DARBINIEKU FINANSIĀLĀS LĪDZDALĪBAS UZŅĒMUMOS TEORĒTISKIE ASPEKTI

THEORETICAL ASPECTS OF EMPLOYEE FINANCIAL PARTICIPATION IN ENTERPRISES

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Anotācija

Mūsdienu ekonomiskā doma nereti aplūko peļņu kā atlīdzību ne tikai faktoru „kapitāls" un „uzņēmējs" sagādātājiem, bet arī faktora „darbs" sagādātājiem uzņēmumā. Metode, ar kuras palīdzību tiek panākta šāda labumu sadale, ir darbinieku finansiāla līdzdalība. Tai piemīt dažādas formas – peļņdalība, kapitāldaļu īpašumtiesības, uzkrāšanas modeļi, prēmēšanas sistēmas. Šajā rakstā tiek aplūkoti darbinieku finansiālās līdzdalības teorētiskie un praktiskie aspekti uzņēmumos.
Atslēgvārdi: darbinieku finansiālā līdzdalība, ražošanas faktori, peļņdalība, kapitāldaļu īpašumtiesības.

Abstract

The contemporary ideas suggest the profit sharing not only among the capital and the enterprise, but the labor as well. The way how to put into effect this approach to wealth distribution is employee financial participation. There may be several forms of employee financial participation – profit sharing, share ownership, saving schemes, gain sharing. This paper will analyze theoretical background and practical issues of employee financial participation in enterprises.
Keywords: employee financial participation, factors of production, profit sharing, share ownership, saving schemes.

Introduction

A neoclassical approach considers that there are three factors of production – land, labor and capital. Due to the contribution of J.A. Schumpeter and other representatives of Austrian school in the XX century, the modern approach assumes four factors of production – entrepreneurship besides the three mentioned above. Entrepreneurship (or entrepreneur – spirit – Unternehmergeist, using the term of Schumpeter) is a factor of production in a sense of ability to bear the risk. The reward for the factors is: rent for the land, wage for the labor, dividends from the profit for the capital and economic profit for the enterprise. Consequently profit is shared among the holders of capital and the entrepreneurs (which usually, but not necessarily are the holders of the capital). But the profit in a large degree depends also from the motivation of employees as the holders of the labor. The contemporary ideas suggest the profit sharing not only among the capital and the enterprise, but the labor as well. The way how to put into effect this approach to wealth distribution is employee financial participation. There may be several forms of employee financial participation – profit sharing, share ownership, saving schemes, gain sharing and many others.

Thus, this paper attempts to analyze both economic and social aspects of nowadays problems in enterprises. Provision of factors of production should be properly and fairly compensated. In this paper author will discuss aspects of profit distribution. From the non-employees representing entrepreneur's position introduction of employee financial participation schemes can also be beneficial as it evolves strong motivation and loyalty for company's employees. Thus, theoretically, companies can achieve at the same time both increase of efficiency and solve ethical problem of fair distribution of company's profit.

The paper is limited to theoretical aspects of employee financial participation. There will not appear analysis and discussion about particular participation schemes.

The aim of this paper is to overview and to analyze different approaches to profit distribution and factors of production in the history of economic thought and to find rational economic justification for employee financial participation in enterprises.

Physiocrats and Factors of Production

If we have a look at the early schools of economic thought we find that in Physiocracy the productive process is treated as the interaction between participating classes of the population. And as a result these classes are the factors of production, according to physiocratists.

They are following:

- The farmer labors on land (sometimes using "crafts") to produce food.
- The artisan labors to produce capital goods (crafts) to be used by the other economic actors.
- The landlord is only a consumer of food and crafts and produces nothing at all.
- The merchant labors to export the food in exchange for foreign imports.

Economic theories of physiocratists were first described in Francois Quesney's *Tableau Economique,* which was published in 1759.

The Physiocrats, especially *Turgot,* believed that self-interest was the motivating reason for each segment of the economy to play its role. Each individual was best suited to determine what goods he wanted and what work would provide him with what he wanted out of life. While a person might labor for the benefit of others, he will work harder for the benefit of himself; however, each person's needs are being supplied by many other people. The system works best when there is a complementary relationship between one person's needs and another person's desires, and trade restrictions place an unnatural barrier to achieving one's goals.

The theories concerning the value of land could not work without strong legal support for the ownership of private property. Combined with the strong sense of individualism, private property becomes a critical component of the functioning of productive process according to physiocrats.

Both *Quesnay* and *Turgot* recognized that capital was needed by farmers to start the production process, and both were proponents of using some of each year's profits to increase productivity. Capital was also needed to sustain the laborers while they produced their product. Turgot recognizes that there is opportunity cost and risk involved in using capital for something other than land ownership, and he promotes interest as serving a "strategic function in the economy".

Classical and Neoclassical Economics Approach

Adam Smith and *David Ricardo* as a representatives of classical economics school focuses on physical resources when defining factors of production, and discuss the distribution of cost/value among these factors. referred to the "component parts of price" *(Adam Smith, 1776)* as:

- Land - naturally-occurring goods such as water, air, soil, minerals, flora and fauna that are used in the creation of products. The payment for use of land and the received income of a land owner is rent.
- Labour- human effort used in production which also includes technical and marketing expertise. The payment for someone elses labor and all income received from ones own labor is wage.
- Capital- human-made goods (means of production) which are used in the production of other goods. These include machinery, tools and buildings. The classical economists employed the word "capital" in reference to money (gold) also. Money however was not considered to be a factor of production in the sense of capital stock. The return to loaned money or to loaned stock was styled as interest while the return to the actual proprietor of capital stock (tools, etc) was styled as profit.

Neoclassical economics continued the distinction of land, labor, and capital. It developed an alternative theory of value and distribution.

A core proposition in neoclassical economics is that the income earned by each factor of production (essentially, "labor" and "capital") is equal to its marginal product. Thus, the wage is alleged to be equal to the marginal product of labor, and the rate of profit or rate of interest equals to the marginal product of capital. A second core proposition is that a change in the price of a factor of production, for example, a fall in the rate of profit, will lead to more of that factor being used in production. A fall in this price means that more will be used since the law of diminishing returns implies that greater use of this input will imply a lower marginal product.

Emergence of production factor "entrepreneurship" or "entrepreneur-spirit": new challenges

Still, in many textbooks on economics, four factors of production are listed: land, labor, capital and the entrepreneur. Many economists priding themselves on being pragmatists, viewing our economy as a whole, and judging the incentives which increase what is called "gross national product" also list the entrepreneur as a factor in production.

Table 1

Common Contemporary Approach to Factors of Production and Compensation for their Provision

Factor of Production	Land	Labor	Capital	Entrepreneur
Compensation	rent	wage	interest	profit

According to *Goldfinger* (1957), if there are four factors in production, there will correspondingly be four avenues of distribution which many economists list as rent, wages, interest and profit. The argument that "profits" over and above normal or average rent, wages and interest in an enterprise are only the wages of management is discounted by many economists due to the fact that the true managers, the managerial class, are employees and in the decisions made to take risks have but a minor influence. We may argue with these economists that the wages of management reach to the highest levels, but their arguments then will compare the "profits" of risk-taking, uncertainty and innovation employed by entrepreneurs to the "commercial interest" paid for the loan of capital where the risk of loss and the erosion of the loaned capital (machines) increases the amount of true economic interest.

Risk-taking and erosion of capital must be and are compensated for in commercial transactions. Economists Frank H. Knight in his book *Risk, Uncertainty and Profit (1921)* and Professor Joseph Schumpeter, the sage of Harvard in his book *The Theory of Economic Development (1934)* develop the theory that the uncertainty of the market and the necessity to plan production to meet market requirements, make all decisions bear the uncertainty of gain or loss, and this uncertainty, in the long trend, must be compensated in the enjoyment of profits.

Schumpeter opposed the existing views of the entrepreneur as a risk bearer and a manager of a company. He argued that an entrepreneur is an innovator – an individual who carries out one of the following five tasks:

(1) the creation of a new good or a new quality;
(2) the creation of a new method of production;
(3) the opening of a new market;
(4) the capture of a new source of supply;
(5) the creation of a new organization or industry.

The entrepreneurial task is thus to identify new combinations and react to these by exercising the leadership to profit from them.

The entrepreneur is not (necessarily) the one who invents new combinations but the one who identifies how these new combinations can be applied in production.

Schumpeter argued that profit is a reward for innovation by the entrepreneur. The innovation gives the entrepreneur an advantage over his rivals, which enables him through the use of new methods, machines or techniques to earn a profit for him.

Professor Ludwig Von Mises, declared that if "single-tax" were in full operation in the nineteenth century, our lands in the middle west and far west would not have been populated and used, because if all the excess of production above the product of labor on the poorest land in use were collected for public use, the incentive to endure the hardships of frontier life would not have existed, since no economic advantage would be enjoyed by frontiersmen.

That is why we can question how can we continue to maintain that there are but three factors in production and three avenues of distribution? We do know that the rapid development making economy productive in the world, and making the best use of available resources and man-power, is largely the result of the quest for "profits," not wages.

The *Horatio Alger* stories of the rise from rags to riches, the success stories, the legends of the golden opportunities of America, were all garnished with the individual successes of "self-made" men who reaped handsome harvests for their ingenuity, their willingness to take risks, plus their efficient efforts *(Goldfinger, 1957)*.

Goldfinger asks whether we are "horse and buggy" in our economics or can we still square observable facts within our concept of three factors in production and distribution? If we take the trouble to identify properly what we mean by "rent", we can readily show Professors Knight, Schumpeter, Von Mises and others that "profits" are actually the wages of management and that the compensation for risk-taking and innovation are part of management, and can be properly compensated.

It should be examined Dr. Von Mises' claim that the collection of all of the excess production above the margin would rob the incentive to enter virgin lands and endure the privations of new settlements. Did Henry George mean, do we mean, by equality of opportunity equality of income? No, but, exacting as rent the whole of the excess productivity of land above the margin would result in the same wages for all and thus make plausible Von Mises' observation unless we had a yardstick to help us determine, equitably and justly, exactly how much of the excess productivity should be collected for public use.

If a forty-work-week is considered normal or general, and if one worker desires to work on his land eighty hours a week, thus raising the productivity, to take from him the excess productivity of his extra labor would seem to be confiscation of private property. Nor did Ricardo in his law of rent, or Henry George in his adoption of Ricardo's law, have such consequences in mind. Ricardo stated in his law of rent that "for the application of the same labor on each" the excess productivity of land above the margin was rent. The qualification "of the same labor" is our yard-stick. If a forty-hour-workweek is general, then the labor of forty hours at the margin and above the margin should fix the rent of the more productive land.

But individuals vary in their productivity for the same hours of labor. Should the excess productivity of the more proficient or gifted worker be collected, as well as the excess productivity of a less efficient worker in the rent of land? Surely, Ricardo and George had in mind a common yardstick regardless of the differences in human productivity. If the rent of land were the excess produced by a worker of general skill, working the usually accepted hours of labor on land above the margin, society would be compensated for the exclusive use made by such a worker.

One more skilful, having greater genius, willing to take risks, using his ingenuity, upon paying the normal rent for the use of better land would then be entitled to all that his greater productivity could produce beyond the payment of his rent.

Thus incentive is encouraged. Thus the increase in production by the use of innovation demonstrated by Schumpeter is preserved while society is benefited by the equality of opportunity to access to land which the collection of the rental value of land would insure.

While, in general, we quote Ricardo and George and advocate the collection of rental value of land, we should always be aware of the fact that economic rent does not mean all of the excess productivity of land above the margin, but does mean all of the excess for a *given amount and quality of labor,* and that amount and quality is what generally prevails in the community.

Thus entrepreneurs are but laborers of a higher quality of labor, and what recompense they receive is wages for a greater amount of labor or labor of higher productivity. Thus, three factors of production and distribution fully account for all the wealth produced and distributed among its factors.

Economic Background for Employee Financial Participation

If we agree with classical and neo-classical schools and Goldfinger and assume that there are still just three factors of production and they fully account for all the wealth produced and distributed among these factors, we should still ask then and debate where the profits should go and who will gain from growing market value of the enterprise over the time? Will it be land, capital or labor or some combination? Who is responsible for profits and growing value of company? It is clear that all the three factors are responsible.

Still there is one question left- what could be economically and socially reasonable way of distributing profit and gains from growing value of the company between those factors?

If we take a look at the „Land", we know that it is compensated by rent and this factor does not become more productive if specific incentives are provided.

Similar situation is if we look at the factor „Capital". Borrowed capital is compensated by interest and also does not become more productive if specific incentives are provided. When we come to the capital that is invested by owners we may say again that it does not become more productive if specific incentives are provided. At the same time it should be compensated by profits as investor undertakes risk of loosing it. But then still another question is left- who should be owners of the capital?

When we approach factor of production „labor" we can argue that it is compensated by wage. At the same time it is heavily responsible for earning profits, especially if role of combination of factors, sound management and innovation in enterprise is attached to this factor (as Goldfinger suggests). And at last but not at least – factor „labor" becomes more productive if certain incentives are provided.

Thus we could argue that some combination or profit sharing among capital owner and labour and even share ownership by labour is sound and honest solution. Besides we could argue that capital owner could be particularly interested in profit sharing with labour and share ownership by employees given understanding of incentives that these schemes would provide to productive factor labour which is heavily responsible for achieving profits and growing value of the company.

There are several further arguments defending social and economical efficiency of employee financial participation. It is believed that it provides for greater equality in the distribution of income and wealth. It also improves relations between employees and capitalists. In nowadays it is even considered as part of a new culture of industrial relations based on innovative managerial strategies and more flexible remuneration policies, which should ultimately result in increased enterprise efficiency.

Further arguments for come to the fact that employee control of enterprises will succeed where state control has failed in equalizing power and wealth and in decreasing worker alienation and exploitation. These advantages are particularly stressed within the context of property owning democracy (or peoples' capitalism), which ought to ensure more widespread ownership than traditional capitalism.

Motivation aspect is also very important here – the change from a system of guaranteed wages in which rewards are independent of effort, to a system providing employees with a part of income directly linked to enterprise performance, will increase individual motivation and commitment, and will provide for greater identification of employees with the interests of their firm, thus resulting in higher labour productivity and improved overall enterprise efficiency. Making employees partial owners of the firm may improve the system of monitoring individual workers.

Employee ownership can also induce wage moderation as enterprises introducing employee ownership may be able to offer lower wages. Employee ownership can thus also lengthen the duration of employment contracts and reduce labour turnover. Employee ownership can also reduce inequality in the distribution of income and wealth, thus leading to reduced intra-firm conflict.

To be also critical, there are some arguments to be mentiond that provide threats for company's efficiency if employee participation schemes are introduced.

First is so called "free rider problem" – since each worker will receive only a small fraction of any additional income due to his own effort, workers will be tempted to free-ride.

The second argument is connected with property rights- it is believed that emplyee ownership weakens property rights, leading to the dilution of the capitalist's incentives and may compromise their motivation, discretion, power, or authority.

At last, it contains also high degree of risk for labour. Because of the physical impossibility of diversifying the use of their labour in different sectors and enterprises (as capitalists can do with their capital), by putting „all eggs in one baskiet", workers will not only bear the risk of unemployment but will also face additional income risk. Thus, if the firm goes bankrupt, they will lose not only their jobs but their savings as well.

Conclusions

Compensation for providing labor from profit and increased value of the company has not been provided in classical and neoclassical economic schools which considered three factors of production – land, labor and capital. J.A.Schumpeter who introduced the fourth factor of production in the first part of 20th Century – enterprise or entrepreneur spirit – also did not envisaged any channeling of profits to labor. He argued that the profit is a reward for innovation by the entrepreneur – the innovation gives the entrepreneur an advantage over his rivals, which enables him through the use of new methods, to earn a profit for him. Most of contemporary textbooks on entrepreneurship today support the idea of four production factors.

Still today we can observe some theoreticians returning to the idea of having just three factors of production saying that it is possible to conduct productive process without the fourth factor – entrepreneur.

It is believed that the traditional role of entrepreneur can be effectively switched to the labor. If not fully then at least partially. This idea is closely related to the phenomena called employee financial participation.

The concept of employee financial participation has strong economical and social background as factor labor becomes more productive if additional incentives are provided and is heavily responsible for profit making in companies. There are further social arguments mostly connected with wealth sharing and idea of people's capitalism, as well as economic arguments mostly connected with increased motivation of employees and thus increase of company's efficiency.

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