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THE ROLE OF INCENTIVES, PROFIT SHARING, AND EMPLOYEE PARTICIPATION IN THE DEVELOPMENT OF HUMAN RESOURCES IN CANADA

Michael McDermott*

I AM VERY PLEASED TO BE HERE today to speak, and am very grateful for the invitation. I have noticed that a number of the things I was going to say have already been said by some of my Canadian colleagues, either in their addresses or in answers to questions. However, that is easily taken care of. When that happens in Canada, you cover the same ground again, but in the other official language. Well, I cannot do that today, so I have to do it all again in English. I had an experience in Montreal during consultations for a review of the Canada Labour Code. I was asked by the minister to moderate the session, which I did. After the first round table, I wanted to thank people for their comprehensive introductory comments. I was searching for a word in French to cover this. I used the word épandu, and I could see some faces grimace. I thought I had captured the right kind of word, but I consulted the dictionary afterwards to make sure. I wanted to say something like extended. I found, however, that the word épandu means spread out. But the brackets say, “agriculture, especially manure.” I knew at once why I got the reaction on their faces.

I have been in the business of labour relations for a number of years, essentially as a government voyeur. In the mid-1960s when I entered the field, observers could have been forgiven for taking a rather simplistic view of the subject matter of this panel. On the one hand, trade unions and many unionized employees were skeptical of profit sharing and employee participation schemes. On the other hand, some employers saw such schemes as a way of engaging their employees in furthering the interests of the firm in the face of what was regarded as trade union indifference to the health of individual enterprises.

While it may have been possible to cite particular examples in support of either view, neither would have withstood rigorous examination as representing the prevailing paradigm. Rather, times were different. Employment, if not full, was more plentiful, and order books were not subject to the competitive pressures evident in today's globalized markets. The future appeared assured. The need for introspection and questioning of existing practices and prejudices seemed less important.

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Well, the world changed. For a variety of reasons, a major objective of Canadian labour policy in recent years, at both the federal and provincial levels, has been employee participation in decision making and ownership. Since the middle-1970s, Canadians have established a range of structures, practices, and policies to facilitate the participation of workers or their representative institutions in economic, labour market, and workplace decision making and in the ownership of the economy.

There are three approaches to employee participation that Canadians seem to prefer. One is trade unionism and the collective bargaining process. In Canada the rate of unionization, although not as high as in some European countries, is at thirty to forty percent. This is much higher than in the United States. In the federal jurisdiction in which I have worked, about fifty percent of the employees are covered by collective agreements.

Looking at a chart showing the standing of about a dozen Western industrialized countries, you see Canada firmly in the middle in its unionized rate. France and the United States are probably at the low end. The Scandinavian countries are at the high end.

The second approach that I want to talk about are the employee involvement mechanisms that have been established alongside or outside the collective bargaining process. The third category will be financial participation.

These three approaches are not mutually exclusive. The point I will be making is that you can have a number of approaches within the context of a predominantly collective bargaining system, or you can choose to do it in other ways.

Collective bargaining and its importance in Canadian society is worth talking about. A recent Supreme Court decision arise out of a long and bitter strike in the Northwest Territories at the Royal Oak Mines Company. The details of the decision are not important for this meeting. However, Chief Justice of Canada wrote a two page addendum to the majority opinion. He stated that while the majority decision “is correct in emphasizing that the principle of ‘free collective bargaining’ is not the only policy interest advanced by the Canada Labour Code, it is undoubtedly one of the most important and one of the most sacred.” That was said by a Chief Justice who is not primarily a labour lawyer. Nevertheless, that is the sentiment he expressed.

Paul Weiler, Professor of Law at Harvard University and formerly general counsel to the U.S. Commission on the Future of Worker-Management Relations stated, “[i]t secures for workers a measure of protection from the employer and the vicissitudes of the labour market, protection from substandard wages and benefits, and from arbitrary and unfair treatment on the job. In addition, such protection is secured through a process which affords workers themselves a considerable
measure of participation in the entire endeavor.”

In other words, collective bargaining has instrumental advantages in that it protects and advances workers’ interests. It requires employers and employees to take responsibility for defining, asserting, and, if necessary, compromising on their interests.

Empirical research supports the view that collective bargaining produces economic benefits for society as a whole. That is to say, balanced, carefully crafted collective bargaining legislation and workable, realistic labour standards legislation, developed in partnership with the stakeholders can lead to higher productivity and economic progress.

Justice George Adams, one of Canada’s leading labour law experts and judge of the Ontario Court of Justice recently reflected on twenty years of collective bargaining in the 1970s and 1980s. He stated “there is no inevitable link between inferior or frozen social standards and a country’s competitiveness. In fact, the reverse is true.”

I know that in the United States, trade union membership has experienced a decline over the past several years. This development was not lost on the Commission on the Future of Worker-Management Relations set up by Secretary Reich and the late, and very much lamented in both of our countries, Secretary of Commerce, Ron Brown. This commission was made up of some of the most distinguished industrial relations practitioners and thinkers in the United States. It included three former Labor Secretaries, a former Republican Commerce Secretary, and two CEOs. The Commission concluded a number of things; I have a couple of quotes from their interim fact-finding report. They concluded, “the decline of unions has contributed to the rise in inequality.” Furthermore, the Commission concluded, “a healthy society cannot long continue along the path the U.S. is moving with rising bifurcation of the labor market.”

Peter Pestillo, who was here this morning, was quoted in that same report; “We can’t afford a collective bargaining meltdown.”

Access to collective bargaining procedures not only affords employees a degree of protection, but also enables them to participate in decisions that affect them directly.

One example of success using a collective bargaining unionized environment is a company that I will not name. However, if you were standing on the shores of Lake Erie and looked across to the other side on a very clear day, you might see it. A large steel plant with about a thousand employees and revenues approaching $800 million. The employees are members of the United Steelworkers of America. The average wage and benefit package per employee is reportedly on the order of $70,000 per year.

With that kind of compensation, even in Canadian dollars, would you say that workers feel a stake in the performance of this plant? I think you would agree that they do. Despite the sizable wage bill, or
perhaps because of it, the plant is one of the most efficient steel producing facilities in the world and has never had a layoff in its fifteen-year history. It proves that that kind of thing can be, or suggests that that kind of result can be achieved in both the unionized and non-unionized setting.

The second approach to employee participation that is prevalent in Canada, and working in conjunction with collective bargaining, consists of numerous joint committees existing at all levels of the economy. You have heard of some of them today. The ones at the national and provincial levels that my colleague Yves Poisson mentioned, such as the Canadian Labour Force Development Board. Another is called the Canadian Labour Market and Productivity Centre. These groups are concerned primarily with broad labour market issues. They have labour, management, and some government involvement in them.

There are also numerous industry-wide labour management groups. Again, I think Yves mentioned a couple of them. He mentioned the Steel Trades and Employment Congress. I would add to that list the Sectoral Skills Council of the electrical and electronics industry. The Steel Trades Congress assisted in what involved a downside adjustment, the considerable adjustment in the steel industry and the shedding of employment. The CSTEC organization helps tremendously in retraining people for other employment activities.

In the electronics industry, the issue was more upside adjustment. Since the skills were ever-changing in the industry, the need to upgrade was there. That is largely what that body involved itself in.

Unions do, in fact, get involved in training in conjunction with management. There are about forty of these sectoral bodies now in existence dealing mainly with training and adjustment issues.

In addition to the work of bodies at the national and sectoral levels, countless self-directed work teams and other joint committees, operating at the plant and firm levels, have also been established.

Gordon Betcherman has done some work on this. He did an analysis of human resource practices of over 700 large establishments across Canada. They were in the wood products, fabricated metal products, electrical and electronic products, and selected business services. Betcherman found that while half of the establishments maintain traditional human resource practices, almost a quarter focus on what he called participation-based human resource strategies. That is, they emphasize employee participation. Another one-quarter used compensation-based human resource practices which stress such rewards as profit sharing and other variable pay schemes.

There are similar indications of these kinds of practices such as joint consultative practices being adopted in Canada. Such practices were recorded by the Conference Board of Canada in a publication put out in 1995. The interesting feature of many of these joint initiatives is
that they are addressing issues historically addressed unilaterally by management. For example, one committee at a large and heavily unionized Canadian Corporation deals with contracting out, business expansion, and job creation. It also has a six million dollar employment fund to carry out and evaluate pilot projects. Another joint committee, this one at the steel plant I alluded to earlier, reviews all contracting out and technological change proposals. Further, it is empowered to make recommendations in these areas before final decisions are made. Clearly, the frontiers of joint action have been pushed back considerably.

The third model of employee involvement is that premised on financial participation. This, as with the previous category, can take several forms. One such form that is innovative and has been receiving considerable attention in Canada over the last decade is the labour-sponsored venture capital fund. The documentation I provided to Henry for the conference actually gives you quite a lot of detail on these labour-sponsored venture capital funds. They involve investment companies which are owned by labour organizations and managed by investment professionals that take equity positions in small- and medium-sized enterprises. The major difference between labour-sponsored venture capital funds and employee-share ownership plans is that the funds encourage individuals to invest in a diversified portfolio of small- and medium-sized businesses. The ESOP approach encourages individuals to invest only in the firm that employs them.

The first and largest Canadian labour-sponsored venture capital fund was set up by the Quebec Federation of Labour in 1983. It is known as the Fonds de Solidarité. Its assets now exceed $1.3 billion dollars, Canadian. It is a major source of venture capital in Canada. Since its establishment, the fund has attracted over 200,000 investors, two-thirds of whom are union members. It has directly and indirectly assisted in the creation and maintenance of more than 15,000 jobs. It has generated over $250 million dollars in revenues for governments. At last count, there were seventeen such funds functioning in Canada. While their assets cannot begin to match those of pension plans, they are growing rapidly. I have heard that they represent as high as thirty percent of the formal venture capital market in Canada.

The country's second largest labour-sponsored venture capital fund was established by several construction unions. Its assets went from $44 million dollars in 1992 to half-a-billion dollars in 1995. In the same period, its shareholder base increased from 15,000 to 91,000 members. Half of its investments are in companies with fewer than fifty employees.

The help that these funds received from governments has been significant. For example, the Federal government allows a twenty percent tax credit for individuals investing in a fund. The credit is contingent
upon similar action in the province in which the fund is registered. As a result, an investor could be eligible for a tax credit of forty percent of the cost of the shares. There are limits, however, as to the amount an individual can invest.

A comprehensive analysis of the economic and social impacts of labour-sponsored venture capital funds has yet to be undertaken. However, analyses have been done of the effects of these funds on some of their recipient or investee firms. For example, they show that the businesses in which the Solidarity Fund has invested are satisfied with the help they received. They report positive changes in labour relations, a stabilizing of sales and employment levels, and an increase in efficiency.

The economic education program that accompanies the fund's investment in a firm has been particularly well-received and is significant. According to one company manager, "[t]he economic education has allowed our workers to understand the need for profit." Another declared, "[b]ecause of the mutual trust that is been engendered, I am not wasting my time trying to convince everyone that I am sincere."

The funds are not without their critics. Some make the point that the rate of return for shareholders of these funds has been low. Others within the union movement question whether the management of a venture capital fund is an appropriate role for labour. They argue that labour's energies should be directed toward improving pension plans. They also criticize the funds for not paying enough attention to social criteria when making investment decisions. Generally speaking, however, many Canadian trade unionists have embraced the idea of labour-sponsored venture capital funds.

Another form of employee financial participation in Canada is the employee-share ownership plan. Since the late 1980s, ESOPs have been growing in popularity, facilitated by legislation in a number of provinces. It has been estimated that the number of Canadian ESOPs increased by about eighty-five percent in the period 1986 to 1990.

I had to go back to 1986 to find an evaluation of the effectiveness of the ESOPs. I went back to a Toronto Stock Exchange review of a thousand companies listed on the Exchange. A quarter of them offered ESOPs. Comparing ESOP-participating firms with conventional firms, on average, ESOP companies experienced higher five-year profit growth, higher net profit margins, higher productivity, higher return on average total equity, and a higher return on capital. The study also supported what numerous other U.S. studies concluded, namely that companies that combine ESOPs with increased employee participation in the decision-making strategies of the firm outperform those that do not. Similarly, various forms of profit sharing are becoming more common in Canada. However, they are not yet widespread. It is estimated that only twenty percent of companies have profit sharing plans. On average they pay out about ten percent of profits to employees.
A major variation on the ESOP and profit sharing themes, although in this case I should perhaps refer to lack of profits, is the employee buyout. A paper prepared at the University of Toronto Centre for Industrial Relations for the International Industrial Relations Association World Congress held in Washington last May, carried the title "Employee Buyouts in Canada: A Blending of Cultures." A good characterization, in my view, of the need to respond to the dramatic restructuring in our economies by retreating from the us-and-them approaches of years gone by and instead, joining management and labour forces in an effort to sustain enterprises and further their viability.

Perhaps the most prominent employee buyout in Canada, certainly the largest, was the Algoma Steel situation in Sault Ste. Marie, Ontario. The company was on the verge of bankruptcy. However, as the country's third biggest steel maker with thousands of employees, it could not collapse without severe and far-reaching economic and social repercussions to the region and, indeed, far beyond the region. Therefore, it was in everybody's interest that something be done.

On the basis of a restructuring proposal put forward by the United Steelworkers, with the help of the federal and provincial governments, the company transformed into an employee-run enterprise. All employees who work at least 1,800 hours each year will receive the same number of shares, regardless of wage or salary. Employees must hold their shares for five years and may sell them only upon permanent separation from the company. During the spring of '92, just after the restructuring plan was accepted by all parties, the union and management negotiated a collective agreement to incorporate the principles of a restructuring plan. It was also an attempt to change the culture of the company. A joint steering committee was set up to develop workplace participation — and to devise programs to redesign the workplace. As a result, joint committees were set up to deal with training, cost reduction, and technology.

Self-directed work groups were established throughout the facility and the number of supervisors was reduced. The time clocks were eliminated. A justice and dignity provision was inserted into the collective agreement requiring management to consider employees innocent until proven guilty under the terms of a new grievance procedure. Since then grievances have virtually disappeared.

In 1994, the second full year of operation under the new ownership structure, the company earned a profit of $127 million. This was a remarkable turnaround for a company that was losing about ten million dollars a month prior to the buyout. Despite this initial success, the company is being watched very closely by some parts of the Canadian labour movement which remain cautious about employee ownership.

The survey that we did of short line railways, largely in the United States, showed that there are many elements of employee decision
making in the short lines. Self-directed work teams were quite common, job flexibility was far greater, and performance-based pay was introduced.

The downside of all this, of course, is that there are fewer workers who now earn less than they were earning before. Nevertheless, they have managed to retain some employment.

We have limited experience in Canada. Canadian National has an operating short line. Canadian Pacific is shortly expected to move in that direction. In fact, I believe there has been an agreement between the running trades unions and the company on the establishment of short lines and the work rules and methods that will apply. It has been negotiated on a tentative basis subject to ratification. However, I do not have great details about that.

In conclusion, my survey of the Canadian experience has not been exactly exhaustive. I hope it has not been exhausting either. This is a conference about NAFTA and the impact of NAFTA on human resources. I had some experience in implementing the labour side agreement which you are going to hear about from John McKennirey tomorrow. I know that under that agreement, the emphasis is placed on the principle of freedom of association and its concrete expression in free collective bargaining. On the other hand, the labour side agreement also recognizes and requires respect for the different social and cultural environments in which the three signatory countries apply the principle. I think that is an important fact to keep in mind.

As we heard today, Canada is a more heavily unionized environment. Nevertheless, within that environment, we are just as able to innovate and practice labour and management cooperation.

I will finish on one last note. There is a quote which I love because it is relevant. You may have heard it before. "Capital is only the fruit of labour and could never have existed if labour had not first existed." A bearded gentleman in the 19th century. . . Abraham Lincoln!