DOES EMPLOYEE OWNERSHIP CONFER LONG-TERM RESILIENCE?

A follow-up study to 'Model Growth: Do Employee Owned Businesses Provide Sustainable Advantage?'

Professor Joseph Lampel

Professor Ajay Bhalla

Mridula Chordia

Cass Business School, City University

&

Dr. Pushkar. P. Jha

Newcastle Business School, Northumbria University

January 14 2014

THE STUDY

In 2010, *Lampel, Bhalla and Jha* with the support of *Employee Ownership Association* and *John Lewis Partnership* published a study that examined whether employee owned businesses (EOB) maintain the advantages of their ownership structure as they grow in size and complexity. The study examined the resilience of EOBs and how they fared under adverse economic conditions when compared to (a) their own performance during a period of economic growth and (b) the performance of non-EOBs? A comparative analysis was conducted of financial performance data for 49 EOBs and 204 non-EOBs in the UK. The secondary financial data collected was analyzed over two successive time periods – prior to the economic crisis (2005-08) and at the onset of the recession (2008-09). Based on the findings, it was concluded that EOBs are more likely to be resilient than non-EOBs.

This study extends the comparative analysis of EOBs and non-EOBs over the periods 2009-10 and 2010-11 to examine whether EOBs continue to demonstrate resilience when the disruption is prolonged.

DATA AND METHODS

The sample in this study consists of 38 EOBs and 239 non-EOBs. To ensure consistency, this study follows the same methodology as the Lampel, Bhalla and Jha (2010) Model Growth study. Membership of the UK Employee Ownership Association (EOA) was the criteria used for selection of EOBs. An updated list of employee owned companies was obtained from the EOA. Where new EOBs were added to the list, matched non-EOBs were also added, by referring to the UK Standard Industrial Classification of Economic Activities (SIC) codes of 2007. A few companies on the original list were dropped either because they were no longer members of the EOA or because of unavailability of financial data over the period of this study. In spite of these changes, the new sample closely approximates the distribution of the sample in the model growth study. The sectors covered by the sample include, among others retail, consultancy, manufacturing, healthcare and software services. Financial performance data was obtained from the FAME database.

FINDINGS

The data and analysis over 2005-2008 and 2008-2009 are reproduced directly from the Model Growth Report. This study therefore extends the original study by adding data and analysis for the years 2009-10 and 2010-2011.

- **EOBs show significantly higher growth in sales turnover relative to non-EOBs over 2009-10 and 2010-11. EOBs maintain their substantially superior performance since 2008-09 and also show stable levels of performance relative to non-EOBs as the recession continued over 2009-10 and 2010-11.**

TABLE 1 - INCREASE IN SALES TURNOVER

Increase over the period -	2005-08[a]		2008-09		2009-10		2010-11	
	EOBs	Non-EOBs	EOBs	Non-EOBs	EOBs	Non-EOBs	EOBs	Non-EOBs
Increase in sales turnover (Mean)[a]	10.04%[b,c]	12.10%	11.08%	0.61%	4.51%	0.04%	4.68%	-6.74%
Increase in sales turnover (Median)	10.81%	11.12%	10.52%	1.02%	3.43%	5.04%	3.85%	1.53%
	EOBs have lagged behind non-EOBs on increasing their sales turnover during this period		EOBs have managed to increase the difference with non-EOBs in this period. This is largely due to the huge decline in non-EOB sales		EOB sales growth rates have moderated, but continue to significantly outpace those of non-EOBs		EOBs continue to show positive growth, while non-EOBs display a steady downward trend	

[a] Average per annum increase reported for 2005–08 data. [b] t-test for the difference of means; statistically significant differences between EOBs and non-EOBs are shaded. (2005-08 and 2008-09: $p<0.05$) (2009-10 and 2010-11: $p<0.01$). [c] Raw scores reported, scaled normalised scores were used for analysis.

Non-EOBs show a significant and steady decline in turnover, dipping into negative growth rates, while EOBs continue to show positive growth in turnover. In the Model Growth (MG) study the reported comparative increase in turnover was higher for non-EOBs over 2005-08. However, as the recession hit in the period 2008-09, the turnover growth rates turned to being higher for EOBs.

EOBs not only maintained superior turnover growth relative to non-EOBs as the effects of recession started to have an impact, they continued to do so as the recession deepened. An important aspect to note is that the EOBs are not immune to recessionary pressures - they are better able to withstand the downturn. EOB turnover rates have also declined from those reported in Model Growth study of over 10% in 2005-08 to just under 5% in 2009-11. However, the non-EOB decline has been faster; they were ahead of EOBs at about 12% over 2005-08, but declined sharply to 0.61% in 2008-9 and now show negative growth of 7%. Therefore, this study supports the conclusion that EOBs display less sales variability across the business cycle.

- **EOBs show significantly higher growth in employee numbers relative to non-EOBs over 2009-10 and 2010-11. The impact of recession has been there but less severe than on non EOBs who have dipped into negative growth figures on employment**

TABLE 2 - INCREASE IN NUMBER OF EMPLOYEES								
Increase over the period -	2005-08[a]		2008-09		2009-10		2010-11	
	EOBs	Non-EOBs	EOBs	Non-EOBs	EOBs	Non-EOBs	EOBs	Non-EOBs
Increase in employee numbers (Mean)	7.46%[b,c]	3.87%	12.91%	2.70%	2.02%	-1.43%	0.65%	-2.68%
Increase in employee numbers (Median)	10.21%	5.61%	11.03%	1.81%	-0.34%	-0.99%	2.18%	0.92%
	The median values are higher than the mean for EOBs and non-EOBs. This indicates a skewed distribution in rates of employment growth due to a disproportionate group of firms growing at very low rates		The median values are lower than the mean for EOBs and non-EOBs. This indicates that some increased their hiring disproportionately to the rest of the sample for EOBs and non-EOBs		EOBs continue to show employment growth, while non-EOBs reduce employee numbers. EOB mean value is higher than the median, reflecting a disproportionate increase in hiring by a few firms		Slight overall increase in EOB employment pulls up the median value. The rate of decline in Non-EOBs employment accelerates as compared to 2009-10	

[a] Average per annum increase reported for 2005–08 data. [b] t-test for the difference of means; statistically significant differences between EOBs and non-EOBs are shaded. (2005-08 and 2008-09: $p<0.01$) (2009-10 and 2010-11: $p<0.05$). [c] Raw scores reported, scaled normalised scores were used for analysis.

The rate of increase in EOB employee numbers though positive and significantly higher than that of non-EOBs, also shows a sharp decline from 2005-08 and 2008-09 figures, for both mean and median values, indicating a general slowdown in employment. A possible reason for this could be that EOBs were approaching their optimal employment levels, or the maximum number of employees that could be sustained given their current sales levels. Having recruited talented people on favourable terms at the onset of the recession, they would now be well positioned to wait out the recession and may emerge stronger as the economy recovers.

- **Despite higher employment growth rates EOBs are only marginally behind non-EOBs on sales turnover/ employee over 2009-10 and 2010-11 (statistically not significant), and seem to be closing the gap despite maintaining higher employment levels.**

TABLE 3 – PRODUCTIVITY INCREASE AS SALES TURNOVER/EMPLOYEE

Increase over the period -	2005-08[a]		2008-09		2009-10		2010-11	
	EOBs	Non-EOBs	EOBs	Non-EOBs	EOBs	Non-EOBs	EOBs	Non-EOBs
Increase in sales turnover / employee (Mean)	1.33%[b,c]	2.94%	0.97%	0.22%	0.80%	1.12%	0.74%	0.87%
Increase in sales turnover / employee (Median)	2.10%	4.42%	0.52%	0.71%	0.94%	1.10%	0.95%	0.91%
	The median values are higher than the mean for both EOBs and non-EOBs. This indicates that the sample mean is more affected by firms with relatively lower sales turnover/employee		The median values are lower than the mean for EOBs. This indicates that the sample mean is more affected by firms that have seen a relatively higher increase in sales turnover/employee		EOB turnover / employee decreases as employee numbers increase. Non-EOBs productivity recovers due to reduction in employee numbers		EOBs show stagnant turnover / employee, while non-EOBs again see a drop in productivity	

[a] Average per annum increase reported for 2005–08 data. [b] t-test for the difference of means; statistically significant differences between EOBs and non-EOBs are shaded. (2008-09 and 2009-10: $p<0.05$). [c] Raw scores reported, scaled normalised scores were used for analysis.

Sales turnover/employee was used as a proxy for productivity. In 2005-08, non-EOBs, in keeping with higher sales and lower employment levels, were ahead on this measure. This changed with the onset of the recession in 2008-09 – productivity of EOBs becoming significantly higher than for non-EOBs.

As the recession deepened, this changed again; turnover/employee was lower for EOBs relative to non-EOBs in both 2009-10 and 2010-11.

In 2008-09, EOB productivity was higher than that of non-EOBs, in spite of a sharp rise in EOB employment growth rates. In 2009-10 and 2010-11, EOBs show only a small decrease in productivity, even as their employment levels continued to grow. Non-EOBs, witnessed a sharp decline in productivity in 2008-09 due to sharp fall in sales. Their productivity, as measured by sales /employee, recovered to 1.12% in 2009-10, but is accompanied by a reduction in employee numbers. Furthermore, in 2010-11 non-EOB productivity dropped substantially more than EOB productivity.

- **EOBs lag behind marginally (statistically not significant) on PBIT but over 2009-10 and 2010-11 improvement in profitability is shared by a larger proportion of EOBs**

TABLE 4 - INCREASE IN PROFIT BEFORE INTEREST AND TAXES (PBIT)

Increase over the period -	2005-08[a]		2008-09		2009-10		2010-11	
	EOBs	Non-EOBs	EOBs	Non-EOBs	EOBs	Non-EOBs	EOBs	Non-EOBs
Increase in PBIT (Mean)	10.91%[b,c]	14.88%	3.12%	2.08%	1.08%	1.14%	1.07%	1.15%
Increase in PBIT (Median)	12.70%	16.61%	4.20%	3.00%	1.26%	1.15%	0.87%	1.16%
	The median values are higher than the mean for both EOB and non-EOB samples over both comparison time periods. This difference is very marginal between EOBs and non-EOBs indicating similar levels of heterogeneity in the two samples				The lower EOB mean value in 2009-10 indicates that a higher number of firms had lower profitability growth. In 2010-11 the mean value is higher, indicating profitability growth across more firms. Non-EOB mean and median values are almost the same, showing symmetric distribution in the sample			

[a] Average per annum increase reported for 2005–08 data. [b] t-test for the difference of means; no statistically significant differences were found. [c] Raw scores reported, scaled normalised scores were used for analysis.

The profitability of EOBs and non-EOBs was not significantly different during 2005–08, even though non-EOBs performed slightly better than EOBs during this period. As the recession continued, we notice that increase in profitability declined across all firms – EOBs as well as non-EOBs. Although the relative performance of EOBs was better in 2008-09, profitability dropped to marginally below that of non-EOBs in both 2009-10 and 2010-11. None of these differences were however statistically significant. A key point is that the median value of profitability for EOBs was higher than the mean in 2009-10, but falls below the mean in 2010-11. This indicates while a greater proportion of the sample of EOBs shows lower profitability in 2009-10, this is reversing with improvement in profitability across a greater proportion of the sample in 2010-11.

- **From lagging behind non-EOBs to comparable performance in 2009-2010 EOBs in 2010-11 have managed to pull together marginally better on employee contribution to profitability. They have incrementally reduced the difference and have done so despite higher employment levels.**

TABLE 5 - INCREASE IN PROFIT BEFORE INTEREST AND TAXES (PBIT) PER EMPLOYEE

Increase over the period -	2005-08[a]		2008-09		2009-10		2010-11	
	EOBs	Non-EOBs	EOBs	Non-EOBs	EOBs	Non-EOBs	EOBs	Non-EOBs
Increase in PBIT / employee (Mean)	1.51%[b,c]	3.78%	0.25%	0.68%	1.74%	1.82%	1.82%	1.80%
Increase in PBIT / employee (Median)	3.11%	4.31%	0.30%	1.19%	1.56%	1.73%	1.70%	1.77%
	Non-EOBs are significantly higher on increase in PBIT / employee. This points to a split between the group of EOBs that have a high PBIT / employee and others that do poorly in this regard		The difference between mean and median values decreased considerably for EOBs, suggesting that strong performers during the 2005-2008 period slowed considerably		There is a significant improvement in both mean and median values, for EOBs as well as non-EOBs. EOBs mean values are now higher than the median, indicating improvement across the sample		EOBs continue to close the gap with non-EOBs. Mean and Median values again indicate improvement across the sample.	

[a]Average per annum increase reported for 2005–08 data. [b] t-test for the difference of means; statistically significant differences between EOBs and non-EOBs are shaded. (2005-08: $p<0.05$). [c]Raw scores reported, scaled normalised scores were used for analysis.

The MG report found that profitability per employee for non-EOBs was higher than that of EOBs during 2005-08, consistent with their higher turnover and profitability during this period. In 2008-09, the gap between EOBs and non-EOBs narrowed, mirroring a decline in non-EOB profitability per employee that was more than twice that of EOBs.

As the recession progressed however, we find that performance of both EOBs and non-EOBs based on this measure was similar. There was a significant improvement from 2008-09 levels for both EOBs and non-EOBs. The EOBs not only closed the gap with non-EOBs, but also continued to show strong improvement across the sample.

EOBs have thus far withstood the recession better than non-EOBs – not only at the onset of the downturn but even as the recession deepened. Further insights that can be drawn from the analysis are as follows:

1. The analysis shows that while non-EOBs tend to out-perform EOBs during periods of economic growth, this performance falters during periods of crisis. In the current policy environment, non-EOBs enjoy greater support, which gives them a natural advantage to benefit from growth opportunities during favourable economic conditions. With recent policy manoeuvres in favour of EOBs the upsurge in EOB performance looks promising.
2. Non-EOBs are unable to maintain both top-line financial performance and employment levels while the EOBs seem to be better at doing this. The contrast can be attributed to the ownership culture of EOBs, which supports high employee engagement to deliver superior performance. For instance, EOBs are thus more likely to empower their front-line employees and to use feedback from them to pursue customer-oriented growth.
3. EOBs support higher employment levels than non-EOBs. This is in line with findings that suggest that EOBs view employees as their biggest asset, and employee commitment as their central advantage. The increase in employee numbers in 2008-09 and 2009-10 points to the long-term orientation of EOBs and their ability to plan ahead for a time when the economy begins to look up. Research suggests that on account of preserving their social capital and knowledge base, they would be well positioned to bounce back strongly as the recession ends – this is an interesting aspect for continued observation.
4. The analysis of profitability highlights a clear difference in the objectives of EOBs and non-EOBs. While non-EOBs are clearly focused on preserving margins, EOBs seem to be less concerned with profitability alone. Pressure from the capital markets is commonly acknowledged as the driver of decisions in non-EOBs; the need to increase share value leads to acute concern over efficiencies and cost cutting, especially during a downturn. Long-term needs are therefore undervalued. EOBs, on the other hand, do not face such pressure from external shareholders, and are able to pursue other non-economic goals, which are a key feature of the employee ownership model.

EXHIBITS

Exhibit 1: Comparative Increase in Sales Turnover – EOBs vs. non-EOBs

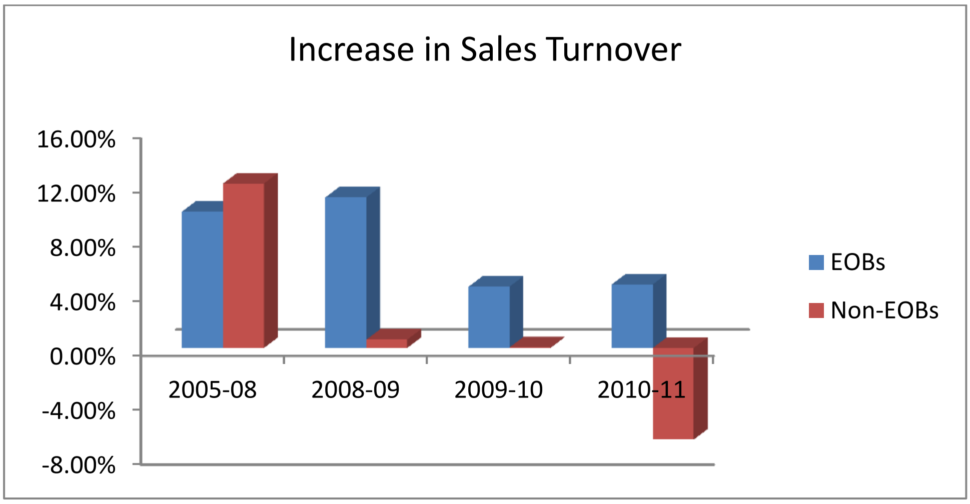

Exhibit 2: Comparative Increase in Employee Numbers – EOBs vs. non-EOBs

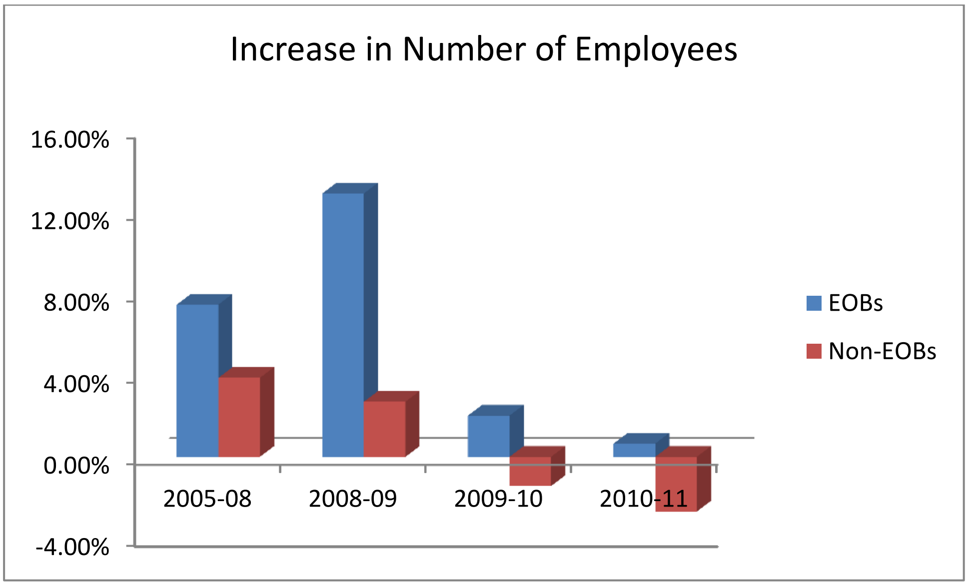

Exhibit 3: Comparative Increase in Sales Turnover / Employee – EOBs vs. non-EOBs

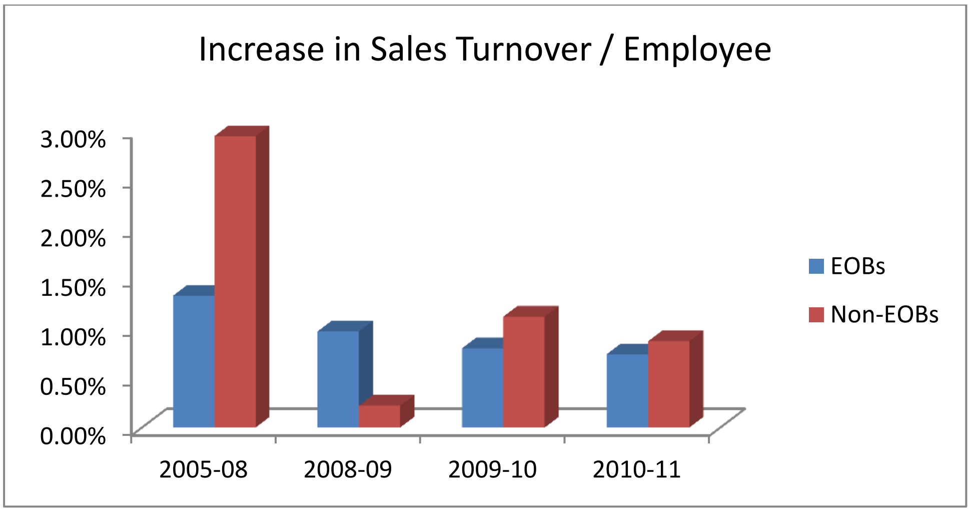

Exhibit 4: Comparative Increase in PBIT – EOBs vs. non-EOBs

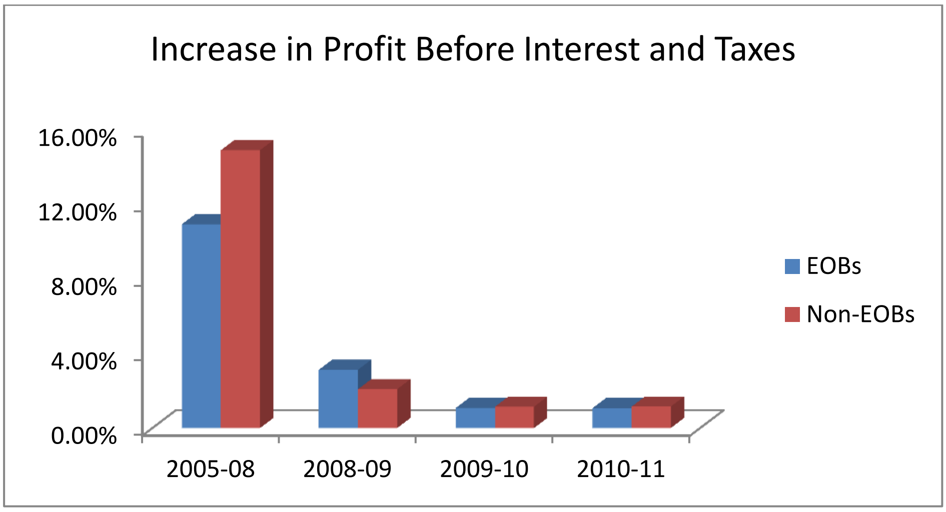

Exhibit 5: Comparative Increase in PBIT / Employee – EOBs vs. non-EOBs