

UNITED AIRLINES' EMPLOYEE STOCK OWNERSHIP PROGRAM HAD TROUBLES FROM START

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United Airlines, now operating under bankruptcy-court protection, was counting on its employee stock ownership plan to help lift it out of its financial mess eight years ago.

But how could it, when just about every aspect of the plan - the design, execution, membership - went wrong? Now United is the blueprint for what not to do when creating an employee stock plan. Too bad it failed, because history shows that employee ownership can be a key driver to a company's success.

"It had some fatal flaws from the start," said Patricia Kelso, who heads the Kelso Institute, named after her late husband, Louis. He is credited with creating the employee stock plan in 1956.

Louis Kelso believed the capitalist system would be stronger if all workers - not just executives and outside stockholders - could share ownership of capital-producing assets. His hope was that morale and productivity would improve.

Companies with employee ownership grow on average 2.4 per cent faster than they would have otherwise, according to the National Center for Employee Ownership, in Oakland, Calif.

And that growth rate jumps as high as 11 per cent at companies where management and employees work together on decision making. Among the most successful ESOPs: Procter & Gamble and Publix Super Markets

In a typical plan, a company creates a trust to which it makes annual contributions of stock. Then the stock is allocated to individual employee accounts within the trust.

Employees get their payout when they retire. At privately held U.S. firms, which make up 91 per cent of the 11,000 ESOPs today, workers can sometimes claim the money earlier if they are leaving the company.

It was back in the early 1990s when talk first began about an employee stock plan at United. At the time, the airline had huge losses and worries were rising about its future.

While the pilots pushed the plan, other labour groups weren't so keen. But they felt it might be their only option to keep the airline alive.

The deal went like this: United workers agreed to substantial wage cuts and work-rule changes in

exchange for a \$4.9 billion loan to buy a 55 per cent stake in the company.

The plan was launched in 1994 and was one of the largest ever. It was greeted with much fanfare, even lauded by the Clinton administration.

But there were problems. Big problems.

“The United model was a poor model,” Kelso said. “It was a last-ditch effort to save jobs.”

To start, it wasn’t a full employee buyout. The flight attendants did not join because of some wrangling with management, and that created factions among rank-and-file workers, which linger even today.

Tensions became more strained as a result of a time limit, which is not often seen in ownership programs. Contributions to employees were only made through 2000, so anyone joining United after that couldn’t participate.

How the plan was funded was also troublesome.

Workers were asked to give wage concessions, and that money was used to create the fund. The usual way is to fund ESOPs is through corporate profits.

When times were good in the mid-1990s and the stock price soared, the sting of the salary cuts didn’t seem as important. But then concerns were heightened by the bear market on Wall Street.

Another problem: The stock plan was introduced at a turbulent time for United.

“United was trying to save the company from bankruptcy back then with its ESOP,” said John Menke, protégé of Louis Kelso and president of a San Francisco firm that specializes in employee stock ownership plans. “That’s not the way ESOPs usually work.”

All those problems were only exacerbated by strains long brewing between management and labour.

At first, it looked as if the two sides might resolve differences. Employees were grouped in teams across different business functions, working together to boost efficiency and cut costs. Management seemed open to ideas from workers up and down the ranks.

The initial efforts paid off. Absenteeism was down and productivity went way up. United was soon being touted as a turnaround story.

But that all-together-now mentality soon fizzled, and the strife resumed by the late 1990s when new management came in and the open relationship with workers ceased.

“Neither side had a complete buy-in,” Menke said. “It was a shotgun kind of wedding to begin with, and everyone hoped they would get familiar with each other. They didn’t.”

Now United’s ESOP will likely be wiped out when it emerges from bankruptcy. Workers will likely lose everything.