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On the "essential condition" of intellectual capital: labour!

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Abstract

Purpose – Following Marx and Engels' identification of the "essential condition of capital", the purpose of this paper is to begin an initial critical exploration of the essential condition of intellectual capital, particularly the ownership rights of labour.

Design/methodology/approach – Adopting a critically modernist stance on unitarist HR and OB discourse, and contextualised within a background on the stock option phenomenon and recent accounting regulation, the paper argues that the fundamental nature of the capital-labour relation continues resiliently into the IC labour (intellectual capital-labour) relation.

Findings – There is strong evidence that broad-based employee stock options (ESOPs) have become institutionalised in certain firms and sectors – but the future of such schemes is very uncertain (post 2005 accounting regulation). Overly unitarist HR/OB arguments are challenged here with empirical evidence on capital's more latently strategic purposes such as conserving cash, reducing reported accounting expense in order to boost reported earnings, deferring taxes, and attracting, retaining and exploiting key elements of labour.

Research limitations/implications – Research supports the positive benefits of broad-based employee stock ownership schemes. Further research on the benefits of such schemes and the reasons why they are or are not implemented is now required.

Practical implications – From the perspective of labour, nothing appears to have really changed (yet) in terms of the essential condition of intellectual capital.

Originality/value – This paper explicitly raises the issue of the ownership rights of labour to intellectual capital.

Keywords Intellectual capital, Stock options, Labour

Paper type Research paper

Journal of Intellectual Capital
Vol. 7 No. 1, 2006
pp. 111-128
© Emerald Group Publishing Limited
1469-1930
DOI 10.1108/14691930610639804

Introduction

In 1776 Adam Smith noted that " . . . labour . . . is the original foundation of all other property" (Smith, 1962); in 1840 Pierre Joseph Proudhon referred to the "vital principle – property" (Proudhon, 2003); and eight years later in the revolutionary year of 1848 Karl Marx and Frederick Engels eloquently argued that "the essential condition of capital is wage labour" (Marx and Engels, 2003): all are so fresh[1], relevant and topical that they could very well have been written yesterday!

What's really so different now? What is the essential condition of intellectual capital (IC)? How is the condition of intellectual capital? Has the "vital principle" changed or morphed to something new in the knowledge and intangibles economy? The nature of employee-employer relations can be viewed through two different perspectives; pluralist and unitarist. There is a clear distinction between both because in traditional personnel management the pluralist focus is on the relationship between management and employees through contractual arrangements in which the former hires and the latter performs. Conversely, current HR and OB research focuses more on the unitarist perspective where the "uni" refers to one-and-together; this latter discourse suggests that the IC-labour relation is changing. This begs some questioning on the nature and depth of such perceived change – is it merely superficial or is it reflective of something more fundamental? Grounded in the apparent increasing usage of broad based employee stock options (ESOPs) and share-ownership schemes, some argue the case for emergent convergence on the roles of owner, manager and worker, particularly in knowledge-intensive firms. This would represent a fundamental change in the capital-labour relation with respect to the ownership rights of labour. Others, in more critical vein, provide ample evidence that many employers do not even regard labour as an asset – let alone grant it any stock options or as much as a taste of any ownership rights! This unitarist and perhaps latently strategic ideological bias in many, if not all, HR and OB discourses is challenged in this paper. Any discussion of ownership, the "vital principle" or the "essential condition" raises contentious issues on why firms introduce stock options, on the perceived changing dynamics of the IC-labour relation, and on the implications of recently implemented accounting regulation on the future of labour's ownership rights and possibilities. Our key argument is very simple: there can be no capital, intellectual or otherwise, without labour. Were Engels, Marx, Proudhon and Smith somehow around at the moment – they would probably agree.

The structure of the remainder of the paper is as follows. First, we briefly contextualise the issue of how ownership may or may not be changing the nature of the IC-labour relation. We then shift focus and tease out some critical insights from the literature related to "expensing" of stock options, one of the accounting issues of the moment due to regulatory implementation in 2005. We conclude that the fundamental nature of the capital-labour relation continues resiliently into the IC-labour relation; the vital principle retains its hegemony – from the perspective of labour, nothing appears to have really changed (yet) in terms of the essential condition of intellectual capital.

Ownership, IC and "pieces of action"

There is general agreement that performance based forms of employee compensation are increasing and on the increased usage of stock options by many, certainly not all, firms over the past decade or so. Favourable accounting and tax treatments up to the

implementation of new accounting regulation in 2005 have both been used to explain the escalation in stock option grants to executives, managers and employees during the 1990s. Note that the main focus in this paper is on employee stock options, but we also draw on relevant literature that takes a more "upper echelons" perspective. The volatile debate leading up to the implementation of new accounting standards, which we discuss below, has raised many other questions. Why do certain firms offer employee stock options? – How should they be accounted for? – Are the dynamics of ownership within the IC-labour relation changing? – these are all highly contentious questions.

In brief, employee stock options are contracts that give an employee the right to buy a share at a pre-specified price – the "exercise price". Most share options are granted with an exercise price equal to or greater than the market price on the date of grant with the expectation that a gain will be made when the option is vested at a later date, by which time the market price is optimistically assumed to have risen. Employee options are predominantly non-tradable and are typically forfeited if the employee leaves the firm before vesting (see Hall (2004) for discussion on transfers; and "The Intel Case" below for a case vignette). When an employee exercises an option, the company issues a new share, which increases the number of shares outstanding (Bodie *et al.*, 2003; EFES, 2005; Hall, 2000, 2004; Hall and Murphy, 2003; Kroumova and Sesil, 2005; Kruse, 1996; NCEO, 2005a, b; OASIS, 2005; Pourceau, 2003; Poutsma *et al.*, 2003; Sesil *et al.*, 2002).

In an interesting exchange of views in the *Academy of Management Review* (Volume 29 Issue 4, 2004) there is both agreement on the increasing use of stock options as part of labour's compensation package and some contention on the reasons for such an increase. Rousseau and Shperling (2003, 2004) argue that there is some convergence on the roles of owner, manager and worker, particularly in knowledge-intensive firms. They further argue that this shift "occurs concomitantly with expanded worker participation in ownership and related privileges in the firms that employ them", including access to financial information and greater freedom in decision making (Rousseau and Shperling, 2004, p. 562). Zardkoohi and Paetzold (2004) agree with Rousseau and Shperling on the increasing usage of stock options but argue that this shift is mainly attributable to high-technology start-up firms with insufficient cash flow to pay high salaries and to a greater use of performance based compensation for managers. It has been commonly argued that many firms at the start-up stage may not have the cash resources to meet large salary commitments – it follows that share options would appear to be particularly suited to their compensation needs (Core and Guay, 2001).

Notwithstanding the unitarist and perhaps latently strategic ideological bias unspoken in such discourse and its assumed soft stakeholder perspective, there is general agreement that many firms, certainly not all, now make increasing use of both stock options and performance related compensation for both managerial and non-executive employees. In more critical vein, Budwar *et al.* (2002) question whether firms actually have labour's best interests at heart; based on substantial evidence, they suggest that most firms ignore their workforces when it comes to issues of ownership, not even, in many cases, describing them as assets, let alone granting labour as much as a taste of any ownership rights. In similar vein, Marchington and Grugulis (2000) critically deconstruct much of the underlying unitarist bias in the "best practice" HRM literature. Moreover, across continental Europe the situation is very mixed due to

differing historical institutional arrangements and a huge diversity in tax treatment (D'Art and Turner, 2004; EFES, 2005; Pourceau, 2003; Poutsma and de Nijs, 2003). Employee financial participation in Europe has been more influenced by profit sharing, with government and trade union support (D'Art and Turner, 2004; Poutsma and de Nijs, 2003). In part, the privatisation of state owned companies has contributed to wider employee ownership.

Rousseau and Shperling provide ample evidence from the US that the use of stock options is not confined to cash-poor high-technology start-up firms. Drawing on the work of Blasi *et al.*(2003), Core and Guay (2001) and others they note that:

> Over one-fifth of US private sector employees – 24 million workers – own stock in their own companies, and 8 million participate in employee stock ownership plans [. . .] Note that those 24 million workers constitute 23 per cent of the American workforce, far beyond the portion of people employed in high-tech start-ups or as executives. A full 70 per cent of worker/owners are employed in large public companies [. . .] On average, the number of options outstanding to all employees exceeded 6.9 per cent of shares, with nonexecutive employees holding 67 per cent of these options [. . .] Broad-based stock options – that is, grants to at least half of a firm's workforce – have continued to increase steadily over the past ten years, from 17 per cent in 1993 to 39 per cent in 1999 (Rousseau and Shperling, 2004, pp. 562-3)

Commenting on employee ownership, Rosen *et al.* (2005a, b) note that "When employees own a stake, the attitude of a company changes – and so does its bottom line . . . Like any business owners, employee owners in these companies are rarely idle". Bracketing the subtle rebranding of labour or employees into "worker/owners" or "employee owners" for the moment, and simply noting its oxymoronic semantic potential for a battery of IC deconstructionists yet to come, we concur that stock options do form a small, if significant, part of labour's compensation package in many firms, and particularly so in the high-technology sector (NCEO, 2005a,b; Sesil *et al.*, 2002; Tracey *et al.*, 2005). Over the decade 1992 to 2002 the average firm in the S&P 500 granted options whose values increased from an average $22 million per firm to $238 million per firm by 2000, falling to $141 million per company in 2002 (Hall and Murphy, 2003). In the USA between 8 and 12 million employees held stock options in 2003: fewer than one million did in 1990 (NCEO, 2005a, b). Further, Kroumova and Sesil (2005) report that, in large US S&P 500 firms, broad-based stock option grants increased by 50 per cent between 1990 and 1998, and the value of stock option grants per employee increased by a factor of four between 1994 and 1998. In Ireland, D'Art and Turner (2005) note that nearly half a million employees were recorded as being covered by "profit"-sharing schemes from 1983 to 2003. In the UK over 30 per cent of the nearly 1,000 organisations across both public and private sectors responding in 2001 offered share-option schemes (CIPD, 2002). This is initially suggestive of some real movement in an emerging knowledge economy by "knowing" labour into the ownership rights of capital – or is it?

There is little theoretical consensus on what factors really drive a firm's decision to adopt broad-based stock option plans. Kroumova and Sesil (2005, p. 4), from a broad agency theory (Jensen and Meckling, 1976) perspective, argue that firms relying heavily on:

> . . . "difficult to monitor" inputs from human capital will be more likely to adopt compensation plans that provide inexpensive substitutes for more formal monitoring (e.g. hiring more managers or supervisors). Monitoring problems are likely to be more severe in

knowledge-based firms where intellectual capital is the main source of customer value, in large firms, or in firms that are experiencing fast growth.

Moreover, Rousseau and Shperling conclude that "ownership is increasingly part of a larger set of practices for firms where a highly committed workforce is viewed as a competitive advantage" (2004, p. 563). They note the criticality of industry or sector-specific skills and that "core competencies may reside not in individuals but, rather, in the collective with whom the employer seeks to contract" (2004, p. 567). The intangible and socially very complex nature of such relational intellectual capital creating processes is exceedingly difficult, and probably impossible, to fully identify let alone fully monitor (Bontis and Fitz-enz, 2002; Edvinsson, 2002; Kruse, 1996; Mouritsen, 2004; O'Donnell, 2004; Sveiby, 1997). Mouritsen (2004, p. 261) puts it succinctly; " … it is impossible to arrive at one finite and set value of intellectual capital". Hence, Coff and Rousseau's (2000) plausible argument that broad-based ownership arrangements may reflect employer efforts to retain, motivate and tie in the relational collective of value creating labour – by granting them a little "piece of the action". Such actions and discourse further the institutionalisation of "worker/owner" identity within unitarist discourse and neo-liberal ideology.

The retention incentive, however, depends on both the volume of options and where the share price lies relative to the exercise price – and there is no evidence from the Irish ICT sector (O'Regan *et al.*, 2004), for example, that firms compensate employees for variation in stock price. If share price is well above the exercise price and the employees must remain in the job before being able to exercise the option, then the incentive to remain is certainly high. Retention incentives are lowest when options are "underwater" especially when alternative employers are willing to make a new grant of more valuable options. A total of 90 per cent of stock options in the USA are granted below the top-executive level – if these employees are motivated to increase the value of the firm, their share of that gain through their option holdings is, however, quite small in relative terms.

The unitarist argument in terms of "participation … [and] … access to financial information and greater freedom in decision making" (Rousseau and Shperling, 2004, p. 562) may also be more critically addressed by digging a little deeper. This aspect of the IC-labour relation is particularly complex, and it is beyond the scope of this paper to deal with it in any great substantive detail. Participation can be direct or indirect and there are substantial differences between information, consultation and decision making wherein the timbre of labour's voice can be addressed in terms of depth, level, form and scope (see Marchington *et al.*, 2001). One-way-traffic in communicating information by capital to labour remains the dominant mechanism identified in the substantive body of emerging Irish research here (D'Art and Turner, 2002; Dundon *et al.*, 2003; Gunnigle, 1999; Roche and Geary, 2000; Teague, 2004; Wallace *et al.*, 2004). In terms of greater freedom in decision making by labour on everyday operational issues one can view such developments as necessarily imposed due to the difficulty of monitoring intangible work. The greater the depth, level and scope and the more strategic the issue, however, one finds that capital tends to rely on communicating sufficient information to labour as distinct from engaging in any consultation process; decision making by labour on strategic issues is simply not on the agenda and "freedom" is perhaps not the most appropriate term to use here.

Moving back to the vital principle, further illustrative evidence on such "pieces of action" is available from ongoing research in the Irish ICT sector, which is perceived by its CEOs and CFOs to be rich in intellectual capital – on average, almost two-thirds of value in the sector is perceived to be intellectual capital and half of this is perceived to stem from the human capital or labour component (O'Donnell and O'Regan, 2000; O'Donnell *et al.*, 2003; O'Regan *et al.*, 2001). This sector has attracted massive investment by US multinationals – where one would expect to see the stock option component of the compensation equation institutionalised in the USA transferred to their Irish subsidiaries – and in turn, perhaps, influencing the Irish owned segment of the sector. It is sufficient for present purposes simply to note the main finding from CIMA sponsored research here that granting stock options as a percentage of the overall compensation equation is a sector wide phenomenon for both managers (approximately 10 per cent) and "other" (or non-executive) employees (approximately 7 per cent)), namely the highly educated labour in this IC-creating sector (O'Regan *et al.*, 2004; Tracey *et al.*, 2005). There is also evidence of widespread use of performance related compensation in this sector (average of approximately 13 per cent for managers and approximately 10 per cent for employees), which supports much of the general literature reviewed above.

However, digging a little deeper into ownership rights within the IC-labour relation in the Irish ICT sector the resilient power of appropriating capital within this relation becomes more visible. As part of the research questionnaire chief financial officers were requested to complete two items on internal ownership rights and the findings from the 116 who responded to these items are presented in Table I. There is no real evidence here on any internal movement on labour's ownership rights with regard to knowledge-based products, processes or services developed within the sector. The overall median values of 7 (on the ownership rights of capital to labour's innovations) and 1 (on labour's rights to its own innovations) provide very strong support for Marx and Engels' original elaboration of the "essential condition". We do not attempt any overly sophisticated or statistical interpretation on this research vignette here – but a median of 1 on a 1-7 Likert scale can be plausibly interpreted as signifying that labour probably has zero ownership rights to any innovative products, processes or services developed in the course of the legally instituted employment relation between capital and labour in this particular sector. This finding does, at first glance, appear somewhat trivial – yet in the context of our discussion on ownership rights within the IC-labour relation it can be very illuminating to conduct some simple critically oriented research on the trivial or the taken-for-granted. Where labour has no ownership rights, the

Table I. CFO perceptions on labour's ownership rights to knowledge based products, processes and services in the Irish ICT sector

	Median	Mean	Std. dev	*n*
The organisation claims ownership of all knowledge-based products, processes and services developed by its employees	7	6.1	1.3	116
Employees claim ownership rights to knowledge-based products, processes and services developed in the course of their employment	1	1.9	1.5	116

Notes: 1-7 Likert Scale: 1 = strongly disagree to 7 = strongly agree; *n* = 116; perceptual responses from chief financial officers (CFOs) in 2001

identity of "worker/owner" does not appear to be in any way applicable! If this is unitarism, it is unitarism on capital's terms – which, from any critically pragmatic pluralist viewpoint, should be in no way surprising (see below on the issue of transfer of ownership rights).

> *Danish labour wins stock options transfer rights – the intel case*
> In November 2004 the Union of Commercial and Clerical Employees in Denmark (HK) won a lawsuit against Intel-Denmark on behalf of two of its members. The lawsuit concerned the right of two union members to keep stock options after Intel closed down its Danish operation.
>
> *Background.* When employed by Intel the two union members were part of Intel's stock option scheme as were more than one hundred other employees. When Intel closed down their Danish activities in 2001 these stock options, according to Intel's interpretation of its stock option scheme, were no longer valid. But that is a violation of Danish law; The Maritime and Commercial Court of Copenhagen handed down a verdict in August 2003 in favour of the two union members, stating that they were entitled to keep the stock options granted when employed by Intel. This court ruling was further affirmed by the Danish high court in November 2004.
>
> *Verdict.* Intel claimed that as the union members were no longer employed by Intel they were no longer covered by the stock option scheme. Intel claimed that the stock option scheme was part of a deal designed to motivate employees and enhance retention. Intel's stock option scheme, therefore, concerned the future and could not be regarded as pay for work in the past. Intel also claimed that any disagreement should be taken to a U.S. court, as Intel is an American company without a representation in Denmark. HK (the union) claimed, however, that the stock options were part of a pay deal and should be regarded as part of salary for work performed—the property rights accrued to the employees. The stock option scheme was part of the original employment contract; hence the dispute must be referred to a Danish court under The Salaried Employees Act (The union feared that it would be impossible for their members to file a case in a US court, let alone win any case there). The court ruled in favour of the union. The stock option scheme was part of the pay deal agreed upon in the original employment contract and any disagreement about this should be taken to a Danish court to be settled according to the Salaried Employees Act. Intel did not specifically mention that the stock options granted through the scheme were to be cancelled when no longer employed by Intel. Instead it was stated that the stock options were "notices of grant", which meant that they were part of a payment package. Hence, the union members could keep their stock options.
>
> *Reactions.* The HK union is quite satisfied with the verdict and is planning to file up to 100 new and similar cases. The Confederation of Danish Employers (DA), however, views the verdict as a problem for future foreign investments in Denmark, in that firms like Intel might avoid investing in a country with such "constraints" imposed on stock option schemes! (adapted and translated from Handel og Kontor (2005))

Critical insights from accounting discourse

Up to 2005, compensation expense was recognised if options were "in the money" at grant date, that is, if they had a positive intrinsic value, where intrinsic value is the extent to which share price exceeds the exercise price of the option. No compensation expense is recorded if the exercise price on the date of grant is equal to (or greater than) the market price at that time. As employee stock options are normally issued with an exercise price above the current market price, firms in most countries were not required to record a compensation expense for their stock option awards (Bodie *et al.*, 2003; Grey *et al.*, 2002; NCEO, 2005a). It follows that they proved to be a very popular means of

apparently attracting, rewarding, motivating and retaining executives, managers and employees (labour) at no "perceived cost" to the firm (capital). This situation, however, may or may not change due to recent accounting regulation that demands that stock options be "expensed" – because this "troubling requirement" (Hasset and Wallison, 2004) or "sword of Damocles" (Botosan and Plumee, 2001) will reduce capital's reported earnings – which can realistically be expected to impact on future allocations of this particular compensation "benefit", as distinct from legally instituted "right", to labour.

Up to 2004, international accounting standards did not address the recognition or measurement of option-based compensation expenses. In 2004, The International Accounting Standards Board (IASB) issued International Financial Reporting Standard (IFRS) 2, *Share-based Payment* to take effect in 2005. Firms, with some exceptions for very small firms, are now required to reflect in their profit or loss and financial positions the effects of share-based payment transactions, including employee stock options. Firms must now measure the "fair value" of options and other equity awards at the time of grant and then expense the value of the award.

So why did stock options become so popular? As stock prices increased sharply during the 1990s many executives, senior managerial personnel and some professional employees holding options became quite wealthy. As stories of the riches gained by option holders spread through the media and word of mouth, the "options frenzy" emerged. US tax laws made stock options relatively less expensive than other forms of compensation and "may help to explain the explosion in executive option grants in the 1990s" (Hall and Murphy, 2003, p. 53*)*. The role played by stock options here is usually interpreted using agency theory where agency costs are reduced by aligning executive, managerial and employee compensation to firm performance (Jensen and Meckling, 1976; DeFusco *et al.*, 1990). To achieve such alignment, firms can choose from a wide array of incentive schemes, including stock options—that is, firms grant stock options to create incentives for executives, managers and employees to make decisions that benefit shareholders (capital, in other words).

Matsunaga (1995) suggests that the issue of ESOPs and their greater usage over time was due primarily to "managerial" incentivisation and the very favourable tax treatment in the hands of both the issuer and the recipients. Kroumova and Sesil (2005) note that this favourable accounting and tax treatment often resulted in inflated corporate earnings, raising the legitimate concern that many firms adopted broad-based stock option schemes to provide an artificial boost to earnings rather than for sound business reasons, or indeed any recognition of labour's role in IC creation or indeed, capital accumulation. Other possible reasons, however, include attracting and retaining key people (discussed above), conserving cash, reducing reported accounting expense (hence boosting reported earnings as noted above), and deferring taxes (Kanagaretnam *et al.*, 2004; Street and Cereola, 2004). Rousseau and Shperling's (2003, 2004) glowingly unitarist HR/OB argument becomes somewhat less plausible when challenged with such accounting evidence and discourse, with "Capital's" role appearing much more latently strategic than in any way benevolently unitarist.

Hall and Murphy (2003) claim that empirical evidence linking option grants to subsequent performance has been largely inconclusive, reflecting the extreme difficulty of conducting convincing empirical tests on this issue. Stammerjohan (2004), on the other hand, suggests a link between executive compensation and subsequent

firm performance with stock options providing effective "long-term" incentives. CEOs, executives or senior managerial levels are generally offered more options than lower employee levels. Yet, as with executive and CEO schemes, evidence of any links between broad based ESOPs and improved labour performance have proven to be just as elusive (Dewe *et al.*, 1988; Winther and Marens, 1997). Sesil *et al.*(2002), for example, provide strong empirical evidence that broad-based stock options are associated with higher value added activity; but they acknowledge that they cannot definitively state that stock options caused such higher value added activities – and probably neither can anyone else at the moment.

Such stock option schemes, particularly for the upper echelons, have come in for considerable criticism. The accounting scandals of recent times (now too numerous to list here) have been linked to excessive risk taking and excessive fixation on stock prices – both allegedly caused, if in part, by the escalation in option grants to the upper echelons (Cassidy, 2002; Madrick, 2003). Several commentators, including Federal Reserve Board Chairman Alan Greenspan and former SEC chief Arthur Levitt, have blamed executive options for the stock market boom and bust between 1995 and 2000. Note the emphasis here on "executive" grants – we cannot find any evidence of such grants to the "lower echelons" being blamed for such fraudulent activity – but labour in the firms concerned certainly suffered because of it. Both Greenspan and Levitt contend that the possibility of a rich reward from options drove some CEOs and their CFOs to manipulate share prices so that higher earnings were reported than were actually achieved (Seligman, 2003); all of which also raises serious questions on auditing practice (see Willmott, 1991). Others argue, in contrast, that the incentive boost provided by options contributed significantly to technological innovation and economic success and that a handful of "greedy" executives "sullied" share options as an effective means of employee compensation (Seligman, 2003). According to seminal agency theorist Michael Jensen "Honest managers were so swept up by the need to produce rising profits just to keep their jobs and their small fortunes, that they stepped over the line. Overvalued stocks are like managerial heroin" (Madrick, 2003). The winning argument in terms of mainstream accounting and governance is perhaps best summarised by Bodie *et al.* (2003, pp. 65 and 71) who state that:

> Financial statements should strive to be approximately right in reflecting economic reality rather than precisely wrong [. . .] It is not the proper role of accounting standards to distort executive and employee compensation by subsidising one form of compensation relative to all others. Companies should choose compensation methods according to their economic benefits, not the way they are reported.

Little wonder that "treatment", in the form of international accounting regulation (noted above), did not take long to emerge for such line-dancing honesty in an attempt to counter such dysfunctional/fraudulent/criminal behaviour at the top – but such treatment now also effects the ownership possibilities (as distinct from rights) of labour which had become, if in part, institutionalised through gaining some level of normative expectancy in certain firms and sectors! Labour, without direct responsibility, carries the cost yet again. Much is revealed here on the real dynamics and perhaps "hidden logics" (Henriksen *et al.*, 2004) within the IC-labour relation that is concealed in more unitarist HR/OB discourses.

In the year 2000 stock options may have overstated the earnings of S&P companies by 9 per cent; in the ICT sector the overstatement was estimated at 33 per cent

(Geewax, 2002). Bodie *et al.* (2003) provide one notable example; had AOL Time Warner in 2001 reported employee stock option expenses it would have shown an operating loss of about $1.7 billion rather that the $700 million in operating income it actually reported. Moreover, for 2001, the average earnings of S&P companies would have been 23 per cent lower if options were expensed (Weil and Segal, 2002). This is some institutional game play by capital, or more accurately, by its principal upper echelon agents!

The empirical evidence that firms, prior to 2005 regulation, used options to conserve cash is mixed. Core and Guay (2001) found greater use of employee options in firms facing financial constraints. In contrast, in a study of new economy firms, Ittner *et al.* (2002) found that firms with greater cash flows used options more extensively. The fear that expensing options will depress earnings and cause further decline in share price is contested by a number of US studies, however, suggesting that many investors do understand the cost of options and that the cost of options are reflected in stock prices (Aboody, 1996; Aboody *et al.*, 2004) – but this remains very much an open question. Bell *et al.* (2002) investigated the market's perception of the economic effect of ESOPs on firm value for a sample of 85 profitable computer software companies. Their findings suggest that the market appears to value these firms' employee stock options not as an expense but as an intangible asset. It is feasible that employee stock options create a valuable intangible asset (that is, contributed intellectual capital) for profitable firms in knowing-intensive industries but perhaps less so for firms in other industries – again, an open question.

Bodie *et al.* (2003, p. 64) claim that "full recognition of option costs need not emasculate the incentives of entrepreneurial ventures". Hall and Murphy (2003, p. 56) argue that share options are an "inefficient way to attract employees" and predict "that expensing will lead to compensation decisions that are better designed to attract, retain and motivate a productive workforce". Moreover, they argue that expensing will not affect current or future cash flows, but may result in granting fewer options, especially to "rank-and-file" employees (general labour, in other words) – stock options should only be offered to attract entrepreneurial top managers or some key engineering or technical employees who can directly affect share price. From this line of reasoning, one might expect the upper echelons and small segments of professional labour to continue to receive "pieces of action" but to see the mass of labour simply treated as a factor of production, a commodity that can be readily bought and sold from the labour market as needs dictate, and a consequent drop off or elimination of broad-based ESOPs. Bryer (2005a,b) cogently defends the continuing relevance of Marx's labour theory of value in arguing that accounting directly supports this theory because capitalists measure realised profit as though it was surplus value extracted from labour. Glowingly unitarist HR/OB discourse finds "short shrift" here from either the hard wing of agency theory or, indeed, from any wing of contemporary critical theory. As the very first sentence of *Capital* puts it:

> The wealth of those societies in which the capitalist mode of production prevails, presents itself as "an immense accumulation of commodities", its unit being a single commodity (Marx, 1977, p. 43).

Such use of employee stock options does not now appear to be that revolutionary or original from the evidence presented here – simply another subtle variation on the

management, control and exploitation of labour within the IC-labour relation. We do, however, note the shift in historical focus – from the centrality of rigidly directing the Taylorist "hired hands" to the subtlety of influencing the thinking, values and self-managing norms and "identities" (Alvesson and Willmott, 2004) of "hired heads", in other words – IC creating labour. The "objects of management control are decreasingly labour power and behaviour and increasingly the mindpower and subjectivities" of labour (Alvesson and Deetz, 1996, p. 192) – and "little pieces of action" are tools that have probably been applied for such purposes in first colonising and then constructing the mindsets of such "worker-owners". Such subtle domination may be rooted in, and facilitated by, unitarist oriented ideology and research – a set of one-sided systematic norms, beliefs, values and attitudes that labour is socialised into internalising – as Alvesson and Willmott (1996, p. 229) puts it, this form of empowerment is "a fatally crippled, ideologically polluted version of "emancipation" that merits harsh critique". We concur. The present condition and history of the IC-labour relation and its linkages to processes of intangible value creation and ownership needs further genealogical investigation in particular organisational, sectoral and societal contexts. The firm is a reflection of broader production and domination processes extant within social, political and economic systems at particular points in time, place and space (Ashton and Sung, 2002; Benson, 1977; Harvey, 1990; O'Donnell, 1999; O'Donnell and Henriksen, 2002; O'Donnell *et al.*, 2001, 2006; Willmott, 2003).

Conclusions

The fundamental issue is ownership. This can only be adequately addressed by taking a point of departure from the particular state of the capital-labour relation in time, place and space. In the limit case, unitarist discourse needs to demonstrate an equivalence or commonality of interests between labour and capital – which is not apparent in the evidence on ownership dispersion, or the underlying reasons for such dispersion, explored here. Addressing Adler's (2002) pertinent questions on being "critical in the name of whom?" – labour, and "what?" – employee stock options, can be considered from a critically modernist pluralist perspective. In contrast to unitarism, this is a more pragmatic and realistically revealing perspective for IC theory and practice to adopt in any discussion on the vital principle or the essential condition. Critical theory can addresses both sides of the *Janus*-faced IC-labour relation in attempting to reveal the underlying, often hidden, logics inherent in the stock option phenomenon and its uncertain future. Moreover, critical theory is more likely to reveal or disclose the inherent tensions within the IC-labour relation, how such tensions may impact on IC practice, and how critically reflective labour may learn to cope with such tensions in addressing the nature of its rights to its own intangible value creating processes and – in gaining a fairer and more equitable dividend on applying same. Were the latter to emerge, one would expect to see developments in labour legislation in parallel with further developments in corporate finance, taxation and organisational structures. Thus far, this debate has hardly begun in terms of intellectual capital.

Overly unitarist HR/OB arguments have been challenged here with both empirical evidence and insights from pragmatic HR/OB and accounting discourse in identifying capital's often more latently strategic purposes such as conserving cash, reducing reported accounting expense in order to boost reported earnings, deferring taxes, and

attracting, retaining and exploiting key elements of labour; not to mention the evidence of fraudulent and criminal activity No evidence was found of any real movement on granting labour any ownership rights to any innovative products, processes or services developed within the firm in the context of the IC-labour employment relation. There is strong evidence, however, that broad-based ESOPs have become institutionalised in certain firms and sectors representing a not insignificant proportion of labour's compensation package – but the future of such schemes is very uncertain post 2005 accounting regulation.

As Habermas (1987) might put it were he to join in the discussion; the organisational lifeworlds of IC creating labour remain dominated by the systems of money and power. We can discern no revolutionary or radical change in the fundamental nature or form of this relation since the seminal works of Smith, Marx, Engels or Proudhon. Bryer (2005b, p. 2) notes that Marx's comment on the political economists of his day, that they "instinctively saw, and rightly so, that it is very dangerous to penetrate too deeply into the burning question of the origin of surplus value" (*Capital*, Volume I, Part VII), is as true of accountants, regulators and most accounting academics today – one can add HR, OB, KM, IC and others here. Capital maintains its privileged position over labour in a continuous state of dialectical tension – and there is much that critical IC scholarship can contribute in informing us about how one might better manage and cope with such tensions. Perhaps we should have taken a point of departure in the "intellectual-labour capital" relation? The what relation? – one might well ask. The strangeness of the sound of the term is perhaps indicative, in a Wittgensteinian sense, of how far critical discourse on the essential condition of intellectual capital has yet to travel. This paper is but an exploratory beginning.

Acknowledgement

The authors wish to acknowledge helpful comments from the anonymous reviewers, from Colette Grey, Tom Turner, Daryl D'Art and from participants at the Intellectual Capital Stream 4th International Critical Management Studies Conference, University of Cambridge in July 2005 on earlier versions of this paper. The usual disclaimer applies.

Note

1. Writing in 1937, Leon Trotsky noted that "This pamphlet, displaying greater genius than any other in world literature, astounds us even today by its freshness. Its most important sections appear to have been written yesterday. Assuredly, the young authors (Marx was 29, Engels 27) were able to look further into the future than anyone before them, and perhaps than anyone since them" (Blaisdell, 2003, p. 123).

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Commentary: on O'Donnell and colleagues' "On the essential condition of intellectual capital: labour!"

In "On the essential condition of intellectual capital: labour!" O'Donnell, Tracey, Henriksen, Bontis, Cleary, Kennedy and O'Regan make a very important connection between stock options and intellectual capital. The authors' key argument is: "there can be no capital, intellectual or otherwise, without labour". In addition, the authors challenge the notion that stock options are used to promote a unitarist perspective. Typically, the use of share-based compensation and specifically the broad dispersion of stock options are used to foster alignment between owners and non-owners (Kroumova *et al.*, 2002). The authors posit that firms may adopt broad-based options not to promote alignment, but rather because their expensing treatment made them appear to be an inexpensive means of delivering compensation. Starting in June 2005 in the USA, firms are now subject to reporting stock options as an expense on their balance sheets. In anticipation of this expensing requirement, firms have started granting options to fewer employees (NCEO, 2005). This suggests some companies adopted them for the wrong reason(s) and may also mean that firms that could benefit from their use may be abandoning them.

What does the research say about when and where stock options do impact on performance outcomes? There is a growing body of empirical work that provides evidence that the broad dispersion of stock options is associated with superior firm performance outcomes (Ittner *et al.*, 2002; Sesil *et al.*, 2002). This body of research provides evidence that there is a performance premium associated with sharing stock options with a broader set of employees, especially in "knowledge" intensive firms. This work is supported by a broader literature on employee ownership that finds better company performance associated with the use of other forms of employee ownership (Sesil *et al.*, 2003). There is also evidence that broad-based stock option adoption is more common where monitoring costs are high, for instance, in settings where intellectual capital drives value creation (Kroumova and Sesil, 2005). This empirical work provides support for the notion that knowledge intensive firms benefit from using broad-based stock options.

We know that value in firms is now predominately a function of intangible capital (Lev, 2001) and, clearly, most of this value is wrapped-up in the intellectual capital of the firm. It is however, still very unclear exactly what "drives" the formation and development of intangible capital. Fundamental research questions on the topic remain. Specifically very poorly understood is the role of incentive compensation and intangible capital value creation. There is no comprehensive "theory of stock options" predicting why, when and where they are effective. Research has shown that labour output is greater in firms that broadly disperse stock options; why this is the case, however, is still unknown. Is this a function of greater effort, more information sharing or a reduction in employee turnover? Finally, what impact does stock option grants have on employee welfare; do stock option grants come at the expense of fixed wages and is employee morale increased or decreased?

This paper by O'Donnell and his colleagues is an important contribution to the literature on stock options and intellectual capital. Clearly, as the authors suggest, in many cases stock options have been adopted for the wrong reasons. Now that stock options are recognised as an expense, they may start being used when and where they do the most good. However, much more research needs to be done to determine exactly when this is the case.

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