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DOES EMPLOYEE OWNERSHIP SURVIVE THE TRANSITION?

Case Study Evidence from Estonia

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Privatisation to employees has been common in Estonia and in other transition economies, but some evidence suggests that employee ownership is declining. In this paper, I use the concept of "degeneration" from the literature of worker co-operatives to explain this decline. In the first part of the paper, I draw from the literature of complementarities in firm performance and apply the argument to the problem of stability of ownership structures. In the second part of the paper, I use evidence from management interviews and employee questionnaires taken at six Estonian enterprises with employee ownership. The evidence suggests that employee ownership is rapidly declining in Estonia. The main reason for the decline is that ownership is not extended to new employees.

Keywords: economic transition, Estonia, employee ownership, ownership change, degeneration, case studies

JEL classification index: D23, J54, P13, P31

INTRODUCTION

One of the surprising developments of economic transition in Eastern Europe was the high incidence of employee ownership (Earle and Estrin 1996; Uvalic and Vaughan-Whitehead 1997). However, now there is enough evidence that the number of employee-owned firms, as well as the average share of equity belonging to employees, has been decreasing.[1] This paper aims to explain the reasons

[1] Evidence for other countries is discussed in Blasi et al. (1997) and Jones (1998) for Russia, Djankov (1999) for several CIS countries, and Estrin and Wright (1999) for the former Soviet Union.

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for the decline by using case study evidence from Estonia. Estonia is particularly suitable for examining the reasons for the decline of employee ownership as it was rather pronounced there (Jones and Mygind 1999).[2] Although Estonia is not widely recognised as being among those transition economies where employee ownership was widespread, privatisation to employees had been common until the start of a centralised privatisation programme, when sales to "outsider" investors became the norm (Mygind 2000).

This paper draws from two well-known bodies of literature and applies them in a new context. The concept of degeneration, introduced in the next section, is borrowed from the literature of worker co-operatives and labour self-management, and is applied to examine the ownership change in transition economies. The literature on the role of complementarities in human resource management and firm performance has already been applied and developed further for employee-owned organisations, but this paper is the first to apply it to the problem of stability of employee ownership. Later I develop a theoretical framework to explain the ownership change in employee-owned firms. I briefly review here the processes that led to employee ownership in Estonia. The theoretical framework used to analyse case studies and questionnaires are also in the article. The empirical material includes interviews in six Estonian enterprises with employee ownership and an employee survey with over 150 respondents.

ON DEGENERATION

There are different definitions of "degeneration", and there are also many explanations for the reasons behind this phenomenon.[3] In the present article, this term refers exclusively to changes in ownership structures.[4] There are two different dimensions of employee ownership: the proportion of equity belonging to employees, and the proportion of employee-owners to the total number of employees (the latter will be called *participation ratio*). Thus a conventional definition for a firm being in "employee ownership" is if employees own at least 50% of the equity and if at least 50% of the total workforce are owners (e.g. Kruse and

[2] Jones and Mygind (1999) reported that in the representative sample of more than 350 Estonian enterprises the proportion of firms with majority employee ownership declined from 15% in 1995 to less than 10% in 1997. In an analysis based on the same sample, Kalmi (2002) showed that the decline continued at a similar rate until 1999.

[3] See Russell (1985) for a lucid survey on the concept. Russell traces the use of the term in the context of employee ownership back to John Stuart Mill.

[4] In the sociological literature, degeneration refers to changes in decision-making structures (e.g. Stryjan 1994; Cornforth 1995).

Blasi 1997, p. 115). In this paper, I highlight yet another dimension of employee ownership, namely the proportion of new employees (i.e. employees who have joined the firm after privatisation) who are owners. It is obvious that if the incumbent owners of an employee-owned firm fail to extend ownership to new employees, the firm will gradually change to outsider ownership when the incumbent shareholders retire. The degeneration argument points out that incumbent employees are *not* likely to have incentives to extend ownership if they gain some rents from their shareholding, e.g. in the form of profits or job security (Ben-Ner 1984; Miyazaki 1984). This argument needs the assumption of imperfect market for shares in employee-owned firms, because incumbent owners do not have the reason not to sell shares to new employees if the latter pay a market-clearing price for the shares. However, for reasons of risk aversions and information asymmetries it is likely that this market functions imperfectly (Dow and Putterman 2000).

The degeneration arguments for the decline of employee ownership and for the exclusion of new employees from ownership have been tested in empirical literature, with somewhat mixed results. While these arguments seem relevant in certain settings, e.g. in US plywood co-operatives (Craig and Pencavel 1992), and in Israeli industrial worker co-operatives (Russell and Hanneman 1992, 1994), there was little support found for the degeneration hypothesis among French worker co-operatives (Estrin and Jones 1992; Pérotin 1997). Generally speaking, it seems that low entry rates rather than unusually high exit rates are the reason for the low incidence of worker co-operatives (Ben-Ner 1988). Paradoxically, it seems that the degeneration argument may be more relevant in transition countries. However, the concept of degeneration has not been previously used in empirical works in the context of transition economies.[5]

DEGENERATION OF OWNERSHIP IN EMPLOYEE-OWNED FIRMS: A THEORETICAL FRAMEWORK

Ben-Ner (1984) suggested that employee ownership could be reproduced only in conditions where there was a causal link between employee ownership and improved organisational performance. In organisational theory, there is a large body of literature that argues for the possibility of productivity gains through employee

[5] Given that the incidence of employee ownership in early transition was exceptional in international comparison, it is surprising that the degeneration literature has not been applied to this context. The only exceptions I am aware of are Ellerman (1990), Weitzman (1993), and Earle and Estrin (1996). These are, however, theoretical, not empirical works.

ownership. It has been argued that employee ownership may contribute to increased commitment, higher motivation, and lower turnover of workforce, and thereby to higher productivity (e.g. Long 1978; Pierce et al. 1991; Kruse and Blasi 1997). The positive impact of ownership is expected to come from the financial incentives ownership creates, from the decision-making rights associated with it, and from the intrinsic satisfaction it gives ("pride of ownership"). To gain these benefits significant organisational changes are usually necessary. Several studies pointed out that certain human resource management practices were complementary to ownership, in the sense that improved organisational performance could be attained only by introducing a "bundle" of practices rather than introducing them in isolation.[6] These include participation in decision-making at the job level, information sharing, employee training, and representative participation. A combination of these practices can be called, in short, "participatory management".

Scepticism of some economists about the efficacy of employee ownership schemes relies on the free-rider argument. Alchian and Demsetz (1972) argue that group incentives cannot replace direct supervision except when the group is very small. However, Weitzman and Kruse (1990, p. 99) argue that "shirking equilibrium" is only one of the possible outcomes and appropriate changes in organisational culture increase the likelihood of coming to a co-operative solution. Many authors see employee involvement or direct participation as an essential element towards co-operative workplace (Lawler 1986; Levine 1995). The potential benefits of direct participation are likely to increase when it is combined with employee ownership and representation in the supervisory board (Ben-Ner and Jones 1995). Levine (1995) also stresses the importance of information dissemination and employee training in capturing the benefits of participatory management.

If ownership and participation are complements, why would any firm introduce employee ownership without participation? Economists tried to explain the incidence of ownership and participation by examining the conditions in which the benefits of employee ownership and participation outnumber their costs. It has been hypothesised that the incidence of employee ownership depends on a number of firm-specific factors, such as the quality and origin of human and physical capital, the degree of homogeneity of work force, the size of the firm, production technology, industrial relations, and the commitment of employees and managers to employee ownership (Russell 1985; Hansmann 1990; Mygind 1992;

[6] The argument that clusters of related work practices have a larger positive impact on productivity than introducing them in isolation was put in the theoretical work by Milgrom and Roberts (1995). Similar arguments were applied and extended to the context of employee ownership by Ben-Ner and Jones (1995) and Levine (1995).

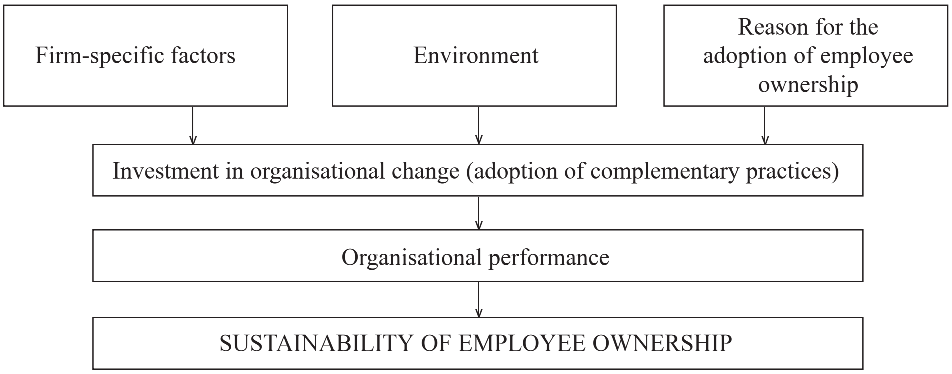
Dow and Putterman 2000). Another set of literature examines the impact of environmental conditions on employee ownership and participation, such as the influence of supportive networks (Smith 2001), and the impact of societal values on ownership and participation (Lawler 1986; Mygind 1992).

It is also possible that participation is not introduced even if it could induce efficiency gains. There are private costs related to changes in bargaining power that may prevent Pareto improvements (Freeman and Lazear 1995). In transition economies (and elsewhere), managers are in a key position to introduce participatory schemes. However, the very success of these schemes may diminish the returns to managers. More frequent information and training reveals to employees the value of their shares and their rights as shareholders, while managers can benefit if employees are not aware of these. Participatory management entails also the sharing of power, which managers dislike. Additionally, since the implementation of organisational changes is costly, a firm which is struggling for its survival or undergoing other major changes may not be in a position to make considerable investments in organisational change. Firms in better economic situation may be in the position to implement these changes. On the other hand, if the firm operates in a not very competitive environment, it may have few incentives to improve organisational practices.

Because of the costs of implementing organisational change, managers and employees have to be very committed to introduce it as a device for improving productivity. It is more likely that employee ownership is introduced for other reasons, such as saving jobs or allowing early privatisation. Employee ownership might also be motivated by the desire to earn profits on shares that were initially sold at undervalued prices. However, these objectives are not consistent with the aim of increasing the number of owners. The more widely job security and profits are shared among the employees, the lower the value of the shares will be individually. If internal actors perceive employee ownership as an instrument of earning rents but do not attach broader goals of industrial democracy or participation at the workplace, their motives are not consistent with broadening ownership to future employees.

The analysis above leads us to the following schematic presentation of causal links (see the *Figure* below). Firm-level and population-level factors, and the reason for the adoption of employee ownership determine whether the employee-owned firm undertakes investment to implement organisational change. Investment in organisational change affects economic performance, and economic performance affects the sustainability of employee ownership.[7]

[7] Of course there are some other factors that affect the sustainability of employee ownership. One of these is the manner of shareholding: employee ownership is less likely to degenerate in



A framework for the sustainability of employee ownership

EMPLOYEE OWNERSHIP IN ESTONIA

In contrast with the popular belief that privatisation policies in Estonia consisted of little else than privatisation through sales to outside investors, actually there were several important projects that led to increased employee ownership. Early experiences with limited employee ownership started already under socialism, when employee collectives were given extended rights in decision-making and distribution of revenues in Estonia. As regards employee ownership, appearance of the so-called leased companies was especially important. The Soviet jurisdiction gave the opportunity to lease the enterprise, so that the state remained the nominal owner, but employees had the right to revenue and control. A small number of enterprises were leased under all-union jurisdiction. However, the Estonian act on leased companies effected from September 1990 was more important. According to Estonian law, employees had the right to apply for the lease of a state enterprise or a subunit of a state enterprise. There were actually two types of leasing. First, there was a collective leasing practice mainly in 1990–1991, and the enterprise was leased collectively by the entire workforce. Ownership stakes were determined by the wages of employees. Later, enterprises leased by collective leasing had to restructure their ownership because the new commercial code

firms with employment-based, indirect shareholding (e.g. US ESOPs) than in firms with investment-based, direct shareholding (Ellerman 1990). The interesting question for the model is how the manner of shareholding is determined. I believe it is largely exogeneous and determined by the legal framework. It is interesting to notice that early Estonian experiences with leasing included employment-based employee share ownership. However, after the revisions of the commercial code only direct shareholding was recognised by the law.

no longer recognised collective leasing. The other type of leasing was based on individual contributions paid by the employees. Typically a smaller number of employees became leaseholders. This type of leasing was popular in 1991–1992. Leasing was used in the absence of alternative methods of privatisation. Later, these firms were usually privatised to the leaseholders.

Another example is the privatisation of collective farms. Members of collective farms received labour shares based on the length of their employment in the enterprise, and these could be invested in the newly established successor enterprise. It should be noted that collective and state farms did not restrict their activities to agriculture. It was typical that these collectives owned a number of auxiliary units, e.g. in machine construction and maintenance, petrol resale, electricity works, construction, etc. Employees also had some privilege in smaller privatisation actions.

The employees' financial participation remained substantial until the start of the "mass privatisation" programme that preferred competitive bidding as a method of privatisation for former state firms. The new privatisation programme launched in 1993 removed all preferential treatment of employees in privatisation. However, before the start of mass privatisation, transfer of ownership to employees was the dominant privatisation method (Mygind 2000; Kalmi 2002).

CASE STUDIES

Methodology

The theoretical framework presented above was examined in six case studies. Case studies were preferred to surveys, because they allowed much more detailed questions. Another reason for case studies was that it allowed collecting individual level survey data to investigate the impact of ownership on attitudes, and to evaluate the determinants of ownership.

There was a paradoxical problem concerning sample selection. If one liked to know what employees think of employee ownership, one should do the employee survey in firms where there still is substantial employee ownership. However, employee ownership in these firms is of a more permanent nature than usual, as they have not "degenerated" into outsider or managerial ownership. I solved this problem by taking the proportion of new employees in ownership as a measure for degeneration. This allowed me to choose firms with enough employee-owners – where degeneration could also occur – to assess the impact of ownership on organisational outcomes. The firms were chosen on the basis of prior knowledge that there was some employee ownership.

The managing director was interviewed twice in all of the six firms presented here (except for one, Sektoron). The case questionnaire was structured but many questions were open-ended. The first set of interviews, which needed 1.5–3 hours per interview, took place in Spring and early Summer of 1999. The second round, which required some 15–60 minutes per interview, took place in Autumn of 1999, after the first interviews had been analysed. The interview was a discussion with the case study author in Estonian, and in the first round a trained Estonian research assistant was present, who took notes and assisted the author. Employee surveys were carried out in five firms. Sektoron was excluded because of the small number of employees. The total number of responses was 162. The response ratio (number of respondents in the firm/number of all employees in the firm) varied between 19% and 26%.

An introduction to the cases

The case firms were quite heterogeneous. There were two firms from industry (Printing House and Estre), one professional service firm (Kompro), one engaged in trade (Sektoron), and two firms in agriculture-related sectors (Puurmani and Ramsi). Most of the firms were medium-sized with 100–200 employees, except for Sektoron that had only 11 employees. Economic performance of the firms also varied. In its industry, Printing House is one of the most successful firms in Estonia. On the other end, there is the agricultural co-operative Puurmani, which was selling its products (milk and meat) below-production costs and its existence was in threat at the time of the interviews. Average wages were quite different, too. While the median monthly wage in firms located in Tallinn (Kompro and Printing House) was above EEK 5000 (EUR 320), in the rural Puurmani the same figure was below EEK 2000 (EUR 125).[8] Finally, it should be noted that the initial majority of shares was in the ownership of non-managerial employees in all the firms except for Kompro (where the majority belonged to five managers).

The reason for privatisation

Printing House, Ramsi, and Estre were participants in the early leasing programme for state-owned enterprises. At the beginning of the 1990s, leasing was the fastest way to achieve independence from the government authorities. Sektoron and Puurmani came from the former collective sector, where privatisation to employ-

[8] The minimum wage in 1999 was EEK 1200 (EUR 75).

ees was more of a rule than an exception. The case of Kompro was different since it was privatised when employee ownership was not favoured in privatisation. In this firm, the manager said that initially the management wanted to buy out the company exclusively, without employee participation, but they could not finance the transaction without employees. In this firm, the main reason for employee ownership was the budget constraint of the management.

The desire to guarantee continuity was important in all of the reviewed cases. Insider ownership seemed to be the best way to avoid closing or downsizing the operations. This was especially important in Ramsi and Puurmani that were the major local employers. Independence from state authorities was stressed especially by the managers of Ramsi and Estre, although this explanation was probably important in all of the cases. Nobody mentioned the improvement of productivity or democratising labour relations as the goals of employee ownership.

The objectives of employees to buy shares somewhat differed firm by firm. In the more successful ones, such as Printing House, Estre and Ramsi, dividends were mentioned as a reason to be owners. Nonetheless, the most frequently mentioned reason was to secure employment. It was the most common explanation in Puurmani (which had the largest number of respondents that were owners), but it was an important reason in all the other firms, too. This indicates that the respondents perceived a relationship between ownership and job security. Out of the other possible reasons indicated in the questionnaire, participation and obtaining information on financial performance were also mentioned relatively frequently. Interestingly, only three respondents mentioned the possibility of capital gains by selling shares. This contrasts the common view that the only motivation for employee ownership was to benefit from the undervalued shares.

The organisational role of employee ownership

The most common human resource management practices in the case firms included various forms of incentive pay and training programmes to improve job-related skills. These management practices were especially popular in Kompro, Printing House and Estre. However, incentives were not connected to share ownership. In fact managers did not consider share ownership as a form of incentive pay. Typically, they argued that the stakes held by individual employees were too small to give incentives for improving performance through an effort-reward link. Consequently, other forms of incentive pay were introduced independently of share ownership, without thinking of mutual compatibility. Also, there were no training schemes that aimed at informing employees about their rights and responsibilities as owners. Neither the needs of effective participation were addressed.

The manager tried to combine ownership and participatory management only in Sektoron. This included employee involvement in certain decisions, disseminating information about financial performance, and regular meetings of the management and the employees. However, the manager expressed complete disappointment with the results. In his opinion, Estonian employees are not interested in corporate success and are generally unable to see the connection between enterprise performance and their remuneration. He also noted that the feeling of ownership among employees could not develop because they acquired shares by using labour shares, not money.

Formal representation of employees was modest. In Printing House and Estre, the majority of employees were unionised. However, the union was rather passive in ownership-related matters, although in Estre it was the largest shareholder. In the 1980s Estre was involved in experiments with codetermination and works council, but later these initiatives faded away. There was a non-managerial employee in the company board only in Kompro and Ramsi, but in neither case did the given person formally represent employees, nor was he/she nominated by employee organisations.

Both managers and employees shared the view that employee participation in decision-making was at quite low level, the only exception was Puurmani. In this co-operative, the influence of employees is likely to be the legacy of collective farm experience. The highest governing body of Puurmani is the members' meeting. At the time of the interview the co-operative had almost 300 members. One might think that in the case of such a large membership each employee has only a marginal impact on decision-making, but in fact the employees of Puurmani gave the highest scores for employee involvement in firm-level decision-making out of the firms surveyed.

Because employee ownership did not play an important role in the organisation, it is not surprising that both managers and employees evaluated the impact of employee ownership to be small. The exception in this regard was Puurmani, with its manager evaluating this impact in wholly negative terms. He said that the co-operative could be economically viable only if the number of employees could be reduced, but members did not accept any layoff. According to him there are too many members and it paralyses decision-making. The manager of Estre was also quite critical, saying that employee ownership disturbs hierarchical relations and prevents layoffs. In other cases, the managers evaluated the impact of employee ownership on employment policies, employee motivation and industrial relations as being either insignificant or slightly positive.

Table 1 summarises the results concerning the organisational role of employee ownership.

Table 1

Organisational role of employee ownership: summary

Firm	Kompro	Printing House	Estre	Puurmani	Ramsi	Sektoron
Reason for the employees' financial participation in privatisation: director interview	Liquidity constraints of managers; save jobs; guarantee continuity of the enterprise	Ministry of Culture wished to keep the firm in Estonian ownership	Reorient activities of the firm through privatisation; save jobs; guarantee continuity	Guarantee continuity and save jobs; invest labour shares	Reorient activities of the firm; independence from state authorities; save jobs	Save jobs, guarantee continuity and social stability; invest labour shares
Reason for the employees' participation in privatisation: employee survey	To get information (on firm affairs); increased job security; participate in decision-making	Dividends; get information; job security	Dividends	Job security; use labour shares; coop services	Dividends, job security	—
Forms of human resource management	Training, team work, incentive pay	Gain-sharing, job rotation, training	Training, incentive pay (related to sales)	Like under socialism	Incentive pay for specialists	Suggestion schemes, disseminating information on firm performance
Representative participation	Weak, union closed	Trade union	Trade union, co-determination terminated	Member meeting	Informal meetings	Regular meetings; results disappointing
Employee participation at the firm level, mean*	3.05	2.16	2.62	3.15	2.29	–
Employee participation at the job level, mean*	3.75	3.4	3.02	3.02	3.29	–
Director evaluation of the impact of employees' financial participation	Neutral or slightly positive; reduces quits	Neutral or slightly positive; improves motivation	Negative; makes layoffs difficult; disturbs hierarchy	Very negative; leads to excess labour; decision-making paralysed	Insignificant	Negative; workers not interested in participation or ownership

* From the employee survey; scale is from 1 (low) to 5 (high).

Employee attitudes

On the basis of managerial interviews, one has the impression that employee ownership is not complemented by participatory management, and employee participation in decision-making remains limited in the firm. Therefore, the impact of ownership on performance is small. While this is consistent with previous findings on employee ownership in the transition (Jones 1998; Woodward 1998), the result could be expressed more strongly if there was support in employee responses. I examine this by analysing the impact of ownership on organisational commitment; it is a common strategy in evaluating the impact of ownership on job attitudes. The idea is that if employee ownership has beneficial effects on organisational performance, this effect must be through a change in employee attitudes (Long 1978; Pierce et al. 1991). Previous research has shown that the effect of ownership on commitment may vary, and it depends on the factors that measure commitment. There has been evidence that employee ownership reduces outward mobility of labour, while there may be no relation between ownership and job satisfaction (Kruse and Blasi 1997).

In the questionnaire, organisational commitment was measured by different statements, which focused on different aspects of commitment.[9] Integration was measured by the following statement: "My personal welfare is closely linked with the welfare of the firm". To evaluate involvement, we used this statement: "I feel I am an important member of the firm". Job satisfaction was assessed with the help of the following statement: "I am satisfied with my work". The fourth variable, loyalty, was formed by constructing a measure for quit intentions: "I often think about quitting" and "If I could get a similar job in another firm I would take it". These factors were measured by a scale from 1 to 5, where 1 indicated complete disagreement and 5 complete agreement.

The expectation based on literature is that ownership influences commitment. However, this claim gets little support from the employee responses. The mean of scores for the entire sample is actually *lower* for owners than for non-owners as regards all the items except for job satisfaction, and differences between these two groups are very small (see the two bottom rows of *Table 2*). However, since the number of respondents differs firm by firm, it might be because of firm-specific variation. *Table 2* also shows the mean of the scores by firms and status of ownership of respondents. Out of 20 comparisons between owners and non-owners, owners proved to be more committed only in 12 cases, a difference that can hardly be regarded as significant. Only the owners of Ramsi scored higher than

[9] The questionnaire items were adapted from Long (1978) and Rosen et al. (1986).

Table 2

Firm-specific means of attitudes (owners and non-owners)

	Integration	Involvement	Loyalty	Job satisfaction
Kompro, owners	3.000	2.667	4.000	4.067
(N=15)	(1.363)	(1.234)	(0.926)	(0.799)
Kompro, non-owners	3.600	2.400	3.800	4.200
(N=5)	(1.140)	(1.517)	(1.095)	(0.837)
Printing House, owners	3.579	2.350	3.600	3.650
(N=19–20)	(1.261)	(1.226)	(0.995)	(1.182)
Printing House, non-owners	3.364	2.545	3.727	3.545
(N=11)	(1.502)	(1.128)	(0.786)	(1.036)
Estre, owners	2.632	2.500	3.550	4.000
(N=19–20)	(1.461)	(1.318)	(1.276)	(0.918)
Estre, non-owners	3.667	3.167	3.739	3.708
(N=23–24)	(1.341)	(1.308)	(1.010)	(1.301)
Puurmani, owners	3.727	2.970	3.265	3.706
(N=33–34)	(1.306)	(1.045)	(1.189)	(1.219)
Puurmani, non-owners	2.875	2.625	3.625	3.000
(N=8)	(2.031)	(1.506)	(1.061)	(1.414)
Ramsi, owners	3.875	3.375	3.750	4.125
(N=8)	(1.126)	(1.188)	(0.886)	(0.641)
Ramsi, non-owners	3.250	3.333	3.667	3.917
(N=12)	(1.485)	(1.497)	(0.651)	(0.900)
Entire sample, owners	3.372	2.729	3.546	3.845
(N=94–97)	(1.376)	(1.201)	(1.118)	(1.054)
Entire sample, non-owners	3.417	2.950	3.711	3.667
(N=59–60)	(1.465)	(1.358)	(0.892)	(1.174)

Source: Case database.
Note: Standard deviations in parentheses. Scale is from 1 (low) to 5 (high) commitment.

non-owners in all four measures of committment, but the differences were relatively small. It is also notable that the scores are relatively high for non-owners as well, although the proportion of non-owners was the highest in Ramsi. The other extreme is Estre, where owners had higher scores only for job satisfaction, while the score for integration was considerably higher for non-owners. Therefore, the null hypothesis that ownership does not influence attitudes is not rejected.[10]

[10] The impact of ownership was also tested in a multivariate ordered logit model that includes several control variables (Kalmi 2002). These results are not discussed here because of space constraints. The main finding is that ownership is completely unrelated to any of the commitment items, while several control variables, notably perceptions of participation and employee relations, are highly significant.

The development of ownership

The development of ownership from the time of privatisation to 1999 is presented in *Table 3.* It indicates employee ownership both at the time of privatisation (EOP) and in 1999 (EO99), and similarly for managerial ownership (MO) and outsider ownership (OO). For 1999, we also have the shares of former employees (FEO99). For employee ownership, participation ratios (the portion of employees, who have shares) are also given in parentheses.

The six firms started from different initial levels of employee ownership. In Printing House, Ramsi and Estre ownership had been equally divided among

Table 3

Ownership development in case firms (%)

	EOP	MOP	OOP	EO99	MO99	OO99	FEO99
Kompro	33	60	7	0	100	0	0
	(77)						
total		*100*			*100*		
Printing house	95	5	0	65	18	0	18
	(80)*			(66)			
total		*100*			*100*		
Estre	97	2	1	59	2	1	38
	(28)			(58)			
total		*100*			*100*		
Puurmani	61	5	6+28**	40	4	8	48
		(83)		(65)			
total		*100*			*100*		
Ramsi	53	6	29+11***	46	23	8	23
		(80)		(24)			
total		*100*			*100*		
Sektoron	n.d.	n.d.	n.d.	10	16	41	33
				(20)			
total		*100*			*100*		

Source: Case database.
Note: Participation ratios for the time of privatisation and 1999 in parentheses.
Not all columns sum to 100 because of rounding errors.
* From year 1995; ** 28% are pensioners of the former collective farm; *** 11% belonged to the state.

employees, though in Estre only a minority of employees owned shares. In Kompro, a significant proportion of employees had shares, but ownership concentrated only to few employees (five management members owned around 60% of shares).

The ownership trajectories of the firms have been very different. In some firms, the trading of shares was not characteristic. The extreme is Estre, where no share has been traded since 1991. Interestingly, since Estre was privatised, a significant increase of the participation ratio has taken place. While workforce has decreased from 549 employees to 172, at the time of the interview over 60% of the initial shareholders still worked at the firm. This suggests that employees, who planned to stay, bought shares. Nonetheless, in other firms the participation ratio declined.

In Estre, as well as in Puurmani and Sektoron, former employees now have significant ownership. In Sektoron, 5 former employee-owners retired, thereby insider ownership has diminished to a minority (there are only 3 insider owners left in Sektoron). In Puurmani former employees outnumber current employees in ownership.

This type of degeneration has been less pronounced in Printing House and Ramsi. In these firms, former employees owned around 20% of the shares at the time of the interview. In both firms, some former employees sold their shares, and the buyers were usually the managers. However, in ownership history issuing new shares was more important than the trading of shares. Only shareholders were allowed to participate in new share issues and there were considerable differences between shareholders as far as subscription for new shares is concerned. As a result, ownership concentrated even more.

In Kompro, the management team called an extra shareholder meeting after the firm had been privatised for about 1.5 years, with the intention to buy out the small shareholders. After the meeting, small shareholders sold their shares to five management team members at 37.5% of the price they initially had bought the shares.

Employee ownership can be regenerated only if new employees are offered shares. However, ownership of new employees was not encouraged in any of the case firms. The option was considered only in Sektoron, but the manager said that new employees were not interested in share ownership. I believe that the attitude of the manager of Printing House is more typical. Responses of the employee survey indicated that many employees, who had joined the firm after privatisation, were interested in buying shares but it was not possible. When I mentioned this to the manager during the second interview, he said the management team did not want to enlarge the number of owners. He argued that reducing the number of owners is more consistent with effective governance.[11] He also said that employees with longer history at the firm should have a more legitimate claim to ownership.

It turned out from the employee responses that the status of employment at the time of privatisation is by far the best predictor of the status of ownership (*Table 4*). Some 75% (94 out of 125) of the respondents, who had been employed by their firm when the firm was privatised, were also owners in their enterprise. On the other hand, less than 15% (5 out of 35) of those who had joined their firm after privatisation were owners. This suggests indeed that employee ownership will be a temporary phenomenon.

Table 4

Ownership and employment status at privatisation

	The respondent is currently		
	an owner	not an owner	Total
How many respondents were employed by the firm before privatisation?	94	31	125
How many respondents joined the firm after privatisation?	5	30	35
Total	99	61	160

Source: Case database.

I also asked the managers to forecast the development of ownership in 2–3 years. In Estre, Ramsi, Puurmani and Sektoron the manager said that it was not possible to stay competitive without additional external funding of investments. Internally it was not possible to generate funds for investment and banks did not give loans. In contrast, the managers of Printing House and Kompro were very negative towards potential outside investors, but these firms were not in the need of additional capital. Printing House was able to get the necessary financing from banks and there were retained earnings as well. In the case of Kompro, the work was human-capital rather than physical-capital-intensive. The case interviews suggested that the likelihood of involving an outsider investor depended to a large extent on the availability and need of external financing.

[11] This is consistent with Hansmann's (1990) argument that increasing the number of owners increases the costs of decision-making.

CONCLUSION

In this paper, I developed a theoretical framework to evaluate the reasons for the decline of employee ownership. For the sustainability of employee ownership it is necessary that new employees can buy shares. However, if employee ownership does not improve organisational performance, incumbent employees will not have the incentive to extend ownership to new employees. It is likely that employee ownership improves organisational performance only if it is combined with participatory management. However, creating participatory management in transition economies may not be a priority for managers, because the initial reason to establish employee-owned firms have more to do with the limited number of options in the early privatisation process, and with rent-seeking and rent-protection, rather than with considerations on improving productivity through employee ownership or extending democracy to the workplace.

The evidence from Estonia seems to suggest that employee ownership is unstable in transition economies. The enterprises were privatised to employees because in early privatisation it was the only realistic option, and many managers preferred employee ownership to outsider ownership. Therefore, the initial commitment to employee ownership was rather weak both among managers and employees. According to managers, the effect of employee ownership on organisational performance is either insignificant or negative. Results of the employee survey do not support the view that ownership is positively related to job attitudes either. As there is no evidence that employee ownership improves organisation outcomes, the model predicts that employee ownership is unstable. The practice that new employees are excluded from ownership is a strong indication of instability. Future research should investigate whether similar tendencies can be found in other transition economies as well.

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