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Does governance confer organisational resilience? Evidence from UK employee owned businesses

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ABSTRACT

Current economic crisis has highlighted the importance of an organization's ability to withstand economic shocks. This has rekindled interest in organization resilience on the one hand, and the relationship between alternative governance forms such as employee owned businesses (EOBs) on the other. We explore this relationship using performance data on 204 publicly traded non-employee owned businesses and 49 EOBs prior to the economic downturn (2004–2008), and during the economic downturn (2008–2009). This data is complemented with a survey of resilience related governance and organizational practices in 41 EOBs and 22 non-EOBs. Our results show that: (a) employee ownership that is combined with employee involvement in firm governance is associated with greater stability in business performance over a business cycle; (b) EOBs have longer investment payback horizon when compared to non-EOBs across a number of activities; (c) Top management in EOBs are more likely to seek employee input in strategic decision making; (d) EOBs are more likely to use employee involvement to achieve tighter coupling between feedback from operations and the setting of strategic direction for the firm. These results suggest that employee stock ownership programs alone are not sufficient to develop higher levels of organizational resilience. Managers must combine employee stock ownership with employee involvement in governance if they wish to build up resilience in advance of adverse economic conditions.

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Introduction

The recent economic crisis and the prolonged economic recession that followed are focusing increasing attention on 'organizational resilience': the organization's capacity to cope with "unanticipated dangers after they become manifest (Wildavsky, 1988: 147)". The failure and near failure of a wide range of firms as the crisis has taken hold points to resilience as central to organizational strategy. Many critics of shareholder capitalism echo this view, arguing that the current relationship between ownership and governance that dominates many corporations promote short-term financial performance at the expense of resilience (Davies, 2009).

Until recently, however, there has been little research on whether the relationship between ownership-governance impacts organizational resilience (Marchington & Kynighou, 2012). This paper examines this issue by looking at the relative performance of two ownership-governance arrangements during the recent economic crisis. The first is the dominant textbook case of publicly traded share-holding firms in which governance is exercised through board of directors who are accountable to the external shareholders. The second ownership-governance arrangement is one where employees substantially own and control the firm. We used two sets of data to compare these two different ownership-governance arrangements. The first consisted of secondary data used to analyze performance of 49 employee owned businesses (EOBs) and 204 non-employee owned businesses (non-EOBs) in the UK from 2005–2009. This was complemented by data collected using survey of 41 employee owned businesses and 22 non-employee owned businesses that looked at managerial practices in each type of firm. Our analysis of the performance data show that EOBs are more resilient than non-EOBs. We follow this with analyses of managerial practices that points to differences in employee voice and involvement that may account for higher resilience.

The paper is structured as follows. We begin with an overview of the concept of organizational resilience. We examine current research on the relationship between organizational resilience and stakeholders' governance. Thereafter we turn our attention to governance in employee owned businesses, contrasting publicly traded corporations where owners are generally external to the organization, with firms where employees substantially own and exercise control over the organization. We then present our data,

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research methodology, and discuss the findings of our research. Finally, we close with a discussion and implications for the managers and future research directions.

Theoretical background

Crisis, resilience, and governance

The literature on organizational resilience emerged from the study of organizations that experience unexpected events such as natural disasters or nuclear accidents that have major consequences in terms of damage to property and loss of lives (Bigley & Roberts, 2001). Framed in this context, resilience is defined as the ability of the organization to "bounce back in the face of disturbance" (Comfort, Boin, & Demchak, 2010). In other words, the organization should not only survive, but also retain more or less the structure and functions it had prior to the event.

Resilience is clearly a desirable property. Most managers are aware that sooner or later they will face unforeseen situations that can put their organization seriously at risk of failure. Building resilience into the organization is therefore strategically advisable, but potentially also costly. For example, firms can protect themselves against supply chain disruptions by spreading their purchasing of inputs across multiple suppliers, but this usually entails higher costs. Likewise, firms can develop a variety of stand-by teams to deal with a range of unexpected problems such as quality failures or unusual customer requests, but this will also add to their overheads.

Building resilience into the organization therefore becomes a process of balancing costs against potential risks. In so called 'high-reliability organizations' where operational failure can have catastrophic consequences costs clearly take second place to achieving resilience. These organizations, as Weick and Sutcliff (2007: 37) point out, are preoccupied with failure. Structuring operations around resilience therefore makes sense in spite of much higher costs. For business organizations that do not face the same type of risks achieving resilience for its own sake without regard to costs is clearly not a practical option. Instead, these organizations have to rely on the resilience of structures, systems, and processes that exist already but are primarily organized to meet the tasks of making products and serving customers. This resilience is 'latent' by contrast to 'designed' resilience which organizations develop specifically to address threats that can potentially damage the viability of an organization. In effect, latent resilience is an emergent property created as a byproduct of what the organization needs to do to function normally.

Researchers have focused on a variety of organizational factors that contribute to latent resilience. Structural flexibility is often seen to create latent resilience (Bigley & Roberts, 2001; Lin, Xia, Ismail, & Carley, 2006). Organizations that are structurally flexible are better able to adjust when faced with unforeseen contingencies such as rapid fall in demand by reallocating resources. Another factor that improves resilience is the accumulation of slack resources. Organizations often accumulate slack resources for reasons that are not directly linked to improving resilience. Nevertheless, these slack resources can be mobilized to meet urgent needs when adverse contingencies arise unexpectedly.

Both structural flexibility and slack represent operational attributes that are macro properties that correlate positively with resilience. Researchers have also examined micro properties that contribute to organizational resilience. Marchington and Kynighou (2012) highlight the importance of high level of employee engagement that enables firms to successfully differentiate themselves from the competitors in times of crises. Gittell and Douglass (2012) have argued that "relational reserves", the interpersonal bonds among employees are crucial for dealing with crises. Roberts, Stout, and Halpern (1994) have argued that locus of decision-making also has important implications for organizational resilience. Organizations in which top management centralizes decision making will be less resilient than organizations in which decision-making authority is allowed to migrate downwards and outwards, closer to the actual site where decisions have to made, and thus better able to make decisions that address challenges posed by changing business conditions.

Thus far the growing body of research on organizational resilience has focused primarily on exploring internal organizational factors that contribute directly to resilience. More recently, attention has turned to the relationship between resilience and external stakeholders. Specifically, researchers have began to ask whether patterns of ownership, and hence governance, encourage the development of internal organizational factors that in turn increase resilience. A recent special issue in Entrepreneurship Theory and Practice argued that resilience is of particular importance to owners of family firms (Chrisman, Chua, & Steier, 2011). A view echoed by Kachaner, Stalk, and Bloch (2012) who argue that resilience is one of the characteristics that distinguish family firms from non-family firms. Ammann and Jaussaud (2012) tested this proposition by looking at the resilience of Japanese family vs. non-family family firms during the Asian crisis of 1997 using a sample of 98 firms of each type. They conclude that family firms "resist the downturn better, recover faster, and continue exhibiting higher performance and stronger financial structures over time (p. 203)".

Studies of family firms suggests that governance creates institutional foundations that allow for the growth of organizational factors that directly contribute to the emergence of resilience. Corporate governance is broadly defined as the mechanism through which "firms operate when ownership is separated from management (Claessens, 2003, p. 5)". Findings that point to resilience as one of the advantages of this type of overlap, also suggest that broadening the overlap between owners and managers, a common feature of employee owned businesses, should likewise result in higher organizational resilience (Connelly, Tihanyi, Certo, & Hitt, 2010).

Governance and employee-ownership

Employee owned businesses (EOB's) form a small but significant part of the economic landscape in advanced industrial countries. In the 19th century employee-owned producers of goods and services were viewed as an important alternative to traditional capitalist enterprises that imposed harsh conditions on their labour force. Contemporary observers who advocated public ownership of industry, argued that the economic efficiency of these types of firms was too low to be competitively viable. Among the most prominent were Beatrice and Sydney Webb who conducted a survey of employee owned enterprises at the start of the 20th century. They concluded that employee ownership interfered with effective management of operations, which in turn tended to undermine the viability of these firms. As they put it:

> "What we see is the Self-Governing Workshop is hardly ever for any length of time a stable form. Its essential features, the union in the same persons of manual workers and managers, hardly ever endures. It is always tending to revert to the ordinary separation of the capitalist system, of non-working capital owners who control, of a manager subject to them who directs, and of manual working wage earners who obey. (Webb and Webb, 1914: 20, 22)".

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