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Can employee ownership learn from experience? On EOTs, ESOPs and Coop–ESOPs

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Abstract

Purpose – The purpose of this paper is to draw out analytical and conceptual lessons from the past three-quarters of a century of experience with employee ownership to examine what works and what does not work – with a focus on the most recent generation of employee ownership.

Design/methodology/approach – The analysis describes embedded and flawed legal design features of certain approaches to employee ownership that will likely contribute to a dissolution of employee ownership within a generation – like a mule that cannot reproduce itself. This paper also proposes a conceptual and now legislated model of a democratic firm as a basis to criticize some models of workplace democracy.

Findings – The analysis finds that the usual standard models, from direct share ownership (e.g. the plywood coops or the Spanish SLs) to the US ESOPs, and finally the UK EOTs, have built-in sell-out tendencies. The findings are empirical in the case of the plywood coops, Spanish SLs and US ESOPs, and are predicted in the case of the relatively new UK EOTs.

Research limitations/implications – Much of the paper is about mule-firm tendencies of some models of employee ownership.

Practical implications – The application of the analysis to the UK EOTs after a generation is a prediction. Now, it is too soon to tell.

Social implications – We don't need more failed models to verify sceptics' claim that "employee ownership doesn't last long."

Originality/value – This is an ongoing debate in employee ownership circles. Some arguments are new and some are older points that have yet to take hold despite evidence of their importance. Finally, the new Slovene legislation of the Coop–ESOP is described, which attempts to offer solutions to the major criticisms given in the paper of the prior models.

Keywords Democratic firm, Employee stock ownership plans, Employee ownership trusts, Mondragon cooperatives, Individual capital accounts, Partner capital accounts, Collective account, Coop–ESOP

Paper type Conceptual paper

Introduction: an apology for learning from the past

The modern era in worker cooperatives and employee ownership can be dated from the post-WWII cooperatives in Europe and America. At that time, an appropriate attitude toward different legal forms and attempts at democracy in the workplace might be "let a 100 flowers bloom." That view has accumulated three-quarters of a century of evidence and know-how regarding what works and what does not work. This question is particularly acute with respect to the problem of a capital structure for extending workplace democracy across generations of workers. For instance, are initially successful democratic firms like mules which cannot reproduce themselves as democratic firms in the next generation?

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Acknowledging the perpetual epistemological relevance of maintaining openness to new knowledge, the continued adherence to the same “let a 100 flowers bloom” perspective that characterized the mid-20th century starting point of our analysis of all worker-centered firms brings to mind Santayana’s quip that those who do not learn the mistakes of the past are doomed to repeat them. Recommendations to not repeat the mistakes of the past are sometimes dismissed as ideology, dogmatism, inflexibility or narrow-mindedness.

Hence, this paper focuses on: (1) recapitulating the basic structural principles behind workplace democracy and democratic firms, (2) discussing the many lessons on “what does not work” and (3) an attempt to incorporate those lessons in designing a new model for a democratic firm.

Employee-owned firms, like any other private firms, face many market-based challenges to their survival – but those problems are not our concern here. The analysis of the structural issues in employee-owned firms is both empirical (by studying the failures of the past) and conceptual in figuring out how to avoid the same problems in the future. Some of the analysis is inevitably normative since the desired outcome is presumed to be a workplace democracy, a democratic firm. Hence, we first turn to a proposed definition.

The democratic firm

Personal rights versus property rights

To understand a firm organized as a workplace democracy, i.e. a democratic firm, it is first necessary to understand the difference between personal rights and property rights.

(1) A *personal right* is a right that a person needs to qualify for – like qualifying to be a citizen in a state or to be a voting resident in a municipality. By its nature, it is not the sort of thing that may be bought or sold. If a person qualifies for a personal right, then they don’t need to buy it. A person may not sell the right since the buyer may not have the qualifying role, and if they did, they would not need to buy the right. Hence, a personal right is not the sort of thing that may be alienated; it cannot be transferred, bequeathed, marketized or commoditized.

(2) A *property right* is a right that may be bought and sold, bequeathed, transferred or gifted to another person.

Human rights are examples of personal rights where the qualifying role is simply personhood. An economic example of personal rights would be the membership rights in a cooperative based on patronage in the cooperative.

Any voting rights one has as a personal right are automatically one-person/one-vote, since one either has the qualifying role or not; there is no notion of multiplicity. Yet, when one has a vote as a property right, e.g. a share in a conventional company, then one can have as many as one can afford.

Prior to ESOPs and then EOTs, the main mechanism for employees to acquire ownership in a conventional corporation was Employee Share Purchase Plan (ESPP), wherein employees would buy shares using payroll deductions or other personal capital, perhaps at a special discount. Historically, ESPPs never counted for more than a tiny proportion of corporate ownership. That was because ESPPs stuck to the standard “capitalist” logic of ownership going to those who supplied equity capital.

How ESOPs break the logic of capital ownership

That logic was only broken by Louis Kelso’s development of the ESOP (and other SOPs). The logic was broken by the membership in the ESOP being a personal right based on employment in the underlying company, and the member’s share of the ESOP contributions from the company to the ESOP being distributed between the individual capital accounts (ICAs), not according to the number of shares in the accounts, i.e. capitalist logic, but as a personal right according to the distribution keys based on labor as measured by salary.

In spite of Kelso's capitalist bravado with books *The Capitalist Manifesto* (Kelso and Adler, 1958) or How to Turn Eighty Million Workers Into Capitalists on Borrowed Money (Kelso and Hetter, 1967), it was his break with the capitalist logic in the US ERISA legislation of the mid-70s in order to get shares into employee hands based on their labor, rather than their capital, that opened the modern era of significant employee ownership. The shares accruing to employees are paid for out of company profits, not out of employee pockets as in ESPPs. That is the *seismic* change referred to as the "ESOP mechanism."

That break in the logic of capital ownership eventually spread to the UK. Prior to the 2014 EOT legislation, common ownership companies, like John Lewis Partnership and Scott Bader, were only established as gifts. But the new generation of EOT's adapted a tax-favored ESOP mechanism that initially led to a significant increase in the number of common ownership companies with the employees as the beneficiaries of the trust. However, in the case of the UK EOTs, the 100% discount on capital gains for the selling shareholders has now been reduced to 50%, with the initial result of a precipitous drop in the uptake of new EOTs. It is too soon to tell about the long-term effects. In any case, our focus is on the avoidable structural problems in today's employee-owned firms, not on questions about the strength of the tax breaks to encourage sellers to sell to an ESOP or EOT rather than to a financial buyer, a strategic (trade-related) buyer or private equity.

Parsing the rights in a company

In any type of company, there are certain rights that consist essentially of:

(1) The *voting rights* to elect the governing individuals or managers and to otherwise make the decisions and policies of the company;

(2) The *profit rights* due to the current operation of the company which may be paid out in dividends or reinvested in the company;

(3) The *rights to the net-asset value* which consists of the rights to the net value of the assets of the company minus the liabilities of the company, e.g. in the liquidation of a company.

In a conventional company, all three of these rights are property rights legally packaged as shares or ownership percentages that may be bought and sold, bequeathed or gifted to others.

Democracy implies governance by those who are governed

In order to define a democratic firm, we must first recall some of the characteristics of a democracy. Abraham Lincoln's brief description in his 1863 Gettysburg address of "government by the people, of the people and for the people" will suffice for our purposes.

Who are the people governed or managed by the governors/managers of a firm? Within the scope of the business activities, the managers govern the people working in the firm. But, in spite of a lot of loose thinking in the literature on "stakeholders," the managers have no governing rights over the customers, suppliers or local residents. And vice versa; those outside parties should have no governing or decision-making rights over the people working in a firm.

The rights of outside parties should be protected by negative decision-constraining rights such as the rights of suppliers or customers to take their business elsewhere or, in the case of the local community, to constrain any external effects of the firm. If those negative control rights are considered insufficient or ineffective (e.g. in the case of monopolistic markets or inadequate and unenforced pollution controls), then they should be strengthened. But it makes no sense to think that all the outside parties, with their varying self-interests, can each have majority control of the governing board of a firm. Mere representation on a corporate board might have an informational function, but it takes effective external decision-constraining rights to actually protect the rights of outsiders.

Parsing the rights in a democratic firm

Thus, in a *democratic firm*, the governing and profit rights, (1) and (2) above, would be the *personal membership rights* attached to the qualifying role of working in the firm. Those rights may not be bought or sold and may not be inherited by one's heirs or gifted to anyone else. Since the membership rights are personal rights, there is no such thing as a property right to membership, such as equity shares, and it is automatically one-person/one-vote.

All this is analogous to a democratic polity such as a municipality. The voting rights are personal rights based on citizens residing in the city, and there is no such thing as multiple votes. Municipalities can issue debt, e.g. municipal bonds, but there is no such thing as equity shares in the city.

The rights to the net-asset value (# 3 above) are different. They represent the accumulated value put into or retained by the firm by *past* or current members. There is no reason why that value should be socialized as common ownership. If the firm has some mechanism for the past members to eventually recoup that value, e.g. in the ICAs (Feldman *et al*. 2025) of the Mondragon worker cooperatives or the partner capital accounts (PCAs) in a partnership [1], then those are property rights. For instance, if a member dies, then those (3) rights would pass to their heirs, while their personal (1) and (2) governing and profit rights would be extinguished. While those ICAs or PCAs represent property rights, they are not "capitalist equity" since each member's or partner's voting and net income rights are totally independent of the size of their ICAs or PCAs. Hence, the ICAs and PCAs represent a form of (interest-bearing) subordinate debt of the cooperative or partnership to be eventually paid back to the member or their heirs.

Examples of democratic and non-democratic firms

In spite of many shortfalls in practice, the ideal of the Mondragon worker cooperatives remains the best present-day example of a democratic firm. In a worker cooperative, the personal rights of patronage are defined as being among those who are governed (always within the scope of the business), i.e. those who work in the firm.

Of course, the most common examples of non-democratic firms are the conventional corporations where membership rights are property rights owned by the shareholders, while the people governed by the management are the employees of the company.

The ironic history of corporations

If we trace the history of corporations back to medieval times, it is ironic that the original concept was essentially a democratic one where the members of the corporation were the people carrying out the activity of the corporation.

> We can here perhaps note a final irony, at least. The concept of the corporation began for us with groups of men related to each other by the place they lived in and the things they did. The monastery, the town, the guild, the university . . . were only peripherally concerned with what its members owned in common as members. (Chayes, 1961, p. xix)

The people represented in the governing of a monastery, town, guild or university were the people carrying out the activities of the organization or association. But in the later history of productive organizations, e.g. businesses, there arose a new way to have one set of people carry out the productive activity of the organization while the governance of those activities was in the hands of a different set of people. That legal institution which separated the activity from its governance was the master-servant, employer–employee or human rental relationship (Ellerman, 2021a).

> The analogy between state and corporation has been congenial to American lawmakers, legislative and judicial. The shareholders were the electorate, the directors the legislature, enacting general policies and committing them to the officers for execution. . . . Shareholder democracy, so-called, is misconceived because the shareholders are not the governed of the corporation whose consent must be sought. (Chayes, 1966, pp. 39–40)

The employment relation allowed the governance rights over the activities of the association to be transformed from personal rights into property rights over the organization, now seen simply as a species of property to be bought and sold like the traditional ownership of things.

> The subsequent history of the corporate concept can be seen as a process by which it became progressively more formal and abstract. In particular the associative elements were refined out of it. In law it became a rubric for expressing a complicated network of relations of people to things rather than among persons. The aggregated material resources rather than the grouping of persons became the feature of the corporation. (Chayes, 1961, p. xix)

Problems in legal structures for democratic firms

Overview

In a democratic firm, the label "employee ownership" is a double misnomer. The workers in a democratic firm are not employees but members (regardless of what the outside legal system calls them), and they hold the membership rights [rights (1) and (2) above] as personal rights attached to the qualifying role of working in the firm, not as property rights that need to be brought or can be otherwise sold, bequeathed or gifted to others. Yet to be practical in today's society, the quest for workplace democracy often takes the form of promoting "employee ownership."

There are many legal pitfalls along the road to workplace democracy (Ellerman and Gonza, 2024b; Gonza, 2025). Hence, there is a need to briefly survey some of the main shortcomings in past and existing legal structures that are oriented toward "employee ownership" or workplace democracy.

The Janus-shares problem of direct transferable share ownership

One of the easiest lessons to learn is the mule firm tendency of EO firms that require each member: (1) to directly own at least one share to be a member and (2) the membership shares *also* carry the capital value built up in the firm. Such shares are called "Janus shares" (Gonza, 2025) since they try to combine two incompatible functions. Membership should be a personal right based on working in the firm and accumulated capital value should be a property right eventually paid out to a retiring or exiting member.

The rather obvious problem is that in a successful company, the membership shares become so valuable that new workers cannot afford to buy the shares from retiring members. Hence, the new workers are hired as non-member employees and the retiring members sell their shares to a competitor or financial investor so that the firm tends to revert to conventional ownership within a generation.

One of the older examples of Janus shares was in the plywood cooperatives located in the Pacific Northwest after the Second World War (Berman, 1967; Pencavel, 2001, 2013). The expected degeneration took place, so no plywood cooperatives have survived today.

A more recent example is the Spanish *Sociedades Laborales* (SL) (Lowitzsch *et al*., 2017) as well as some Italian worker cooperatives. In the late 1980s, the author had lunch with the head of the SL association for the Basque region in Spain. He complained about the problem of new workers not being able to buy the shares of retiring workers and described attempts to get retirees to sell at a lower price. I explained that this was a "solved problem" by having nominally priced membership shares and *separate* internal capital accounts (ICAs) for each member to carry their accumulated capital value to be eventually paid out by the firm. When I mentioned that this was the solution adopted by the Mondragon cooperatives "just across the street," he thundered that "cooperatives are 19th century and SLs are 20th century" and that was the end of the discussion. Today, a third of a century later, the same problem remains with the SLs. Once a legal form is implemented over decades, it may become "embedded" or "locked-in" (David, 1985) and thus defended against new learning.

Another form of employee ownership with direct share ownership is profit-sharing plans, where the bonuses can be converted into shares, which typically are restricted shares that cannot be transferred except back to the firm. If the profit shares are only available to a limited segment of employees, then the scheme is only a variation on ESPPs. If the profit-sharing is with all employees (according to some formula), then the conversion into shares is like in ESPPs, only those employees with enough income to invest in those shares. Moreover, this firm of direct share ownership seems to sponsor the mentality of a shareholder rather than a co-owner. In one recent example (based on personal communication with the CEO), when the Government was considering an increase in capital-gains taxation, most of the employee shareholders put their shares back into the firm prior to the tax changes. That is shareholder play-the-market mentality, not co-owner mentality.

In a natural experiment in Norway, a shipyard company was split into two essentially equal companies, one with individual employee ownership and the other with collective employee ownership. A later empirical investigation found support for the hypothesis: “Employee collective owners will have a stronger feeling of being owners through their co-ownership than employees holding shares individually in a private conventionally owned firm.” (Økland and Kvitastein, 2015, p. 194). This is important for the goal of building an ownership culture and a “company of co-owners.” The study did not investigate the generational question of what happens when the initial cohort of employee owners (individual or collective) retires.

Social or common ownership

Socialist reasoning. Attempts to move in the direction of workplace democracy (or worker self-management) from the socialist left are likely to involve the idea of common or social ownership. In particular, this involves denying the past workers the (3) rights to the net-asset value that was accumulated by them reinvesting part of the net income in the firm rather than taking it out as bonuses or dividends. If the net income was taken out as bonuses or the like, then it became the property of the worker-members. But for a variety of reasons, socialist thought holds that reinvested earnings must be penalized by being “socialized” instead of being recorded for future payouts in the members’ ICAs as in the Mondragon cooperatives or in worker co-ops with retained patronage dividends (Zeuli and Cropp, 2004). There is no connection between a member’s voting or net income rights and the size of their ICAs. Socialist reasoning considers any private property rights taken out in the present as wages, salaries or bonuses to be fine, but the property rights to retained earnings to be taken out in the future in a democratic firm as being “capitalist” (Jossa and Cuomo, 1997).

The problem *in theory* with social or common ownership is the denial of the rights of past workers to the fruits of their labor reinvested in the firm instead of being paid out in cash.

The problem *in practice* with social or common ownership is that, insofar as the employees have influence on investment decisions, the structure says to the employees: “Any net income you pay out now as bonuses is yours and any net income you reinvest in the firm, you lose all rights to it.”

The Yugoslav self-managed firms. The most obvious practical problem is the bias against reinvestment of current earnings and the resulting bias in favor of debt financing investment, which postpones the problem perhaps beyond the time horizon of the older workers. In the conventional economics literature against the Yugoslav model of self-managed firms, these biases were called the “horizon problem” (Furubotn and Pejovich, 1970). This problem is solved by the system of ICAs (Ellerman, 1986, 2020), even though many conventional economists want to consider it somehow intrinsic to any sort of workplace democracy.

The UK Employee Ownership Trusts. More recent examples of common ownership firms are those described as “Employee Ownership Trusts” or EOTs in the United Kingdom. The firms resemble the American Employee Stock Ownership Plans or ESOPs in that the selling shareholders are paid off from the future earnings of the company, not out of employee pockets. This aspect of ESOPS and EOTs is a major advance made in employee ownership over the ineffectual Employee Shares Purchase Plans (ESPPs) of the past and present. But the EOTs crucially differ in having common ownership instead of the ICAs of the US ESOPs or PCAs as in a partnership.

In addition to the above-mentioned biases of social ownership, the EOTs have another problem, the "*first cohort problem*," that creates the tendency to be "mule firms" (i.e. firms that will not reproduce themselves with employee ownership). Since the UK EOTs do not include ICAs, the only benefits of the employee ownership are bonuses. But it is very difficult for any bonuses to be paid out when the acquisition debt is being paid off out of the company's revenues

> While these [bonus] payments are still subject to NICs [National Insurance Contributions], they provide a real, material benefit to the employees of an EOT company. The company must generate sufficient cash flow to pay the bonuses and they may not be paid up to the full level, if at all, for the first several years of EOT ownership, as the company may need to dedicate its excess cash flow to repaying the debt used to finance the transaction. (Karch, 2018, p. 10)

The problem is *not* that the first cohort does not get bonuses at all or small bonuses (Pendleton and Robinson, 2025, p. 14); the problem is that they have no way to recoup that reinvestment in the firm to pay off the debt since it is common ownership. By having to forego bonuses during the payoff period of the acquisition debt, the first cohort of employee-beneficiaries will be building up "implicit equity," i.e. bonuses they earned but could not recoup after paying off the debt since it is common ownership. Since the only way they can recoup that implicit equity is to sell the company, "the structure can create pressure on successful businesses to be sold so that the equity value 'trapped' in the EOT can then be distributed to employees." (Lawrence and Mason, 2017, 20).

Indeed, this future mule-firm tendency was repeatedly pointed out by Nigel Mason, one of the leading thinkers about employee ownership in the UK.

> A threat to the long term future of EOTs lies embedded in the way they are currently structured. In the current set up, employees have no right of access to the equity value locked up in the trust. So a successful EOT business could face pressure to accept a takeover offer so that all or some of the equity value trapped in the trust can be distributed to the employee beneficiaries. The dilemma for EOT companies is that holding all equity collectively in trust is good for long term, stable governance; but bad in that employees have no right to a share in potentially rising capital values. (Mason, 2019, p. 12)

Averaging over the twenty EOTs that Mason's firm, RM2, had advised, he calculated the average payout to each employee from a sellout would be 175,000£ (about a quarter-million dollars today) even assuming no appreciation in value. One does not need to assume "a neo-classical economics view that individual action is guided primarily by incentives and self-interest" (Pendleton and Robinson, 2025, p. 14) to consider that one "can imagine some employee beneficiaries questioning why such value should remain inaccessible to them indefinitely." (Mason, 2019, p. 12). As an option, Nigel Mason "proposed that EOTs should be able if they wish to allocate their shares to individual employees on an equitable basis . . ." (Mason, 2019, p. 12), i.e. to have ICAs, which is also an option in the recently legislated Canadian EOT/ESOP.

The "naked in, naked out" argument for common ownership. In the discussion about the UK EOTs, there is a recurring argument for common ownership based on what is referred to as a "naked in, naked out" description of partnerships. To understand the flaws in this argument, we might first consider that relationship between partnerships and the idea of a democratic firm.

One way to understand the idea of a democratic firm is as a partnership where qualifying as a partner is based on working in the organization (in practical terms, working beyond a certain probationary period and perhaps paying a nominal membership fee). Thus "being a partner" in such a firm would be a personal right and hence governance would be based on a one-person/one-vote system. The partner's distributive share would be based on the existing measure of salary perhaps with a consideration of tenure in the organization factored into the distribution keys for the share of a partner. Then the PCAs would be the value-based ICAs using ordinary accounting values that yield the net asset value (NAV) on the balance sheet, and not based on a “market valuation of stock.” (Ellerman, 2025).

Existing partnerships differ in many ways from such a “democratic partnership” (e.g. not everyone working in the organization is a partner), but our points are based on the similarities, not the differences. The similarities are the existence of value-based PCAs like the ICAs in Mondragon cooperatives or in the Coop–ESOP with value-denominated ICAs. The PCAs use ordinary accounting values for the increases (i.e. retained portions of a partner’s share in the net income not paid out in cash) and decreases (i.e. cash drawings) in the PCA balances. There is no “market valuation” involved. Since partnership shares are not marketable property rights like the shares in a conventional corporation, there is no “market” value of the partnership; there is only the NAV. When a partner retires or leaves, any remaining balance in their PCA is paid out to them in cash.

But confusion has arisen because in some partnerships, exiting partners think in terms of the analogy with a conventional share corporation (e.g. a joint stock company or a limited liability corporation) where shares are valued using some formula based on expected future cashflows or profits. Some professional “partnerships” might even be legally incorporated as limited liability corporations. Such valuations give a value that is essentially the NAV *plus* the discounted present value of future profits, i.e. NAV + “Goodwill” (Ellerman, 2025). For instance, they might argue that in the early days of the partnership, the name was little known, whereas now the partnership has a good reputation, so in their exit, they should not get just the balance in their PCAs but some additional payments recognizing the “goodwill” they created. The sound arguments *against* such additional payouts for “goodwill” are confusingly described as promoting “naked-out” and then that is fallaciously interpreted as an argument for common ownership, i.e. no ICAs at all.

But the PCAs are the partnership version of the ICAs in Mondragon cooperatives or the Coop–ESOP model, and the exiting partners get the payouts from their PCAs and are thus not “naked out” *in that sense*. Lawyers and law firms promoting common ownership in EOTs are not arguing that partnerships should eliminate the PCAs in favor of common ownership. They are arguing (on a sound basis) that partners should not get *additional* payouts for “goodwill” as if the partnership was really a share corporation. They then *confuse* such additional payouts with the payouts to share-denominated ICAs as in the US ESOPs. Sound arguments against additional payouts for “goodwill” in partnerships are misinterpreted as arguments against ICAs in ESOPs and in favor of common ownership.

Here are examples of this fallacious argument in the literature.

> An EOT conveys ownership in the company to employees, just as an ESOP does. However, there is typically no equity component (no individual employee share accounts) with an EOT. The standard practice is that when employees leave the company, they do not receive any compensation relative to the value of the company. As is said in the United Kingdom, participants in an EOT are “naked in, naked out.” This means that employees do not buy into the plan when they enter the company and are not bought out when they leave. This is just the same as in any professional partnership, like a law firm, architectural firm, or medical practice. In some cases, a nominal buy-in and fixed buyout might be involved in such a firm. But the main benefit of participating in such a professional partnership is to participate in the profits, not the equity growth of the firm. (Broughton *et al.*, 2024, pp. 17–8) [2]

In a professional partnership, the partners get their share of the net income in two ways:

(1) the cash drawings, and

(2) the increases in their PCAs when cashflow demands (e.g. buying a building or offices in a building) do not allow paying all of a partner’s share in cash so the remainder is credited to their PCA to be paid out in cash later, i.e. it is *not* socialized in “common ownership.”

Neither of those ways of getting a partner's share of the net income include any "goodwill." The phrase "equity growth" normally includes the increase in retained profits, i.e. the (2) increase in the PCAs, plus the "goodwill" (as discounted future profits). The benefits of participating in a professional partnership include the (2) increase in retained profits, not the "goodwill."

> The "naked out" part of this means that a retiring partner does not realise a capital return for goodwill built up over time. What the partner gets is a share of profits over the time he or she was a partner. This business model can stand the test of time. There are no distracting discussions on what "my equity" is worth and "how will I get paid that increase in value"? (Fieldfisher, 2015)

But the ICAs in an ESOP, particularly the value-based ICAs, are the counterparts to the PCAs in a professional partnership, and hence the fallacy in taking the no-payouts-for-goodwill argument as an argument against any ICAs and in favor of common ownership.

Trusts with employees as beneficiaries. Legal trusts are used when someone is not trusted with direct ownership and control. The most familiar example of this reasoning is when a minor inherits money placed in a trust with the minor as the beneficiary until the child comes of age. In both the American ESOP and the UK EOTs, the direct ownership of company shares is put into a trust. The employees are the beneficiaries of the trust – but, in these cases, the employees never grow up and "come of age."

Low-brow reasons for trusts. In the American case, the ESOP was essentially invented by Louis Kelso. Joseph Schuchert, managing partner of Kelso & Co., was quite explicit.

> Our programs are the antithesis of workplace democracy... . We've been criticized for not giving workers more participation, but we believe workers are natural shareholders, not natural managers. (quoted in Hiltzik, 1985, p. 54)

According to Hoerr and Hammonds (1988), Kelso felt that employee voice in corporate decisions would result in "amateur management" (quoted in Murphy, 2005, p. 659). In any case, the ESOP holds shares in a trust as an artifact of the way ESOPs were legislated as a carve-out from legislation for private pension trusts.

High-brow reasons for trusts. In the UK case, that structure seems to be motivated by a high-minded notion of trusteeship. If employee-owners had actual control over the company, then they might be motivated by self-interest, whereas a trusteeship could pursue lofty social goals favored by elite stewards.

> What Gandhi's theory of trusteeship encourages is to get to the position that a company is not employee owned unless it also serves society and the environment, locally and globally, as well as its shareholders, its employees (call this EO with added Gandhian purpose or "EO Version 3"). (Nuttall, 2022, 138)

In spite of the high-minded rhetoric of stewardship or trusteeship serving "society and the environment, locally and globally," this paternalistic and non-democratic form of employee ownership – as if the employees were perpetual minors – has no place in a democratic firm any more than in a democratic polity.

Five more problems with the US ESOP

Outside management equity-like plans. In the American form of corporate governance, managers typically have overall incomes several hundred times the lowest employee pay (Mishel and Wolfe, 2019). This creates "market pressure" to reproduce this same ratio of management incomes to employee income in employee-owned firms. Since it is neither credible nor tax efficient to have manager salaries that high, the schemes are usually implemented using stock options awards, share appreciation rights, profit interests and other forms of synthetic, phantom or virtual equity.

In ESOPs, these management outside equity-like plans are at least pernicious in violating the all-in-the-same-boat ownership culture of the ESOP, equity-yachts for managers outside the ESOP and equity-skiffs for employees inside the ESOP. And they additionally create a strong incentive for management to solicit buyout offers that will deliver a "lifetime wealth event" for them.

In EOTs, these outside individual equity-like plans for managers are doubly pernicious since the inside equity plan for the mere employees is *common* ownership. Thus, EOTs can have individual equity-like plans for managers outside the EOT and common ownership for employees inside the EOT. And in the case of the first cohort problem for EOTs, these outside plans add considerably to the pressure for management to engineer a sellout.

But since these mule-firm tendencies with common ownership trusts will not be obvious for a generation, *the rush is on* to establish this form of common ownership throughout the British Commonwealth as well as elsewhere (Pendleton and Robinson, 2025).

The two-company problem for the US ESOP. Private pension plans attached to companies may invest very little or not at all in company stock. The US ESOP was created as a carveout from that pension law restriction to create a special type of private pension plan, the ESOP, that could invest 100% of its assets in the underlying company.

One of the problems arising from this origin of the US ESOP is that employees may see little cash from their ownership until near or at retirement – although dividends on shares might be passed through the ESOP to the employees with shares in the ESOP.

While all employees are eligible to have share accounts in the ESOP, shares are allocated to employees only as the debt to acquire or repurchase shares is paid off. In the time periods between buying tranches of shares from original owners or retiring employee owners, the new employees get no shares. This creates the *two-company problem* between employees with shares and those without.

Another problem with the pension aspect is the lack of diversification of employee wealth, coupled with the older employees carrying disproportionate risks in their large share account balances.

Overaccumulation of repurchase liabilities. In the US ESOP, the ESOP is required by law to repurchase the shares of exiting or retiring employees. Since the older employees, e.g. the first cohort of employee owners, are carrying greater risks in their large account balances and are nearing retirement, there might be a "run" or "stampede" of employees retiring around the same time. This creates pressure to sell out in order to satisfy those accumulated liabilities. Even if there is no bulking of repurchase liabilities, they are still stochastic or chancy events which make cash flow planning difficult. Other than the artifact that US ESOPs were legislated as a carveout from pension legislation, there is no reason why the shares cannot be repurchased and recycled earlier as cash flow allows – which also gives employee-owners some cash evidence of their ownership before retirement and reduces the problem of non-diversification (having one's job and retirement eggs in the same basket).

A collective account. Another problem with repurchase liabilities in the ESOP context is the implicit promise to pay back the full value of the shares, however that value is determined. The firm cannot take out an insurance policy in the event of not being able to buy back the shares – since that is hardly a random event. But if such events were insurable, the insurance premiums would subtract from the payouts. Hence, the best the firm can do is to *self-insure* by, in effect, subtracting the would-be insurance premiums from the account payouts.

This is a fancy explanation for thinking through a policy solution of not paying back the full value (however determined) of the shares, thereby increasing the probability of being able to pay out the reduced amount without selling out the firm. That reduced amount of the would-be insurance premiums is allocated to a *collective account* – again as in the Mondragon cooperatives. By systematically channeling some shares or value into a collective account, an ESOP could increase the likelihood that the ICAs could be paid out without forcing or inviting the sellout of the ESOP. And nevertheless, in the case of a sellout, the value of the shares in the collective account would, by law, have to go to charitable non-profits promoting employee ownership.

Over-valuation of ESOP shares. An ordinary share in a conventional company is a marketable property right representing not only a (3) share in the NAV (assets minus liabilities) of the company but the [(1) and (2)] voting and net income rights in the *future* operation of the company. In particular, the voting and net income rights are over the future activities of the current and future employees of the company.

But in an ESOP (as well as a partnership), not to mention a democratic firm, the current members *do not own* the voting and net income rights of the future members, since those future members will qualify for those rights by their work in the company in the future. The future members of the ESOP are not employees of the current members. The political analogy is that the future citizens in a democratic polity do not have to buy their citizenship rights from the current citizens.

This is also the argument why exiting partners in a professional partnership should not receive a payout for "goodwill" above and beyond the payouts of the PCAs. The "cash value" of phrases like "reputation" and "goodwill" is to be found in the future profits, where "profits" refers to the excess of future revenues over future expenses. But in a partnership, those future revenues are held by the future partners. It is therefore wrong to include the discounted present value of future profits in the payouts of past partners. There is no wage or salary to put a limit on the future partners' share of the revenues so that the remainder would be "profit" claimed by the current partners. The same logic holds in an ESOP. The future members/partners are residual claimants just like the current ones.

Today, a democratic work community organized as a democratic ESOP is nevertheless embedded in an economy of conventional corporations where corporate shares are valued on the basis of NAV *plus* the current value of the assumed or projected future profits. In practical terms, corporate valuators use various rule-of-thumb formulas (Fazzini, 2018) to arrive at their valuations, but in the idealized models of finance theory (Miller and Modigliani, 1961), the theoretical value is given by four equivalent formulas and is provably equal to a fifth formula, the NAV *plus* the discounted present value of the future pure profits (Ellerman, 1982, Chap. 12; Ellerman, 2021b, Chap. 3; Ellerman, 2025). Since the present value of future profits (usually called "goodwill") is precisely what is *not* "owned" by the current members in an ESOP, the logical value to assign to the shares in an ESOP is the NAV, not the value assigned by conventional valuators based on an estimate of future operating results. Indeed, even conventional American and international accounting standards do not allow a company to put that company's estimated "goodwill" on its balance sheet as a presently owned asset.

One of the four Miller-Modigliani formulas for the theoretical value of corporate shares is the discounted present value of all future dividends.

> Properly formulated, the dividend approach defines the current worth of a share as the discounted value of the stream of dividends to be paid on the share in perpetuity. (Miller and Modigliani, 1961, p. 419)

This shows, at least in theory, why one cannot have an ESOP or EOT where the acquisition debt for the acquired shares can be paid off with a certain number of years of dividends on the same shares. Moreover, such a dividend-only ESOP or EOT (with no special contributions only to the ESOP/EOT) is also infeasible since dividends have to be paid on all shares, not just the shares acquired by the ESOP or EOT (Ellerman, 2026). Thus, the dividends paid out to buy back some shares would also be paid to all the other shareholders whose shares are *not* being bought back! Just to buy back $1/n$ of the shares by dividends only, the firm has to pay out $n \times 1/n = 1$ or 100% of the firm's value. The remedy for this infeasible scheme is for the firm to directly buy back $1/n$ of the shares and gift them to the EOT or ESOP – which is what is done, in effect, in the US ESOP, the UK EOT and Coop–ESOP.

When an ESOP is buying shares from a shareholder, the shareholder could, in theory, sell the shares elsewhere on the market, so the negotiated share price is probably influenced by that marketability and the conventional valuation formulas based on marketability. But once the shares are inside the ESOP, they are no longer marketable pieces of property, so there is no logical reason to continue to internally value them at their purchased price. The logical valuation for the company shares on the assets side of the ESOP's balance sheet is to then revalue them at NAV since they have lost their marketability (and the current and *future* voting and net income rights are turned into personal rights attached to the current and *future* functional role of working in the underlying operating company).

In summary, the five problems with the US ESOP, which also promote sell-outs, are:

(1) Management synthetic equity plans and stock options outside the ESOP;

(2) The two-company and cash only-near-retirement problem;

(3) The over-accumulation of repurchase liabilities tied to exits or retirements;

(4) The lack of a collective "self-insurance" account to reduce the repurchase liabilities;

(5) The annual and costly overvaluation of ESOP shares.

The Coop–ESOP as a practical model for a democratic firm

The Institute for Economic Democracy (http://ied.si) in Slovenia has developed a "Coop-ESOP" or "European ESOP" model (Ellerman *et al*., 2022; Gonza *et al*., 2024) that attempts to address the above-mentioned problems in the legal structures for democratic employee ownership. Draft legislation for this model was passed into law by the Slovene Parliament on October 23, 2025 (Ellerman *et al*., 2026).

The model is built upon the US ESOP model but with some significant changes.

An employee ownership cooperative to hold the shares

The first major change is that the paternalistic trust, as the special purpose vehicle holding the employee shares, is *replaced* by a special type of worker cooperative, an *employee ownership cooperative* (EOC). The purpose of the EOC is to hold the shares as their registered owner – even though the employee-owners have a form of indirect ownership in their ICAs. The ICAs may be denominated in shares, as in the US ESOP, or denominated in value, like the Mondragon ICAs or partnership capital accounts.

The qualifying role for membership in the EOC is being employed in the underlying operating company – usually beyond a probationary period. As a cooperative, the members have one-person/one-vote regardless of the size of the ICAs. As usual in a worker cooperative, the members elect the president and the board of directors, which exercises the rights of ownership in the EOC percentage ownership in the underlying company, e.g. in electing representatives to the supervisory board of the underlying operating company. If the EOC ownership was 100%, then it would be the functional equivalent of a Mondragon cooperative.

The valuation of ESOP shares at net asset value

A conventional valuation of the shares being sold by a shareholder to the ESOP may be appropriate since the shareholder has the option of selling the shares elsewhere, e.g. to a competitor or to private equity. But once the shares are inside the ESOP, they should be revalued to NAV for two reasons. One obvious reason is that the shares are no longer marketable. But the more subtle and important reason is that the current ESOP members should not be interpreted as employing the future ESOP members, so the profits to be produced by future members should not be imputed to the value of shares indirectly held by the current members (Ellerman, 2025). That is essentially the same reason why exiting partners in a partnership should not receive additional "goodwill" payouts in addition to the payout from their PCAs.

Yet the current law for US ESOPs requires annual conventional valuations of the shares as if the share value were "NAV + discounted present value of future profits." This is both wrong in theory and quite costly in current terms and burdens the future repurchase-liability responsibility with inflated valuations and impedes the adoption of new ESOPs. With internal NAV valuation, there is no need for costly and inflated annual valuations since the relevant NAV is on the underlying company's year-end balance sheet. These changes will not be well received by the ESOP advisors who make their living off of the annual valuations or by the United States Department of Labor personnel who want to make sure workers get the "true value" of their shares as "adequate consideration."

The share recycling or rollover program

Another major change is the system of recycling or rolling over the shares (or values) in the ICAs. The idea is that after the acquisition debt is paid off (or before if there is sufficient cash flow), then the company continues to make ESOP contributions to the EOC to buy back and recycle the oldest entries in the accounts. Each entry in the individual accounts is dated, and the entries in shares are "bought back" (or the entries in value are paid out) on a First-In-First-Out (FIFO) basis (see Zeuli and Cropp, 2004, p. 63).

This recycling or rollover program addresses a number of problems.

(1) It reduces the accumulation of repurchase liabilities since the shares or values are continuously paid out, so they are recycled to the current accounts and don't accumulate in the older accounts.

(2) It has the effect of equalizing the account balances or risks borne by the members since the bigger and older accounts are paid down and the younger and smaller accounts receive their share of the recycled shares or value.

(3) It addresses the cash payout problem since the members do not have to wait until at or near retirement to start seeing some cash from their ownership.

(4) It reduces the diversification problem if the members choose not to spend these early cash payouts on wage goods but to invest them in some assets whose value will probably appreciate, e.g. financial funds or real estate.

(5) And it addresses the two-companies problem since all the employees, new or old, get credits to their internal accounts whether through loan payments or rollover contributions.

The collective account

When profits are reinvested in the underlying company, that increases the net-asset value recorded in the ESOP internal accounts. A certain percentage of that increased value can be credited to a collective (self-insurance) account instead of being assigned to the accounts that will eventually need to be paid out.

Some of the important attributes and differences are summarized in the following Table 1.

Concluding remarks

This analysis of the past forms of employee ownership can be used to analyze new proposed or legislated models, e.g. (Ellerman, 2026). The relevance is less to expect long-established forms of employee ownership to change (due to institutional inertia and lock-in effects) than to inform new forms of employee ownership not to repeat the mistakes of the past. It is hard to boil down the complexities of structuring employee-owned firms to a few implications, but, nevertheless, here are some broad strokes:

(1) Avoid individual direct share ownership in favor of employee shares being in a special purpose vehicle, but also avoid "collective ownership" inside that legal entity by using ICAs (preferably denominated in value);

Table 1. Important attributes and differences in the allocation of reinvested profits between individual ESOP accounts and the collective (self-insurance) account

EO structure	Ownership	Capital values	Cash to owners
Plywood Coops and Spanish SLs	Direct individual ownership	Individual shares carry capital value	Dividends + share sales
US ESOPs	Indirect individual ownership in a trust	Capital value in individual cap. Accts	Dividends + ICA payouts at exit
UK EOTs	Collective trust ownership with profit-sharing	Common ownership with no ICAs	Bonuses with “Naked out”
Coop-ESOPs	Indirect individual ownership in Co-op	Capital value in Indiv. Cap. Accounts	Dividends + Rollover + Exit payouts
Mondragon Co-ops	Direct membership	Indiv. Cap. Accounts	ICAs paid out on exit

Source(s): Author’s own work

(2) Always think through the generational “mule firm” problem of how to structure the firm so that it reproduces as employee-owned after a generational change;

(3) Avoid treating shares once inside the ESOP or EOT as if they were still marketable and should be valued conventionally – as if the future member/partner/residual claimants were the employees of the current member/partners. In employee-owned firms, as in partnerships, the capital accounts of members/partners should be based on net-asset value;

(4) A few working examples of a proposed ownership structure should be developed and studied before legislation to inform the legislation, which should give the model legal certainty, tax benefits for the seller and should authorize tax-deductible contributions from the company only to the ESOP or EOT, unlike dividends, which are after-tax and have to be paid to all shareholders.

Since most countries have conventional corporate laws as well as laws for cooperatives, the Coop–ESOP model can, in theory, be implemented most anywhere, not only in Europe but also in Latin America (Gonza and Juri, 2024) and elsewhere. In Slovenia, the model had been implemented in a pilot phase, i.e. without any legislation providing tax benefits, and then draft legislation was passed into law in October 2025.

Notes

1. See (Gov.UK, 2025) for the UK (Hurwitz, 2023), for the US (Achen Henderson CPAs, 2023), for Canada or Google on “partner capital accounts.”
2. This quotation can also be found on the NCEO website at https://www.nceo.org/publications/using-employee-ownership-trust-business-transition (accessed Sept. 9, 2025).

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