

E-Systems established an ESOP and a parallel Employee Stock Ownership Trust on July 1, 1973. The trust that secured a loan of $7,000,000 to be repaid over seven years. These funds were used to purchase approximately 500,000 shares of company stock on the open market. The shares were used as security for the loan.

After the original loan was fully repaid in 1980, the E-Systems board authorized the trust to purchase up to 1,000,000 additional shares of common stock for allocation in future years. These authorized shares will be purchased as the need arises and at prevailing market prices for allocation to workers in the same manner as in previous years.

The Board of Directors of the company determines the amount of money it contributes to the trust each year. During the period of the original loan, this amount corresponded to 2 percent of total salaries, as specified in the loan agreement. Moreover, during the past two years, the same percentage was maintained, although in future years it will depend on corporate profits and liquidity.

Company contributions may be in cash, common stock, other company securities, or other property. As contributions are made to the trust, shares of E-Systems common stock are purchased and allocated to each employee's trust account. This allocation is based on a relationship between each employee's base pay and the total base pay of all eligible E-Systems employees.

The shares of stock and cash allocated to each employee's account are held in trust until the employee retires, dies, terminates employment, or otherwise incurs a break in service of one year or more. Thus, the employee is not required to pay capital gains taxes on the money until the stock or cash is received.

All ESOP allocations are maintained in one of the following individual employee accounts:

- Stock Account -- Each account is credited each December 31 with shares of company stock purchased and paid for by the trust or contributed by the company. It is also credited with each employee's allowable share of company stock forfeited by terminating participants and with any stock dividends or stock splits that might be declared by the board of directors; or

- Cash Account -- This employee account is credited with that part of the company contribution that is not used to purchase stock and any cash that is forfeited by terminating participants. In addition, all cash dividends are paid on the company stock credited to each employee's stock account but which are not as yet fully vested will be credited to this account. Furthermore, this amount will be increased or decreased for each employee's share of the trust's net income or loss computed at the end of each year.

Each calendar year, each employee receives an ESOP annual statement that includes such information as the balance in each account, amount of cash and stock allocated for the year, each employee's share of net income of the trust for the year, amount of cash and/or stock dividends and stock splits credited to each account over the year, and cash dividends actually paid to each employee over the year. This annual statement is only one of many sources of ESOP or other corporate information that an employee receives as part of a concerted educational process supported by E-Systems.

For those employees who worked for the company prior to July 1, 1973, their eligibility in the plan began as of that date. For all others, eligibility begins as of their employment date. The original concept resulting in the establishment of the ESOP held that an employee should be given positive incentives as soon as possible.

Right of ownership to the allocated stock is governed by a vesting schedule of 10 percent per year until the employee completes 10 years with the firm. At that time, full ownership, including dividends, is passed to the employee. If an employee is temporarily laid off the vesting schedule continues unless the company calls back the employee and he refuses to return. If an employee dies before vesting is complete, he automatically becomes fully vested and his heirs receive full value for the stock.

The company pays dividends quarterly to the ESOP trust. The trust, in turn, credits the cash account of each employee for the appropriate dividend based on the number of shares allocated to the corresponding stock account. These cash dividends are then paid quarterly to each employee. This allocation is based on the vesting percentage that each employee has attained. The amount not paid out remains in the employee's cash account.

In addition to the quarterly dividend payment, and until an employee is 100 percent vested, he receives an additional dividend payment with the first quarter dividend each year. This represents the additional vesting earned for the previous year.

By virtue of owning stock, employees also receive voting rights based on the number of their vested shares. Although most employees interviewed stated that they merely sign over their proxy rights, they did express concern in the hypothetical case that these rights would ever be taken away from them. All shares not vested in accounts of employees, and all vested shares in which no voting instructions are received, are voted by the trustees as the ESOP Administrative Committee directs.

Upon retirement or death, the employee becomes fully vested, and he, or his heirs, receives the stock certificates and any balance left in the cash account. The retired employee, or his heirs, may then keep the stock or sell it back to the trust, without incurring a brokerage fee, for up to one year after termination. If he waits for more than one year, the retiree pays the fee.

Upon leaving the company for reasons other than retirement or death, the employee receives only the vested portion from both his stock and cash accounts. The unvested portions revert to the remaining participants in the trust.

ESOP Benefits to the Company and to the Employees

After almost nine years of ESOP activity, E-Systems managers and employees, both union and non-union, agree wholeheartedly that it has been a success. Quantifying this from the employee's point of view, however, is far easier than from that of the company.

Virtually all employees interviewed stated that not only they but also all of their associates were very pleased with the ESOP. They said that it gives them a sense of security for their retirement, and the dividends provide a minimal, although significant, cash flow. It also makes them feel a part of the company's overall activities.

This attitude, however, did not prevail in the early years of the plan. At that time, the small number of shares in each person's account, plus the low vesting percentages, combined to keep the impact of the financial benefits low. (Dividend checks were sent to employees beginning in 1977, and averaged less than a dollar for the first few years.) Nevertheless, as the number of shares that each employee has been allocated grows (through additional allocations, stock dividends and splits) and as full vesting is approached, the amount of dividends have increased. Since the ESOP's inception, the company has distributed a 10 percent stock dividend. In addition, three stock splits of 60, 33 1/3, and 100 percent have occurred since 1973. In 1973, 100 shares were worth $900, at $9.00 per share; in 1982, those 100 shares have increased to 470, with the per share value being $38.00, a full 20-fold increase.

From the company's point of view, the direct impact of the ESOP is not as easy to measure. The start of the ESOP in 1973 corresponded to a complete restructuring of the firm as well as financial independence from the parent company. Corporate business expanded rapidly, but it also increased for the rest of the industry. In the case of the company, ESOP benefits become an issue of attribution. Without a doubt, productivity and profitability have increased greatly, as have other indicators such as sales per employee. Other quantifiable indicators such as employee absenteeism, tardiness, and turnover are all down over pre-ESOP years. Nevertheless, there is no practical way to attribute directly these gains to the ESOP.

From a normative view, the situation is different since impressions and feelings are valid indicators. In this sense, managers and employees unanimously thought that such factors as the attitudes of employees toward their jobs, management, and their fellow employees were all greatly improved over pre-ESOP days. In addition, communication between workers and management, the quality of work being produced, and union/management relations all had greatly improved. Both employees and managers pointed to the ESOP as reason for the improvement.

Often the best indicators, however, are anecdotal. When the research team asked one blue collar worker what the ESOP meant to him, he replied, "Before, I just worked for my salary and didn't care about the company. Now if I see someone sitting on his butt I go over and point it out to him. His sitting on his butt reflects on the value of my stock!"

ANNEX D

ZIMBABWE BACKGROUND AND ESOP CASE STUDIES

ANNEX D

ZIMBABWE BACKGROUND AND CASE STUDIES

ZIMBABWE BACKGROUND

Historical Framework

Until 1979, the Rhodesian economy was structured to promote the interests of European settlers to the detriment of its African inhabitants. Prime farmland and industry were almost exclusively owned by the settlers or foreign companies; legislation and government services spurred commercial farm production but eroded the capability of subsistence cultivators to support themselves.

The unilateral declaration of independence (UDI) of 1965 brought international trade sanctions and an introversion that reinforced the socio-economic trends of the previous 40 years. A rolled environment was created, nurtured with low d strict import and foreign exchange restrictions, elf-sufficiency. Blessed with rich natural and mineral resources productively used by the enterprising white community, the economy grew at a healthy 7 percent rate until 1974. But the quadrupling of oil prices, the world economic recession, and a bitter guerrilla war precipitated a 12 percent annual gross domestic product decrease until the ascendency of a black african government in 1979.

Post-Independence Environment and Trends

The new government has been wavering between policies that would promote its short-term political aspirations and those that could lead to long-term growth with concomitant benefits to the black majority. It must deliver tangible benefits to quell the raised expectations of its black constituents while retaining the skilled white labor and capital resources necessary for economic growth. The challenge is to create sufficient incentives for both groups to cooperate and stimulate more equitable resource transfers between segments of the dual economy. Policies adopted during these critical years will determine whether this delicate balance will be maintained. If successful, Zimbabwe can serve as an example to other countries, and it increases the security of southern Africa. The alternative is economic decline, creating a climate for radical political change.

Despite some initial hostile rhetoric against the private sector, the government now espouses a mixed economy with a slowly expanding public ownership of a few key companies. Pronouncements have also been made on the desirability of lessening the country's dependence on foreign companies. Currently 70 percent of all capital is owned by foreigners; of that percentage, 50 percent is owned by the British, 30 percent by the South Africans, and 20 percent by the Americans.

Buoyed by the best harvest on record, the lifting of trade sanctions and a surge in consumer spending, Zimbabwe achieved an impressive 12 and 8 percent real growth rate in 1980 and 1981 respectively. A sharp reversal of this performance, however, is expected in 1982. The world recession has cut the demand for exports, mineral prices have plummeted, a drought has constrained agricultural production, and domestic policies have reduced investment and squeezed profits. A critical lack of foreign parts and skilled labor is the key constraint against increased production in industries retaining a vibrant market.

Zimbabwe's current 14 percent debt service ratio is the maximum it can shoulder, thus inhibiting further foreign exchange loans. Rapid growth of the money supply and consumer demand have forced the inflation rate to 16 percent. The stock market is severely depressed as a result of:

- The steady climb of prime interest rates from their 19-year sheltered level of 4 1/2 percent to the 1982 rate of 13 percent;
- The introduction of a 20 percent tax on dividends to Zimbabwe residents and a 30 percent capital gains tax;
- The reduction of import permits and foreign exchange restraints;
- The introduction of Zimbabwe's first minimum wage ($142 a month for industrial workers) coupled with severe restrictions on employee dismissals; and
- A salary freeze on incomes above $27,000, stimulating the migration of skilled labor to companies that have higher salary levels or to other countries (1,700 emigrants a month).

In addition, although the Government of Zimbabwe's "growth with equity" policy statement welcomes foreign investment, only disincentives have been provided. The remitable rate of return on foreign investment in a wholly owned subsidiary is only 19 percent. Since 50 percent of post-tax earnings must be reinvested in Zimbabwe, the share of capital owned by foreign interests will increase over its present 70 percent level. Income received from transnational stock sales to the Zimbabwe public has also been blocked. Thus, the practice of the government thwarts its stated intention to lessen the influence of foreign concerns.

The government has taken constructive measures to improve labor-management relations. The wave of post-independence labor unrest has now subsided. Each firm now has elected worker representatives who meet with management on a monthly basis. Worker participation groups channel their grievances through these representatives and are responsible to maintain high productivity and product quality. Unions are beginning to gain strength, but currently are subject to divisions that restrain their effectiveness.

Role of the United States

The United States accounts for a large share of Zimbabwe's trade, investment, and foreign aid. In 1981, the U.S. trade surplus with Zimbabwe was $9.6 million. U.S. companies owned about 14 percent of all capital stock, and $75 million in aid has been pledged for each year from 1982 to 1984. Two-thirds of this aid will be channeled to the Zimbabwe private sector to purchase U.S. equipment and industrial raw materials. Both companies profiled in this section hope to take advantage of this program.

Zimbabwe provides a vast market for U.S. goods. The government plans to spend $2.6 billion to revamp its infrastructure and requires agricultural and industrial equipment to replace machinery made obsolete during the UDI period. Foreign exchange is currently the only constraint inhibiting such imports.

As a major donor, the United States may be well positioned to introduce ideas that could be of mutual benefit to both governments. Although many laws have been enacted, most policies are still open to negotiation. A mechanism that might further improve worker-management relations and increase the earnings of low-income employees without hurting their companys' financial position might appear attractive. Although worker participation is a major government theme and receives wide publicity, it has yet to be defined. Employee share participation schemes could provide a shape to this elusive participation concept, and serve the long-term interests of foreign and domestic companies. Leveraged ESOPs could be used to buy out sole proprietorships that otherwise would be abandoned when their owners die or emigrate.

AID could take constructive steps to help the Government of Zimbabwe formulate policies more conducive to economic growth. Such measures include:

- The sponsorship of a conference of local industry and financial leaders, representatives of companies with major holdings in Zimbabwe, and government officials to discuss tax and investment policies to encourage additional investment while broadening the base of ownership through ESOPs;

- Financial assistance to enable employees to purchase shares, perhaps tied to using capital infusion to buy U.S. equipment; and

- Technical assistance whereby ESOP experts could work with government planners to design tax incentives for ESOP adoption and, later, to work with company accountants and lawyers to design a plan that suits the company's needs.

ZIMBABWE CASE STUDIES

ART PRINTERS

Company History and Structure

Art Printers was known as the Art Printing Works when it was founded in 1906. The company obtained a listing on the stock exchange in 1951 and kept its focus on printing until, in 1973, it acquired two manufacturing companies from Nedlaw Investment and Trust Corporation. In doing so, Nedlaw became the majority shareholder, and Art Printers was structured as the manufacturing unit of Nedlaw. In 1978, Art Printers acquired yet another manufacturing operation, and in 1981 constructed a new tissue mill that has become its most recent subdivision. In all, Art Printers owns and operates the following five manufacturing companies:

- Artmail -- stationery;
- P.P.I.-Spicers -- paper and plastic products supply;
- Saltrama-Plastex -- flexible and rigid plastic packaging;
- Wiroplastics -- wire mesh, tube, and sheet metal products; and
- Kadoma Tissue Mill -- tissue paper.

In 1981, the assets of Art Printers were $50 million. While Art Printers represents the largest portion of Nedlaw Group activities, the Nedlaw Corporation owns a number of smaller companies. Some of these companies, according to Nedlaw management, may soon be acquired by Art Printers. A majority of Nedlaw shares are owned the Nedlaw chairman, N.D. Walden, who appears to exercise tight control over his holdings. Mr. Walden, however, prefers low visibility and has given Mr. G.B. Nyandoro the chairmanship of Art Printers. The boards of the operating companies under Art Printers are chaired by the general manager of Art Printers, and each has three or four worker representatives.

Company Performance

Art Printers has performed well over the 1974-1979 recessionary period, holding sales and profit about level while the overall economy declined. During the economic upturn from 1979 to 1981, the company's sales and profits increased at a higher rate than the economy as a whole. Sales went from about $16 million in 1978 to $21.6 million in 1979, an increase of 30 percent, and then increased another 30 percent in 1980. In 1981, sales reached $37.8 million, a 36 percent increase over 1980. Profits went from 12 percent of sales in 1978 to 15 percent in 1981. The company may still be performing better than the general economy but, because of serious problems now affecting industrial activities in Zimbabwe, it is expected that Art Printers' sales and profits will decline in 1982.

Most of the company's product lines are secure due to strong market positions and few competitors. The plastics operations are heavily dependent on imported raw materials, which are becoming more difficult to obtain. The new tissue plant will have strong government support because it will be the country's first major tissue producer and will eliminate the need for tissue imports.

Human Resources

At the end of 1981, Art Printers had 1,342 employees. The problem of high turnover of middle and senior level management that has troubled many companies in Zimbabwe has apparently not severely affected Art Printers. In 1981, there were 39 appointments made to middle and senior management positions. Of these, 32 appointments were made from within the company. There is very little turnover at the worker level, but this is true throughout the country.

Employee-Management Relations

The Nedlaw Group companies appear to have a good working relationship between management and employees. There were no strikes at any Nedlaw plant during periods when other companies in Zimbabwe were experiencing labor problems, and serious labor disputes that disrupt production have not occurred. Instead, workers' committees elected by the workers were established well before most other companies. In addition, three or four workers sit on the boards of each of the five Art Printers companies, an unusual occurrence in Zimbabwe.

Wages and Benefits

Wages and benefits at Art Printers appear to be well above the industrial norm, although few statistics are available against which company data can be compared. Informed sources outside the company agreed with comments of Art Printers management that the company takes good care of its employees.

The company has a bonus system based on profits that last year afforded an end-of-year bonus to all employees of one month's salary or wages. Since profits may be much lower in 1982, however, management is already warning workers that the annual bonus in 1982 may be less or not at all. Management also gives bonuses, based on performance in meeting production goals, throughout the year.

The company's pension plan has been in effect since 1964 but was revamped in 1971. It gives all employees earning over $1,620 per year one-fiftieth of their last annual salary or wages for each year of service to the company at retirement (age 65). The plan also includes a life insurance component.

Canteens provide free tea and bread to all workers during tea breaks and free lunches to all weekly wage earners. Salaried employees can purchase subsidized lunches. The workers have lockers and changing facilities as well as modern shower facilities.

Another benefit provided by the company is housing. The government requires that workers at the minimum wage $139 per month receive a $8.10 housing allowance. The company does not have workers at the minimum wage and therefore does not need to provide an allowance, but it gives the workers $13.50 for those not in company rented housing. It also subsidizes the rents of employees in company housing. For a small number of workers who live in company rented apartments just outside Harare, the company pays a minimum of $54 per apartment and receives rent of $16.20-$21.60 from tenants. The company has just constructed what may be the most comfortable housing facilities for workers to date in Zimbabwe. The company had to construct housing near the new Kadoma Tissue Mill because little housing existed in that area. At an investment of $2 million, the company built houses for all mill employees. It charged them no rent (their wages are similar to workers in Harare); the construction cost per dwelling ranged from $16,875 to $87,750.

History of ESOP Development

The employee ownership plan represents one more benefit among many. Because of the its size, the plan does not rank among the more important benefits. Yet the plan has generated considerable interest among the workers.

For four years, Art Printers had been searching for a means to provide some ownership benefits to its employees. Early attempts, however, would have given more benefits to management and salaried employees than to the lower-level wage earners.

The most important objective of the ESOP in the view of management is the apparent political gain from giving the workers part ownership. By sharing ownership with the workers, Art Printers apparently hopes to avoid or delay any government attempts to nationalize the company. The plan is being presented as a middle ground between socialism and capitalism as currently practiced in Zimbabwe. Because the government is concerned about its tendency to discourage private investment, the ESOP concept appears to be an attractive option. The company has been receiving good press coverage, and a television feature was just taped describing the plan.

Communicating the Plan to Employees

To explain how the plan would operate to the workers, the company showed a 20-minute videotape to groups of 20-30 employees. A question and answer period that lasted as long as 1 1/2 hours followed the film. In addition, each employee received a printed description of the plan in English, Shona, and Ndebele. Workers were to have a role in deciding how the assets of the plan were to be used and distributed. Moreover, the workers would be represented on the board of a special trust set up to administer the plan. From the videotape presentation, the workers learned not only how the trust would function but also the process by which the workers would elect trustees.

Structure of the Plan

The directors of Art Printers developed the structure of the trust and its mode of operation. The trust was set up as a separate company with the name Art Group Employees Trust (private) Limited. This was to avoid a 20 percent tax on dividends as the tax is not applicable on a transfer of dividends between companies. The trust has six trustees: three are appointed by the Art Printers directors, and three are elected by the employees. The three appointed trustees are known as the professional trustees and consist of a High Court or Supreme Court judge, a lawyer, and an accountant.

The judge chairs the trust, has a casting vote, and receives no remuneration. The lawyer and accountant receive no remuneration or profit from the trust but are paid for their services by Art Printers. The three employee trustees receive no remuneration as trustees and must be employees throughout their term of service or they lose their trustee position. One professional trustee and one employee trustee are retired from the trust each year but are eligible for reappointment or re-election.

The management of Art Printers has said that the professional trustees are to assist the employee trustees in administering the trust and are not to look to Art Printers' management for voting instructions. However, since two of these trustees are remunerated and potentially reappointed by Art Printers management, their neutrality could be questioned. The judge would also have questionable neutrality if he wished to be reappointed. When interviewed for this study, however, he demonstrated independent thinking and has a reputation for independent action.

Election Process

The election process for the three employee trustees starts with the election of the electoral committee. This is done by secret ballot, and all employees are eligible to vote. Each of the five operating units of Art Printers elects two representatives to sit on the Electoral Committee, which comprises these 10 people. The election, held in mid-1982, generated considerable interest among the employees. This is the only direct ballot the employees have for operation of the trust, but there are other ways they may be able to vote or comment. One of these ways is when the Workers' Committee for each of the five operating units nominates two employees as candidates for the trustee positions. While the employees do not vote individually for these candidates, it appears that the Worker's Committees act in accordance with the perceived interest of their members and occasionally use lunch time in the canteens to discuss issues with the workers. The 10 candidates are then interviewed by the Electoral Committee, which selects the trustees.

Stated Perceptions of Two Elected Trustees

The committee selected an electrician, an accounts clerk, and the general manager of one of the operating divisions. The general manager is an African with an MBA from a U.S. university. The study team interviewed the electrician and general manager. The former was not sure how he would communicate with the employees but expressed a desire to represent their views. The general manager, in contrast, saw his role as serving employees' interests as he defined them. He was, therefore, not interested in setting up lines of communications from the employees to the trustees.

Role of the Trust

The trust has an important role in determining how the shares are to be held and how the dividends are to be used and/or distributed. Art Printers organized the trust to be the holder of the shares contributed by the company and to vote those shares as a block at shareholders meetings. Any independent purchase or sale of shares by the trust must be approved at a general meeting of the shareholders and by a special resolution that requires a 75 percent majority vote of all shares. Art Printers' management has indicated its interest in seeing the trust use the dividends to purchase additional shares.

Except for this restriction on purchase and sale, the trust has been given full authority to decide how to handle the shares and dividends. Although management told the study team that the trustees could decide to distribute the shares to employees and to develop formulas for how this distribution would be made (for example, vesting or employee performance) it appeared that the trust in fact was expected to retain the shares and focus attention on how the dividends would be used and distributed.

Possible Conflict of Views on Using Dividends

Most workers would like to have dividends go directly to them. Both management and trustees interviewed, however, prefer to see dividends used to make investments and/or undertake projects (for example, build recreational facilities) that would indirectly benefit the workers. They think that the combined strength of the dividends will benefit the employees as a whole more than if each employee were to use his dividends individually. The employees may take issue with such a policy. Since they were to have a role, albeit indirect, in trust decision making, they may either try to influence policy or, if unsuccessful, become disinterested in trust matters. The possibility also exists that the trustees and management may convince the workers that the trust decisions are best for them. The Art Printers' strategy of giving responsibility for structuring the benefits to employees risks disappointing a majority of workers.

Company Contribution to the ESOP

The trust will obtain its shares as a contribution from Art Printers. The total number of shares to be contributed is the number equal to 15 percent of all issued shares. If the number of issued shares increases, Art Printers would increase its contribution to keep the trust shares at 15 percent of the total.

The company's 15 percent contribution is to be achieved gradually by annual contributions to the trust of 15 percent of distributed profits. The shares come from authorized unissued shares that can be contributed at par value ($1.33). In 1981, the company made its first contribution, amounting to 324,000 shares ($437,400). If distributed profits were to remain the same each year, the full 15 percent of issued shares (without any new additions to issued shares) would require nine years to attain. Profits are currently down, however, and the company expects that the contribution this year will be less (in number of shares) than in 1981.

The trust will receive dividends for the shares already contributed (the first and only dividends paid to the trust amount to $35,100) as well as the contribution of 15 percent of distributed after-tax profit until the target of 15 percent of total issued shares is reached. If, for example, the trust already holds 10 percent of issued shares, it would receive the 15 percent of distributed profit in the form of new shares at par and then 10 percent of the dividends from the remaining 85 percent of distributed profit. The trust would thereby receive a total of 23.5 percent (15 percent plus 8.5 percent) of distributed profit.

The new shares given to the trust dilute the value of the shares held by the regular stockholders. In addition, the contribution of shares draws 15 percent of distributed profit away from dividends. The result could be a cost to shareholders of 25-30 percent of distributed profit in the years before the last contribution is made. If profits remain low, this burden on the regular shareholders could be drawn out over a long period of time.

Art Printers management expressed a desire to leverage the contribution by taking out a loan and then making the entire 15 percent contribution at once to lower the overall cost to shareholders. The interest on the loan could cost less than the potential draw on distributed profit under the current system, but the company may wait until interest rates are lower and perhaps for more favorable treatment from the government for such loan uses. Unlike in the United States where principal as well as interest can be used as pre-tax expenses for ESOP loans, in Zimbabwe only the interest could be deducted. Art Printers was most interested in the possibility that it could receive a tax credit for contributions to an employee trust. If the company were to borrow to make the full contribution now, it may lose some of the benefits that may be forthcoming if government interest in these plans increases.

Conclusions

This ESOP is too new to determine a level of success. The company is satisfied with progress to date as the employees appear excited about their participation, and the plan is receiving attention in the media, thus providing some of the political gains the company intended. This interest is at high cost to the company, however, due to the financing strategy. It also may backfire if the employees are not satisfied with future trust decisions and with the income they derive from the plan. For the long term (10 years and beyond), the prospects are better. The amount the trust has to spend or distribute will be much larger.

DUNLOP ZIMBABWE

Company Description

Until 1980, Dunlop Zimbabwe was a wholly owned subsidiary of the British Dunlop Group. Responding to statements made by the prime minister of Zimbabwe, the holding company sold 21 percent of Dunlop Zimbabwe's shares to the Zimbabwe public and, as an experiment, placed 4 percent within an employee share trust.

Tires accounted for three-fourths of Dunlop's $48,600,000 1981 sales; industrial rubber products, floor tiles, furniture, engineering, and sports equipment manufactured by subsidiaries provided the remainder. The company has a monopoly on their production and faces little competition in its other product lines.

Although post-tax profits dipped slightly in 1978, sales, profits, earnings per share, and net asset value per share have climbed steadily during the past five years. In 1980-1982, post-tax profits increased 36 percent and the company made substantial investments to modernize equipment and expand plant capacity.

During its 30 years of operations, the company has had no worker layoffs. From 1977 to 1981, the number of employees remained stable, with 398 monthly salaried employees and 952 weekly wage earners. However, a freeze on salaries above $27,000 a year has resulted in a high turnover of artisans and middle managers; for example, 89 percent of the Finance Division's staff has left during the past 18 months. Those with young children generally have emigrated, while older employees have switched to companies that have frozen salaries at higher levels. The company cannot find replacements for most positions. The less skilled labor turnover is extremely low; this is because wages are relatively high, government approval is required for dismissals, and workers skilled to operate tire manufacturing machinery have no alternative employers. Unlike many companies, minimum wage legislation did not affect Dunlop since it already had been paying higher than minimum wages.

Dunlop also established a workers' council 20 years before the recent legislation. Until 1973, worker representatives were appointed by management. The 12 worker representatives are now elected and meet each month with nine management representatives. After independence, the Government of Zimbabwe established industrial boards for each industry; since Dunlop is a monopoly, it has its own board. Each year, management and worker representatives meet with the board to discuss wages and working conditions. Unless their findings are positive, the company cannot continues its operations, which are later published in the government gazette.

Dunlop workers are not unionized nor are they represented on any boards of directors. Management officials acknowledge that the former will occur in time but, unlike the Nedlaw Group, plan to resist the latter.

Dunlop Group Benefit Plan History

Weekly wage earners working on the assembly line are given production incentives with bonuses when they meet output targets. Merit bonuses, based on score sheets filled out by supervisors, are given to weekly workers whose productivity cannot be measured. In addition, all workers and salaried employees receive an annual bonus amounting to a "thirteenth pay check." In theory, this bonus is paid only to those performing well, but actually all employees expect and receive this payment.

The company is not required to provide a housing allowance since all workers earn more than the prescribed wage; instead, it has guaranteed a portion of mortgage bonds for about 30 employees. All employees (if they joined the company when younger than 55 years) are covered by a pension scheme. Salaried employees and weekly wage earners contribute 7 1/2 percent and 5 percent of their earnings respectively to the fund; their contributions are matched by the company. Retired employees receive monthly payments and their survivors receive death benefits.

In addition, the company offers free literacy courses to all employees, allocates about $135,000 each to train company artisans, operates a subsidized canteen, and sponsors sports and social clubs.

Reasons for Introduction of the Employee Share Participation Scheme

Dunlop decided to sell 25 percent of its Zimbabwe company to the public to minimize the risk of nationalization. The Government of Zimbabwe initiated the idea of setting aside a portion of these shares for employees, but the London-based management was also interested in using its Zimbabwe company to experiment with this scheme. If successful, the home office planned to consider initiating similar schemes in other overseas subsidiaries.

The company's only other motive in 1980 was to give all employees more of a stake in the company and reduce the already low rate of turnover. Management did not believe the scheme would have any effect on worker-management relations for productivity.

No strikes had occurred since the establishment of the workers' council, and worker productivity always had been high.

Employee Share Participation Scheme Description

Management wanted to introduce the simplest possible scheme since most workers are semi-literate and thus would not understand complicated ownership concepts. About 900,000 (3.7 percent) of a total of 24,000,000 shares were set aside for employees and pensioners in November 1980. The $2.43 share price ($0.68 par) was the same as that paid by the Zimbabwe public. The market responded well to the new issue; shares were three times over-subscribed, and the price initially climbed by 10 percent.

The company established an employees share trust, which received a $2,187,000 loan from the Merchant Bank to purchase shares on behalf of employees. This 13 percent, three-year loan has a roll-over provision and is expected to be repaid fully within 5-10 years. Post-tax dividends on stock repay the principal, while Dunlop covers interest charges and the trust's administrative expenses. The three trustees appointed by management include the company's managing director and two outside professionals. Although the trust is legally entitled to purchase and sell shares on the open market, such action will not occur until the loan is fully repaid.

All employees having at least one year's service by November 1980 were entitled to participate in this one-time offer. Each employee had 40 shares for each year of service allocated into an individual account. Dividends are credited to each employee's account to reduce the amount of loan; after five years, however, employees may purchase shares outright by paying the outstanding balance.

An additional 20 shares for each year of pre-November 1980 service were available to employees for cash purchase at the issue price of $2.43. Employees could also elect to purchase such shares over a one-year period through salary withholdings. Until fully repaid, these shares, in essence bought with an interest-free company loan, do not qualify for dividend payments. Thus, in November 1980 a worker employed for 10 years received 400 shares allocated to his account and had the option of purchasing an additional 200 shares over a one-year period.

Each year, employees completing one additional year of service may purchase 40 shares on a cash basis until all shares available in the trust have been sold.

Employees leaving the company may keep their paid-up shares or sell them on the stock market. It is believed, but not yet tested, that this transfer of shares from the trust to employees and the income derived from stock sales will be exempt from the 30 percent capital gains tax. Employees remaining with the company, however, cannot sell their stock. After the loan has been repaid, the trust may use dividends to purchase new shares or may pass them through to individual employees.

Effect of the ESOP on the Company's Performance and Employees

To date, the ESOP's effect has been negligible. Although share value increased at first, the price has dropped to 38 percent of its initial value. As a result, employees are not interested in buying shares through the company for $2.43 when they can purchase them for $0.92 on the open market.

Management has been disappointed with the plan and thus has failed to publicize it. The depressed value of Dunlop shares is not a reflection of the company's financial performance, but rather is endemic to the lack of confidence in all companies in Zimbabwe. Management remains hopeful that the market will turn around and push its stock price up to its true value. If such an economic recovery occurs, then the employee share participation scheme may still one day be viewed as a model for the country and the Dunlop Group.

ANNEX E

THAILAND BACKGROUND AND ESOP CASE STUDIES

ANNEX E

THAILAND BACKGROUND AND CASE STUDIES

THAILAND BACKGROUND

Economic Profile

Thailand, with a population of 50 million, has one of the world's most rapidly growing economies. Of total gross domestic product, agriculture accounts for about 40 percent but is slipping as a result of limitations on fertile uncultivated land that formerly allowed output to increase at a 5 percent annual rate. Although rice accounts for two-thirds of cropland usage, increasing production of export-oriented cash crops have been boosting farm-gate income. Industrial production over the last two decades has taken an increasing share of GDP, rising from 19 to [illegible] percent. Industrial growth has been particularly strong in [illegible]e light industry and import substitution areas.

The country has a rich resource base that feeds industry and provides commodities for the export market. So far, only limited petroleum reserves have been found, but large natural gas reserves have been located in the Gulf of Siam. A large investment program has been developed to process the gas for petrochemical and liquified petroleum gas exports.

From 1976 to 1979, Thailand's annual foreign trade deficit increased from about $600 million to $1.9 billion and then shot up to more than $3 billion in 1980 and 1981. In the six years from 1975 to 1981, exports increased an average of 22.5 percent per year while imports rose 22.2 percent. For the first quarter of 1982, however, imports were down almost 12 percent over the first quarter of 1981, while exports grew almost 20 percent.

The consumer price index jumped from a 10 percent increase in 1979 to almost 20 percent in 1980 but fell to about 12 1/2 percent in 1981. The index plummeted to an annualized 1.7 percent for the first seven months of 1982.

While Thailand seems to be bringing its trade and inflation problems under control, it must maintain a strong export market for its key commodities. Decreased world demand for its raw materials, however, has lowered prices and sales volume. Recent U.S. and European Economic Community trade barriers to some Thai agricultural products threaten the growth of exports. Fortunately, Thailand has been able to diversify its exports. In 1950, only four commodities made up 81 percent of the exports. By 1979 the leading four exports held only 43 percent of total exports, while the trade sector of Thai gross national product reached close to the 50 percent mark.

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Trade Policy

Import tariffs and quotas are used to keep import levels down, and the tariffs provide about 20 percent of government revenues. Quotas have also been used to support development of import substitution industries. There is a current ban on imported automobiles, for example, as local assembly plants supply the market.

Exchange controls exist mainly to record transactions for tax purposes, and any legitimate transaction will be approved. The baht has been tied to the dollar for many years at about 20 baht to the dollar but was devalued twice in 1981 and now is about 23 baht to the dollar.

Human Resources

Manpower resources in Thailand appear to be adequate for current needs and future development. This is true at unskilled, semi-skilled, and skilled levels. Unemployment is close to 5 percent with under-employment in agricultural areas and a current glut of university graduates. Technical skills represent the only apparent critical weakness in the Thai labor force with many engineers currently working in the Middle East. The agricultural sector employs about three quarters of Thai workers, whereas the manufacturing sector accounts for about 7 percent. Thailand has a very high labor force participation rate (73.5 percent in 1978) due mainly to the strong role of women in all sectors.

Public-Private Sector Roles in Financing and Ownership

Much of Thailand's development has been self-financed. Foreign private investment represents a small amount of total private investment. A major portion of the equity in the commercial and manufacturing sectors is held by people of Chinese origin who control the business community. Many of the larger companies are majority owned and controlled by ethnic Chinese families. As late as the 1960s, there was still a strong societal division, with Thais dominating the public sector and ethnic Chinese dominating the private sector. However, as a result of intermarriage, assimilation of ethnic Chinese into Thai society and increased numbers crossing the public-private sector barriers, there has been very little tension between the two sides compared to that of Malaysia and Indonesia. Still, the concentration of ownership remains strongly in the hands of a small number of Chinese families who are said to influence government policy. Both equity and debt financing for industry come from private, predominantly ethnic Chinese sources. The commercial banks are an important source for loans, and although law prohibits an individual from owning more than 5 percent of a bank's stock, the major banking decisions are still controlled by the families whose combined stock represents a controlling interest.

The government strongly supports the private sector although public ownership of some companies (parastatals) continues due to past policies and an ingrained system that makes change difficult. There is currently some political maneuvering by minority parties to create and offer parastatal stock to civil servants. Whether this idea will take hold and what form it would take will depend on the fortunes of these minority parties in the parliamentary elections to be held in June 1983.

Tax Policy

Depending on their legal status, companies are treated differently by the Revenue Department. Registered companies have corporate profits taxed at a 30 percent rate whereas unregistered companies are taxed at a 40 percent rate. Since companies must have a certain level of capital to be registered, small companies cannot take advantage of the lower tax rate. Discrimination against small business also exists on capital gains taxes. Stock sold on the stock exchange is free of capital gains taxes while sale of stock outside the stock exchange is subject to a 10 percent tax. The tax on outside trading is often not paid, however, since transfers of stock are generally not reported.

The tax base is narrow due to a relatively small number of taxable companies and taxable personal incomes. In addition, there is considerable corruption among tax collectors and many small businesses are managed so as to keep profits hidden. Not only are company profits kept out of the sight of tax collectors but personal income for a large portion of the work force is also difficult to assess and to tax. This leaves the burden on companies that for reasons of size or level of government scrutiny keep clear records, and on employees of these companies and civil servants whose salaries are on record. For personal income up to $1,310, the tax rate is 7 percent. The tax is progressive and there are 12 different tax rate levels (for example, $8,734 at 22 percent, $26,201 at 45 percent, and above $87,336 at 65 percent). Dividends are taxed as regular income. There had been an exemption for the first $437 of dividends per tax year, but it was reportedly rescinded in 1981. There is a 15 percent withholding tax on dividends.

Pension Funds and ESOP Support

Thailand has no social security system, and the government does not strongly encourage pension funds although a company is allowed to contribute up to 9 percent of salary from pre-tax earnings (Bangkok Bank has a special exemption since its fund pre-dated the current law -- it can contribute 10 percent). Interest earned from savings in a pension fund is tax free. Pension funds must be set up outside the company with independent management. They are difficult to set up and maintain and have not yet become popular. Most benefit plans are based on immediate benefits to employees with little consideration for future needs. The Thailand Investment and Securities Company (TISCO), a private company, manages pension funds for a number of companies.

The Royal Thai Government has yet to show any interest in supporting ESOPs. It provides no tax advantages to these plans. Of the two operating plans the consultants studied, one is financed by after-tax personal income and the other by after-tax corporate profits.

Stock Exchange

The Thai stock exchange has been used more as a trading forum than for raising new capital. Existing shareholders are often given preferential treatment for new issues. This is apparently a mechanism for existing shareholders to maintain their control. The stock market is criticized for its high level of inside trading and manipulation and its volatility. In late 1982, the market boomed with some stocks increasing in value 300-500 percent. Although the volatility of the market argues against employee stock ownership (since the value of shares may be lower than desired at the time of employment retirement or withdrawal from the company), the purchase of shares at par and a fairly consistent pattern of high dividends still provide sufficient benefits. If employees can hold onto their shares until the market is up again, even greater benefits can be accrued.

THAILAND CASE STUDIES

BANGKOK BANK

Bank History

Bangkok Bank, founded in 1944, has grown to be the largest commercial bank in Thailand and is ranked 221st among the world's commercial banks. While Thailand's central bank, Bank of Thailand, plays the leading role in the financial market due to its official public sector status, Bangkok Bank maintains a dominant position in the private sector as it holds one-third of the assets of the country's commercial banks.

Bangkok Bank was the first private financial institution in Thailand to offer a farm credit program, which started in 1962. It also aided farmers through the provision of financial, technological, and marketing support, and it established a number of integrated agricultural projects. In the industrial sector, it has played a significant role in financing import-substitution and export-oriented industries such as textiles, food canning, electrical appliances and animal feed. The bank initiated personal loan services in 1962 and gradually moved into the area of housing loans, small business loans, check guarantee service, civil servant welfare loans and education loans.

Financial Growth

Total assets of the bank rose from $19 million in 1954 to $145 million in 1963. In 1972, bank assets stood at just over $1 billion and by 1981 were up to $6.4 billion. Over the last 10 years, the bank's net profit grew from $7.6 million in 1972, to $42.4 million in 1981. The Thai economy in 1981 had many financial problems, but the bank still fared well with assets rising 21 percent, deposits 25 percent, credits 20 percent, and profits 10.5 percent.

During 1981 new shares were issued twice, 1.5 million for the first issue and 2 million for the second. These issues raised the bank's paid up capital to $78.6 million on June 1 and $87.3 million on November 5. Combining the $4.9 million in share capital realized from the sale of shares to outsiders and $21.8 million appropriated from the year's profits, the bank's shareholders' equity reached $278 million, compared with $47.7 million in 1972.

Dividends have been rising gradually and steadily from $0.50 through the 1950s and 1960s to $0.80 in 1972. From 1977 to 1979 they rose to $1.20; in 1980, $1.70; and in 1981, $2.27. Share value rose from $6.43 in 1954 to $12.20 in 1963 but was only at $9.55 in 1972. It then rose steadily to a high of $18.54 in 1980. In 1981, share value was down to $13.96 and further declined in 1982 with the September price at $11.13.

Bank Ownership

The total number of shareholders now stands at 19,243. A breakdown by type of shareholder shows 34.51 percent of the shares owned by individuals, 58.11 percent by companies, and 7.38 percent by the government. Over the last 10 years, the number of bank branches has grown from 118 to more than 265, with 15 of these overseas. The number of employees grew from 6,927 in 1972 to 16,682 in 1981 and currently stands at more than 17,200.

Control of the bank has been, and remains, in the hands of the Sophonpanich family, who founded it, although a major leadership role for many years was played by Boonchu Rojanasathien, who was not a family member. He rose from accountant to bank president and developed such a strong reputation for his work at the bank that he eventually became finance minister and deputy prime minister. Today he is the head of a political party and a potential future prime minister.

Employee Turnover

Turnover of staff at the bank has been less than 1 percent a year and is highest at the higher staff levels as many senior people are lost each year to smaller banks. At those higher levels, advancement opportunities are greater by moving to another bank.

Remuneration

Salary levels at Bangkok Bank are lower than other banks, but salary alone does not fully reflect remuneration level. There are so many other benefits that the total package is more than twice the salary alone. Although the personnel director as well as staff members interviewed see the bank's full packages of salary and benefits as being greater than other banks, personnel staff at Thai Farmers' Bank said that the overall package of all major commercial banks is about the same although the pieces of each package will differ. The personnel directors of 16 Thai banks and 5 foreign banks meet each month to discuss their benefit packages.

For cash remuneration, Bangkok Bank employeee will receive a salary based on rank plus a cost-of-living (COL) allowance and an annual bonus. Currently at the lowest level a sweeper is paid $91.00 per month in base salary. Added to this is a COL allowance of $43.00. The COL is increased each year but part of the COL is added into the salary on a regular basis so that the COL does not become greater than salary. Annual increases in salary at this lowest level are $6.52. The annual bonus at this level is three months of salary. Also, the worker will receive into his pension fund an amount equal to 10 percent of his salary. The bank calculates total monthly remuneration at this level to be $189.

Other Benefits

The employees have access to the bank's medical clinic (four full-time doctors and seven part-time doctors). In addition, they receive free hospital care, an extra $13.00 per month for child care for two children, maternity leave with $87.00, subsidized lunches, and housing loans.

At higher levels, the main difference besides the amount of base salary is that the bonuses are in the four- to six-month range, with department heads receiving a six-month bonus. The amount of money that can be borrowed increases with salary (80 times salary). These loans are at low rates ranging from 8-10 percent (for 12 years), while the commercial rate for housing loans is currently 18-19 percent.

For middle management, base salary is $278 per month, and the bank calculates full remuneration to be $558. The monthly base salary increases about $17.00 per year at this level.

Another employee benefit is training. In 1981, the bank had 95 training courses with a total of 4,015 participant staff members. In addition, 321 staff members took part in 149 outside training programs and seminars and 27 officers were sent on observation tours and to participate in seminars overseas.

Employee-Management Relations

There is very little formal organization for employee-management communications. Some bank employees are unionized, but only about one-third of non-management staff are union members. In fact, the trend in the bank is not towards more unionization as many employees regard the unions as ineffective. There are no employee councils or committees to represent the employees. The personnel manager thought of only one forum for employee representation and that was the Bangkok Bank Sports Club. The club officers are elected by members and discuss matters other than just club activities. These officers can occasionally meet during working hours. Another opportunity cited for discussion of employee-management relations is the meeting of branch managers, which is held every other year.

In 1981, the bank began a program to develop quality control centers. Some of the branches already have operating centers while other branches have still to set them up. The senior quality control group in Bangkok Bank was chosen by management.

At the branches, the employees selected their representative for a quality control workshop in Bangkok and have since been forming their groups. Each quality control group is to have about six members.

Description of ESOP

The bank's ESOP is linked to its two pension funds, Provident Fund I and Provident Fund II. The first fund was set up to hold the company's pension contributions to the employees. Each month the bank contributes to the pension fund for each employee an amount equal to 10 percent of the employee's net salary. This money earns 10 percent interest (compounded annually) per year tax free, and the contribution itself is also not taxed. The employee can take the total amount saved for him in the fund at retirement or when he leaves the firm. He can also borrow from the fund.

In 1964 the bank set up Provident Fund II, with pension benefits linked to length of service. The bank contributes to Fund II twice during a person's employment, once at the end of five years of service and once again at the end of 10 years. Each time, the bank calculates the total amount credited to an employee in Fund I up to that point (including interest payments). It then contributes an amount equal to 50 percent of that sum to Fund II. This money is not taxable to the employee but comes out of the bank's after-tax profits as the government allows pension contributions to come out of expenses up to only 9 percent of net salary. Since this amount is already going into Fund I, the bank receives no tax advantages from its ESOP. The bank can makes a 10 percent contribution into Fund I rather than 9 percent through an exemption since its plan was already in effect when the restriction was enacted. The contribution to Fund II, however, has not been exempted.

Unlike Fund I, the second fund cannot earn tax-free interest. Thus, bank managers decided to use Fund II to purchase bank stock at par, thereby giving employees an opportunity to become part owners and earn dividends.

The employees make their major purchase of stock at the end of five years of service soon after the bank makes the Fund II contribution. At the next issuance of stock, all of the Fund II five-year accounts are swept of money and the fund buys the shares. The employees individually own those shares, receive dividends, and can vote their stock. They cannot sell their stock, however, until they retire or leave the bank. When they do retire or leave, they can take stock with them or sell it to other employees (thereby saving a brokerage fee), or on the stock exchange. Sales on the stock exchange are free of the 10 percent capital gains tax while sale elsewhere is subject to the tax. Most private sales, however, go unreported.

Once an employee has purchased stock, he becomes eligible to participate in future offerings. These are made when new stock is issued and allows employees to purchase stock at par at a ratio of one share for a predetermined number of shares based on the number available and the number of owned shares the employee could use to make the new purchase. The bank, however, makes no further contributions to Fund II to help finance these new purchases until the end of the tenth year. While the employees can use the money from this second contribution for stock purchase, the amount of stock available is much less than the amount of money (in terms of buying power) in Fund II. The money in Fund II earns no interest and cannot be withdrawn until retirement or termination of service, but can be used to purchase new shares over the remainder of the person's employment. Shares bought with this money have the same restriction on sale as with the first contribution to Fund II, but shares bought at par from the employee's own financial resources (outside Fund II) have no sale restrictions.

The bank does not communicate much to its employees about the two Provident Funds. It issues a general notice about the terms of a new issue but little else is said. Employees wishing to know the status of their accounts can request and receive the information from the Personnel Department. The bank does not make public statements about the funds or stock purchase plan, but the study team found that many persons outside the bank knew of the plan's existence. The plan is considered by many of these outsiders to be very successful, and the Personnel staff at Thai Farmers Bank gave it high praise. Within Bangkok Bank, those most enthusiastic about the plan are employees with long periods of service. They have been able to purchase shares over a long period of time (up to 18 years) and many have accumulated relatively large blocks of shares. They receive sizable dividend checks and know former employees who have left the bank and realized a considerable sum of money upon selling their stock.

Conclusion

The Bangkok Bank ESOP can be considered a success. After 18 years of operation, it is appreciated by both the bank's management and the employees. The bank derives no immediate financial benefit from the plan, and there is no clear linkage between it and increased employee productivity. The plan is viewed as one more benefit to employees, but the bank views its overall benefit program as important for employee morale and to attract the skills it needs. Bank management does not foresee any changes in the benefits package.

SAHA UNION

Company Description

Within 20 years, Saha Union has grown from a zipper manufacturing company to the largest textile and garment conglomerate in Southeast Asia. In 1972, the Saha Union Corporation became the holding company for Venus Zippers and seven other firms producing garment accessories. Five years later, creditors of Thailand's largest textile venture asked Saha Union to manage one of that company's unprofitable plants. Successfully turning around the operation, Saha Union set up cotton farmers' cooperatives to supply its 5,000-ton capacity ginning factory; expanded into the production of rubber products, cellophane tape, household appliances, marine products, plastic parts, and machinery; and established its own capital investment company. The corporation established a manufacturing plant near San Francisco and recently concluded an agreement to produce Nike sports shoes.

Structured growth complemented Saha Union's product line expansion. The company has been transformed from a $1.5 million privately held company to a publicly traded company with a tenfold increase in paid-up capital. The assets of the 30 interlocking companies controlled by Saha Union reached over $200 million in 1981.

Although Saha Union and affiliated companies' sales have increased by an average annual compounded rate of 43.7 percent during the past five years, net profits dropped from $231.1 million in 1979 to $31.7 million in 1981. Major factors contributing to this decline were higher production costs and finance charges that pushed up expenses, while protectionist European policies and stagnant world demand held prices down. The company, however, is well positioned to maintain 75 percent of the Thai domestic market and resume its traditional earnings performance when its trading partners regain their economic health.

With almost 11,000 workers, Saha Union is one of Thailand's largest employers. The company has never laid off any employees, but rather transfers those at less profitable subsidiaries to new acquisitions. Unlike some of its competitors, Saha Union employees have never gone on strike and united attempts at unionization have failed.

Employee Benefits

The motto of the company reflects its founder's philosophy of linking employee welfare with corporate growth: to earn a maximum return to shareholders while providing long-term benefits and security to employees. Saha Union's founder and current president, influenced by Japanese management techniques, has promoted a benefit package that exceeds that of most Thai companies. These benefits include a:

- Credit Union -- savings (5 percent deducted from post-tax salary) earn 12 percent tax-free interest; 13 percent is charged on loans that cannot exceed 50,000 baht;

- Housing -- about 45 percent of employees live in company dormitories. Those earning less than 3000 baht pay 30 baht a month; those earning more pay 50 baht. Only unmarried employees are eligible;

- Transportation -- free bus service is available for all employees;

- Medical Facilities -- an infirmary, physicians, and subsidized pharmacies are available to all employees;

- Sports -- a gymnasium is provided, and team sports are encouraged;

- Canteen -- subsidized meals are available to all;

- Education and Training -- most employees participate in development and training programs while about 25 are sent abroad each year for management and technology training;

- Corporate Store -- all employees are members of this store, which carries a wide range of products at low prices;

- Entertainment -- the company sponsors dances and other social activities; and

- Emergency Fund -- Saha Union provides grants averaging $125 for unexpected emergencies.

Employees in every company elect one representative to manage each of these 10 benefit programs. Committee representatives elect a chairperson for each program who meets with management representatives to determine budget allocations. These meetings also serve as a mechanism to communicate grievances or suggest improvements. Decisions are reached by consensus rather than by voting on specific issues.

In addition to these benefits, Saha Union:

- Pays higher than the legislated minimum wage;

- Grants all employees an annual bonus typically equivalent to two months wages (only a one month bonus was paid in 1981);

- Encourages employees to suggest methods to increase production, reduce costs, and improve product quality; and

- Sponsors an annual three-day company retreat, attended by 600 employees as well as supervisors and management.

Description of the Employee Stock Ownership Plan

Enabling employees to purchase stock at subsidized prices was a continuation of policies designed to promote employee loyalty as well as capitalize Saha Union. Until 1978, shares were distributed only as bonuses to senior management. The president compared the value of broader employee ownership to the sturdiness of resting on 11,000 poles instead of a few. The main motive, thus, was simply to encourage employees to feel like owners.

In 1978, 60,000 newly issued shares were purchased at par value ($5 per share) by the Saha Union Employees Mutual Fund. An interest-free loan was secured from the Saha Union Capital Investment Corporation to purchase the stock whose market value was considerably higher (currently $6.78 a share). Five percent of the post-tax monthly salary of confirmed salaried employees or one day's wages of daily laborers was automatically deducted over one year to pay for the stock.

In 1980, more than 60,000 newly issued shares were again set aside for employees. All stockholders were allowed to purchase an equal number of shares already owned at par value; new employees had 5 percent of their monthly salary deducted to purchase shares. The third new issue in 1981 allowed only previous shareholders to purchase new stock at par on a 5:1 basis. Thus, employees joining the company since 1980 have not been able to participate in this share offer. Any future offers will be at the discretion of management and shareholders. Employees currently own about 6 percent of outstanding shares.

Employees cannot sell their stock until they retire or leave Saha Union. The stock, however, can be used as collateral for loans granted by the employees' credit union. And, since a $1.00 dividend per share has been declared every year since 1979, generating a 20 percent return on employees' equity, a steady supplementary income stream is tangible evidence of ownership to employees.

The impact of employee stock ownership is difficult to determine since it is only one of many benefits accorded to employees. The company's financial performance had deteriorated since the ESOP's introduction, but the two events are coincidental rather than causally related. Management did not expect any changes in worker productivity, which has always been high, or absenteeism and turnover, which has always been low. There are indications that middle management turnover is a problem, apparently due to low salaries, and has not been offset by the ESOP. Employees participate at annual stockholder's meetings and have helped to elect a few members of the Board of Directors. Instead of nominating fellow workers to the board, employees have suggested the managing directors of their respective companies. This conforms to a more traditional Thai practice of rising through the success of superiors rather than attempting to form horizontal ties with fellow workers.

Because shares are distributed in proportion to income, however, lower paid employees receive relatively insignificant numbers of shares. A female machine operator who had been employed with a Saha Union company for seven years, for example, owned 16 shares (current market value = $109) that earned $14 in dividends last year. Thus, stock ownership is seen by employees as a valuable symbol of their role within the company rather than as an important complementary source of income. Other company benefits coupled with the high unemployment rate of unskilled Thai workers accounts for the low turnover of assembly line employees; apparently, stock ownership has not provided sufficient incentives to middle management personnel, who reportedly are leaving because of lower than average salaries.

The Saha Union ESOP still is in its infancy and could have significant impact on the company and its employees if additional shares were made available at par value. Although management doubts that employees will ever achieve majority control, no limit has been placed on the percentage of shares they might eventually own. But the value and number of shares made available to employees through a new issue depend upon the company regaining its strength. That in turn depends upon a recovery among the industrialized countries, which account for 70 percent of Saha Union's sales. Management claims that the array of costly employee benefits has helped retain high productivity but nevertheless has lessened the company's ability to compete on the domestic market. Thus, employee benefits have both contributed to the company's success and forced it to seek export markets that have increased its vulnerability.

ANNEX F

COSTA RICA BACKGROUND AND ESOP CASE STUDIES

ANNEX F

COSTA RICA BACKGROUND AND CASE STUDIES

COSTA RICA BACKGROUND

Environment

The economy of Costa Rica is competitive and open, with no political or social barriers to entering into almost any type of legal economic activity. There is no discrimination against foreign investment; companies may be 100 percent foreign owned, and complete repatriation of profits is allowed. In fact, government incentives to attract foreign investors are numerous. The most important policy instruments have been a common framework of protective tariffs, tariff exemptions for interregional trade, exemptions on imports of raw materials and equipment, tax

l monetary policies favoring industry.

le government intervention exists, however, in the allocation of credit (the banking system was nationalized in 1948) and in the ownership of key industries and services, including electric power generation and transmission, railroad services, refining of petroleum products, and the entire insurance industry. CODESA, the state-owned development bank, has virtually become a public holding company for many industries. Government intervention is also reflected in contractual obligations to the Central American Common Market; a system of credit allocation to the various agricultural, industrial, and commercial sectors; an overvalued currency until recently; and price controls on certain items.

The result has been the establishment of a protected manufacturing sector highly dependent on imported raw materials and semiprocessed goods. The government's philosophy has been to improve living conditions of the poorer sectors of the population while providing public support to basic social services, striving for greater equity in disbursing the national income, and expanding income and employment-producing opportunities.

Nevertheless, over the last few years the government has been caught between its relatively expensive policies of social welfare and an effective means of paying for them. Furthermore, the situation has been aggravated by the general worldwide recession and increased energy costs. As a result, the country suffers from a severe shortage of foreign exchange to meet an ever increasing external debt, large government deficits, increased unemployment, high inflation, and a general contraction in production. In addition, political factors have predicated against the timely adoption of certain corrective measures (including budget contraction, currency devaluation, and exchange controls) that could have lessened the current economic crisis. As a result, the impact of devaluation, when it was finally undertaken, has resulted in a more than 650 percent decrease in the value of the colon over the past 18 months.

The gross domestic product has dropped from a high of 6.3 percent in 1978 to 0.8 percent in 1981 and, furthermore, to a projected negative growth of 6 percent for 1982. The agricultural and commercial sectors (in which the two models reviewed are located) experienced diminishing growth rates of 2.5 percent and 5.7 percent respectively in 1975, and 0.9 percent and 1.5 percent in 1980. For more than 20 years, the unemployment figures for Costa Rica have been quite low, averaging 4-5 percent between 1960 and 1980. In the last year and a half, however, unemployment has doubled, to 9.5 percent with an additional underemployed population of 11.0 percent. In 1982, inflation is expected to reach 55 percent, down, however, from 1981's rate of 65 percent. In addition, from 1978 to 1981 the value of imports increased more than twice the value of exports, leading to a negative balance of payments of $185.7 million in 1981.

Existing and Proposed Tax and Labor Legislation Supporting Employee Stock Ownership

Although permitting some types of deferred compensation programs, tax and labor laws in Costa Rica, as in most Central American countries, do not specifically give tax or other financial advantages to ESOPs. Severance pay (one month's salary for each year worked up to eight years) is a legal requirement in all cases other than when an employee voluntarily leaves the company or in which an employer can prove gross negligence. In any case, the setting aside of the funds can take the form of an actual deposit into a bank account, incurring a tax reduction but also reducing working capital. It can also take the form of a simple accounting entry whereby the funds stay in the company but do not incur a tax deduction until they are payed out to a departing employee.

Pension funds, however, are specifically permitted by law and can be used as a tax deduction and as a way of complying with severance pay obligations. Nevertheless, this mechanism is seldom used because in addition to reducing the company's working capital, it would require payment to all departing employees rather than just those included under the severance pay obligations. Neither in the case of severance pay nor of pension funds may company stock or other forms of equity be used to satisfy the severance pay obligations.

An employee association is the only exception to these restrictions. Where such an association exists, the laws allow the company to make tax deductible severance pay contributions (either in cash or as equity calculated at fair market value) to the association in the name of each individual employee. If the payment is in cash, there is often an agreement whereby the cash is then used to purchase stock from the company with at least part of the money. The remainder of the funds is then invested in other securities or income-generating property. In either case, the dividends or interest from either the stock or other investments serve to increase further the employee association fund. In addition, the company can obtain critically needed funds through the sale of company stock to the association.

When an employee involuntarily leaves the company, the association is charged with the severance pay obligations. Thus, both the company and its employees benefit: the company is relieved of its severance pay obligations and retains most of its working capital as well as its tax deduction, and the employees collectively may use the monies for investments before they leave the company. To date, 45 companies have adopted ESOPs through employee associations. These companies have joined together with approximately 340 others in the Solidarity Union. This organization exists to promote and protect worker ownership activity and to advocate broad-based capital ownership.

Of further interest in considering Costa Rica's tax and labor legislation is the pending ratification of a new labor and tax code that will have a far-reaching impact on worker-owned activity in the future. The proposed legislation, "Sector Economico Laboral" (SEL), embodies the following concepts:

- The establishment of a national labor relations board to oversee all employee dismissals with the power to overrule a company's present right to make them. Representatives from labor, government, and the private sector would be members of the board;

- Severance pay contributions, which currently take the form of accounting entries without actual transfer of funds, would have to be made yearly into a trust administered by the National Social Security Administration. These accumulated funds would be used to:

  -- Finance worker-owned and -operated companies;

  -- Finance the national cooperative movement in converting existing producer cooperatives into worker-owned and -operated cooperative enterprises;

  -- Finance housing projects for workers;

  -- Transform existing state-owned enterprises into worker-owned and -operated joint ventures within the private sector; and

- Severance pay would become the inalienable right of all employees, including employees who leave voluntarily or are dismissed for cause. If employees are under 60 years old upon leaving the company, however, they would receive only one-half of earned severance pay.

SEL, however, would be in direct conflict with the goals and experience of the companies belonging to the Solidarity Union. Current severance pay investments, stock transfers to employees, and employee benefits through the use of these severence pay funds would be disallowed. According to the Solidarity Union, this private sector activity would soon be controlled by the public sector. An already overburdened, under-experienced, and under-staffed bureaucracy would be further taxed. In addition, worker influence within the various companies and worker benefits through participation in dividends stemming from stock ownership would be greatly reduced.

The Solidarity Union, therefore, has made a counterproposal to the government, including the following points:

- Severance pay obligations should extend beyond the current eight-year limitation (which is already practiced by many of the union company members); however, severance pay obligations would be waived in the case of employees dismissed for proven cause;

- Employee associations that already exist or that would be formed in the future would serve as the financial conduit for severance pay funds; these funds would then be invested in income-generating activities including the purchase of company stock;

- Employee associations should be based on the principle of free association at the discretion of the employees and not of the government;

- Severance pay obligations should apply equally to public and private sectors;

- Private as well as state run companies should be encouraged to establish vertically integrated subsidiaries co-managed by the workers and management of the "mother company," with total stock ownership reverting to the workers over a specified period; and

- Workers should have complete freedom to determine how their funds are to be invested and how their association is to be managed.

SEL is scheduled to be presented to the congress in January, 1983. It is possible that the country's economic conditions will prevent the government from taking on yet another costly social service, and that Solidarity Union's position will prevail.

In summary, Costa Rica's economic environment is one of democratic principles and economic pluralism. The country's sector contains many forward-thinking, enlightened business leaders who understand the benefits, actual and potential, of expanded worker ownership and co-management. From the companies' studies and the related officials and representatives interviewed, it appears that the expanded worker ownership movement, embodied by the Solidarity Union, has indeed been successful for both workers and management.

COSTA RICA CASE STUDIES

LA GLORIA

Company Description

La Gloria, S.A., one of the largest chains of department stores in Central America, was founded in 1902 by Santiago Crespo, grandfather of the present managing directors and principal stockholders. At present, the parent company is owned by two Crespo family holding companies that jointly control the main department store in San Jose and the administrative offices of the entire operation.

GLYSA, a subsidiary holding company of La Gloria, owns four branch department stores in the suburbs surrounding San Jose. Established in 1976, GLYSA is majority owned by La Gloria's founding investors and 35 percent owned by the Employee Association, comprised of the employees of both La Gloria and GLYSA.

At the time of the field investigation, La Gloria and GLYSA had 426 full-time and 75 part-time employees. Officers and managers make up 9 percent of the work force and sales persons 44 percent. Sixty-seven percent of full-time employees are women, 18 of whom occupy management staff positions and one an executive management position. Seventy-five percent of employees have at least a third-year high school education, and all employees are literate.

The salary level at La Gloria/GLYSA for a division chief, the highest salaried position in the firm, is only 4.5 times greater than the lowest paid full-time employee who has been with the company one year. The seven top management officers receive only a token salary but are major stockholders and depend on dividends as their major source of income.

The La Gloria/GLYSA stores currently have a market share of 30 percent of the retail trade. The second largest competitor, El Globo, controls 20 percent with the remainder, distributed among many hundreds of small retail stores. One other competitor, Mil Colores, recently closed as a result of poor sales and a low return on investment.

Despite Costa Rica's bleak economic situation and a fire that destroyed its main store in 1976, La Gloria has managed to survive reasonably well. Although the company's net worth dropped 18 percent between 1977 and 1981, total assets showed an increased value of 21 percent, from $3.1 million in 1977 to $4 million in 1981. During the same period, total sales showed a similar percentage increase. Net after-tax profits demonstrated the most dramatic increase -- 59 percent between 1978 and 1982.

The GLYSA subsidiary, where the combined work force of both companies have been stockholders since the company's founding in 1974, shows a similar pattern. Net worth decreased between 1977 and 1981, although by only 4 percent. Total assets value, however, increased 64 percent, rising from $560,000 in 1977 to $920,000 in 1981. Total sales also increased 69 percent, from $830,000 in 1977 to $1,200,000 in 1982. Net after-tax earnings increased only slighty during the same period, by 6 percent.

La Gloria/GLYSA Benefit Plan History

Throughout the evolution of La Gloria, its management has always maintained that employee welfare and contentment are critical to a company's success. As a result, the employee benefit package has always been broad. According to employees, the first major benefit is the open and benevolent disposition of management. Employee problems, whether job related or not, can be discussed with supervisors. Moreover, several of the more quanti fiable benefits have been instituted as a result of these discussions. Nevertheless, the principal result of this benefit is that employees feel part of the organization, which has many of the elements of a family. This in turn, according to employees, has led to increased productivity and loyalty.

Of the other benefits, it is difficult to distinguish those provided by the company and those provided through the Employee Association. The lowest categories of workers receive wages 50 percent above the required minimum wage. Meanwhile, other employees at higher levels receive salaries of 5 percent or more above the sector average. Likewise, salespeople can receive a 1-2 percent commission on sales, thus often doubling their take-home pay.

Another direct benefit is medical care by a resident doctor paid by the company to visit each store and attend regularly to the medical needs of employees. (Workers in Costa Rica can receive free medical attention at Social Security hospitals, but La Gloria employees prefer the company doctor.) In addition, the company has established a basic foodstuffs store where employees and their families can purchase commodities at substantially reduced prices. La Gloria also constructed a country club for its employees and has since donated it to the Employee Association, which administers it.

Reasons for the Introduction of Employee Stock Ownership

The reasons behind La Gloria's employee stock ownership initiative go beyond the company to a national movement started more than 30 years ago. Inspired by the thoughts and writings of Alberto Marten, a founder of Costa Rica's modern democracy, this movement has gone through several organizational forms and today is known as the Solidarity Union (Union Solidarista). The basic philosophy of the organization has not changed over the years, however, and is typified by a recent pronouncement of Jose Maria Crespo, a long-time supporter of the movement and general manager of La Gloria:

> It is said that political democracy cannot exist without economic democracy. The Constitution which guarantees our individual political and social rights has no meaning if economic guarantees are not offered to the working class. In the Solidarity Union we believe worker's ownership to be a joint action that permits the participation of the company and the worker within a framework of mutual respect and justice for all. Both employers and workers must contribute to the economic development of the country. Together, they must generate employment opportunities and create more owners of the nation's productive capital.

This philosophy advocates broadened capital ownership and a parallel sharing of profits between managers and workers as a societal goal. Worker welfare appears to be the principal, and indeed only, philosophical rational for the movement. Combating labor unrest or leftist tendencies within the labor movement is not, apparently, included in the philosophy. Testimony to this are the bylaws of the Soliarity Union, which state that ". . . the movement shall never be in conflict with a union," as well as its motto "Sursum," which means, "Neither to the right, nor to the left, but forward."

This philosophy, however, needed a financial mechanism for its practical manifestation. This mechanism was the severance pay that employers are obliged to set aside for their employees. For employers to receive a tax deduction, they may elect to fulfill their severance pay obligations by paying into a special bank account or to an employee association. They also can elect merely to account for the severance pay by setting it aside with an accounting entry, but in this case they do not receive a tax deduction until a payment is actually made to a departing employee.

The vast majority of the Solidarity Union company members, including those of La Gloria, have chosen to fulfill their severance pay obligations through their individual employee associations. This practice not only provides the associations with a financial base, but it also allows them to seek financial viability and growth through the income received from investing the severance pay monies.

Between the early 1950s and 1975, La Gloria's Employee Association funds were principally invested in government treasury bonds and in loans granted to individual employees. In 1975, however, the Crespo family proposed a joint venture involving the company and the association. The association would lend more than $82,000 to the company for the construction of a new suburban branch store. Interest to be paid on the loan would be used to finance the association's acquisition of 35 percent of the stock in the new holding company, GLYSA, to be set up as a subsidiary to La Gloria.

The association's members voted to approve the plan. This example of employee participation in a company's equity position was the first in Costa Rica's history and has served as a model.

GLYSA has continued to expand and now is the holding company for four La Gloria branch stores. One of the buildings in which a branch store is housed is also owned by the Employee Association. This was also done through a loan by the association to outside investors. Over the years, however, these investors were bought out, and the building is now wholly owned by the association.

Description of Employee Stock Ownership

Employee stock ownership in La Gloria is simple and straightforward. The monies paid to the Employee Association through the severance pay obligations are invested through a broad portfolio (including the one-time purchase of GLYSA stock), and the income produced by these investments is distributed to employees as a percentage of their base salaries.

The legal severance pay obligation is one month's salary per year up to a limit of eight years. Nevertheless, La Gloria, as an extra bonus to its employees, has waived the eight-year limit and, furthermore, has instituted a retirement-voluntary savings plan. In this plan, an employee chooses whether 5 or 10 percent of his salary is to be deducted automatically from each week's paycheck for deposit into his account with the Employee Association. In turn, the company matches this percentage with individual payments into the same account, thereby fulfilling its severance pay obligations and receiving a tax deduction.

The Board of Directors of the association invests these funds into a wide variety of bonds, treasury notes, and assets, as well as personal loans to employees. These loans, apart from annual dividends, represent to employees the most important benefit of the association. They are granted at 8 percent interest and require no collateral if the amount is below that which the employee has in his association account. If the amount requested is more than the employee has in his account, then another employee must countersign the loan as a guarantor.

The 35 percent of GLYSA stock held by the association belongs to it, and individual employee ownership rights do not apply. As such, the stock is not traded but rather remains in the portfolio of the association as its principal asset and for which it receives company dividends. Both the company's management and the association's directors look with optimism toward increasing the 35 percent ownership. This increase will be done through a similar mechanism -- a loan, with the interest paying for the new stock -- as the company requires new capital and as the association's financial reserves permit.

The Employee Association's members select its Board of Directors by secret ballot. There appears to be a good deal of turnover on the board as many employees interviewed had been, or had friends who had been, past members.

The Employee Association elects three out of eight members of the GLYSA Board of Directors. There are no association members of La Gloria's board; instead, there are two employee representatives out of a total of 10 members.

Employment Stock Ownership Benefits to Employees and the Company

The benevolent enlightened nature of La Gloria's management in affording benefits to its employees makes a precise attribution of employee stock ownership benefits difficult. This difficulty is compounded when one considers the Employee Association, with its separate benefit program.

Direct employee benefit from stock ownership in GLYSA is limited to stock appreciation and yearly stock dividends. This benefit, however, is relatively small compared with the overall dividends each employee receives from the total Employee Association portfolio of investments. Between 1978 and 1981, the GLYSA share of total association dividends paid to workers averaged 9-26 percent. Moreover, in the case of stock appreciation, stock value is not a manageable concept since it is calculated through a lengthy valuation of GLYSA assets. No figures were available to the field team, for example, concerning stock value since this valuation process had not been performed since GLYSA was first formed (it is currently being done, however.)

Membership in the Employee Association, which is voluntary but virtually 100 percent of the employees are members, can provide substantial financial benefit, depending on an employee's salary level and years with the firm. The range of dividends as a percent of total income, excluding top management staff, is from 3 percent for a beginning employee to 75 percent for a middle-level management employee with 18 years service.

Specific quantifiable benefits to the company are even more difficult to attribute to the company's overall benefit program, let alone to the stock ownership program. Nevertheless, both employees and management felt strongly that the overall benefit program, of which stock ownership was a part, has had an important impact on productivity and profitability, as well as on other indicators such as employee turnover, absenteeism, and cooperation among employees. Employee-management relations and labor unrest were other non-quantifiable variables that appeared to have been positively affected by employee benefits. There is currently no union at La Gloria, and according to employees interviewed, there appears to be no need for one because relations are excellent between workers and management.

COOPEMONTECILLOS

Company Description

Coopemontecillos began as a large cattle producer's cooperative and has recently emerged as a highly viable profitable business venture. In addition to cattle-marketing activities, the organization administers six industrial subsidiaries: animal slaughtering, meat packing, meat processing, tanning and related industries, exports, and retail sales. Coopemontecillos also holds equity positions in several related businesses, including 100 percent in a gelatin processing plant, 25 percent in an export agency, 33 percent in a printing company, and 12 percent in an export shipping line.

The cooperative was organized in 1964 by the National Agricultural Production Board to organize cattle production and the export of meat and meat products. It began as a cattle producer's marketing cooperative, with the different industrial divisions being added on as the organization grew and the financial situation allowed. Nevertheless, by 1977 the cooperative was on the verge of bankruptcy because of mismanagement and depletion of working capital caused by an excessive payout of dividends to cattle-producing members.

In a joint effort to save the organization and the jobs of the employees, 500 members of the cooperative and 233 employees (out of a total work force of 800) approached several local banks in a search for much needed working capital. A consortium of banks agreed to lend the necessary money based on the collateral of individual guarantees, the cattlemen pledging their land and livestock and the workers pledging 5 percent of their yearly salaries for seven years, should the cooperative default.

In exchange for the employees' support, the cattlemen agreed that all present and future employees could voluntarily become members of the cooperative and share in the division of any profits. Through negotiations, they agreed that yearly profits would be divided, 78 percent to the cattlemen and 22 percent to the workers. Furthermore, they also decided that 78 percent would be divided proportionally according to the number of cattle sold to the cooperative by each member, and that 22 percent would be divided according to the salary levels of the employees.

Additional share capital was raised by allowing cattlemen and employees alike to purchase shares in the organization. For this, they received an annual variable rate interest payment of 12-24 percent, (in addition to dividends described above). Employees could also purchase shares outright or could volunteer for a 5 percent salary deduction to buy shares automatically.

In 1979, an Employee Association was founded to make full use of the severance pay monies that companies are required to set aside in either a bank account or an association to receive a tax deduction. The association then uses these funds to make individual loans to employee members, as well as for other employee-related activities.

At present, the cooperative has 1,042 cattlemen and 780 employee stockholders. Employees currently own 20 percent of total shares, up 7 percent from last year. Other business indicators such as total sales ($32.1 million), total assets ($11.0 million), net profits ($5.6 million),and net worth ($14.0 million) have all increased substantially since reorganization in 1977. This increase, however, also is due to the exported products of the cooperative being priced in dollars while its costs are in colones, as well as to the devaluation of the colon over the past 18 months.

Coopemontecillos has been granted a 27 percent allocation of Costa Rica's U.S. meat import quota; it has three other competitors for this market. It also controls 60 percent of the export market and 40 percent of the domestic market for leather. In processed meat, the cooperative holds a 20 percent market share.

Of the total work force, 26 are professional staff including four executive managers, 12 are technicians, 205 are administrative or office personnel, 25 are sales people, and 660 are skilled or semiskilled workers. Women make up 15 percent of the work force. Forty percent of the employees are under 20 years old. Twenty-four percent have a high school education or better.

Coopemontecillos is adminstered and organized along traditional cooperative lines. There is a general assembly composed of one delegate for each 10 employees or cattlemen. This body elects a seven-member Administrative Board and a five-member Vigilance Committee. By arrangement, which dates back to the early founding of the cooperative, the National Agricultural Production Board has one representative on the Administrative Board, but this convention is due to end in October 1982. The cooperative is managed on a daily basis by a professional management staff, who are also members of the cooperative and the Employee Association.

Coopemontecillos' workers have no union. Instead, they are organized into groups of 10 persons. Each group elects representatives to the General Assembly. These groups also serve as two-way conduits for the exchange of information between managers and officials and members and employees. Furthermore, each division of the organization has a labor arbitration committee to settle labor disputes; it is composed of workers and managers. A third type of committee, the Labor Board, also exists. This board is also composed of elected managers and workers and deals with overall planning and policy issues of each cooperative division.

History of Employee Benefits

Employees working for Coopemontecillos receive a wide array of benefits both from the cooperative and the Employee Association. The cooperative, for example, provides the free services of a doctor, a dentist, and a family nutritionist on a regular basis to all employees. Major medical and life insurance is also provided free of charge, as are work uniforms and the use of a country club. Interest-free loans are granted to workers who desire further schooling, and the cooperative has also organized a basic foodstuffs store where employees may purchase items that are only nominally marked up.

Nevertheless, the most important benefit mentioned by employees interviewed was that of feeling part of the organization in terms not only of participation in the distribution of dividends, but also of their opinion and ideas having an impact on the organization's decision making.

Benefits from the Employee Association are presently of two types: a systematic savings program and a loan program. These programs function in conjunction with the severance pay obligations. Employees can elect to save either 5 or 8.33 percent (one month's yearly salary) of each salary as an automatic payroll deduction. This percentage is then matched by the cooperative in fulfillment of its severance pay obligations. Both the employee's contribution and the cooperative's are recorded in each employee's account. The employee may then borrow up to 10 times against this amount by using two fellow employees as guarantors. The interest most commonly charged is 20 percent.

If an employee leaves the cooperative, for any reason, the association returns the severance pay portion of the employee's account to the cooperative, which in turn pays it to the employee as severance pay. The remaining portion of the employee's account is paid directly to the ex-employee by the association. As an additional employee benefit, the cooperative exceeds the legal requirement on severance pay of eight years and pays out one month's salary for each year of employee service.

Reasons for the Introduction of the Employee Ownership Plan

Coopemontecillos' stock ownership and benefit plans resulted from a philosophical focus, a financial advantage, and the avoidance of a shutdown. The philosophical focus stems from the

Solidarity Union movement of which Coopemontecillos is a member. The movement holds that owners, managers, and workers must assist one another in the efficient operation of any business venture and, more important, should also jointly share in the benefits of the business venture.

The issues of a financial advantage and the avoidance of a shutdown are linked and were critical to the reorganization and establishment of the employee ownership program. In 1976, the cattlemen and the employees, who at that time were non-members, jointly faced a difficult problem. In that year, the cooperative was about to go bankrupt, a situation that would have left the cattlemen without a marketing structure and the workers without jobs. It is doubtful that either one of the two groups could have received a working capital loan from a bank. Nevertheless, the two groups together, promising individual personal guarantees, were successful. This, however, forced the cattlemen to agree to open cooperative membership to the workers and to allow them to participate equally in the ownership, benefits, and profits of the cooperative.

Description of the Employee Ownership Program

The employee ownership program at Coopemontecillos functions in a way similar to other cooperative societies. Members, in this case cattlemen and employees, purchase shares in the cooperative for a fixed price. Interest is paid on this share capital according to a percentage approved yearly by the General Assembly. The rate in 1981 was 24 percent, and earlier it was 12 percent.

Year-end profits are divided and paid to members based on member usage of the cooperative. In the case of the cattlemen, this usage is determined by the number of head of cattle marketed through the cooperative. In the case of employees, it is based on the relative salary/wage level of each employee. The split of 22 percent of profits to employees and 68 percent to cattlemen was determined as an average value that each group provides to the finished value of the final product sold.

Year-end dividends, once determined by the above formula, are then paid out in either cash or shares, or as a combination of the two. This decision is also made by the General Assembly and is normally based on the yearly working capital needs of the cooperative. In 1981, for example, employees received as dividends two monthly paychecks in cash and two additional ones in shares. For 1982, it is predicted that these dividends will increase to three monthly paychecks in cash and three in shares.

Utilizing this method allows the cooperative to control better its supply of working capital while precluding share value appreciation. Instead, appreciation is in the form of an increased number of shares.

When members leave the cooperative, either cattlemen or employees, they receive a cash payment for the value of their accumulated shares. Ninety-five percent of what is owed to them is paid immediately upon departure, and 5 percent is held until the cooperative determines that the member owes no debt to it.

Employee Ownership Benefits to the Cooperative and Employees

Identification and attribution of employee ownership program benefits are usually difficult and non-quantifiable in nature. The problem in this case, however, is complicated by the joint issues of devaluation and export products.

Without a doubt, the cooperative has made major improvements in its financial situation since reorganization in 1976. Sales per employee, for example, increased from $14,500 in 1977 to $34,500 in 1981. In addition, the ratio of net profits to sales increased from 0.4 percent to 17.6 percent over the same period. The problem with these figures, however, is that the effects of devaluation cannot be separated from those of the employee ownership program.

Employees and managers alike did feel strongly that the opening of membership to workers and the concomitant employee benefits from that membership had had a direct impact on productivity and profits, as well as on other indicators such as employee turnover, absenteeism, and employee/management relations. One should remember that the economic benefits from membership, that is, interest payments, and cash and share dividends, are but a part of the cause of these normative improvements. Of even greater importance, as affirmed by those interviewed and observed by the research team, was the definite feeling of worker ownership that pervades the entire organization and appears to be the galvinizing factor in the overall success of the organization.

ANNEX G

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ANNEX G

SELECTED BIBLIOGRAPHY

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