

Executive summary of the research study (April 2020)

"Incidence of employee share ownership in Germany and Europe – Development perspectives"

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The study provides an overview of the models of employee share ownership (ESO) and their incidence in the EU Member States, with a focus on Germany. The emphasis here is on small and medium-sized enterprises on the one hand and start-ups in Germany on the other.

In contrast to large companies, mezzanine investments and, in particular, silent partnerships dominate in German SMEs. Genuine equity participations under company law as employee share programs in unlisted companies are rare, ESO in limited liability companies (GmbH) even rarer. ESO via intermediary entities exists but is still the exception. In contrast to other European countries or the USA, start-ups primarily involve phantom stocks, which systematically represent merely an untypical profit-sharing arrangement but not a share in the capital.

In a systematic overview the study provides up-to-date information as follows:

- **Analysis of available empirical data:** The data sources provide a coherent picture of the use of ESO in the EU and in Germany. Differences result particularly with regard to the different sizes of enterprises: The larger the company, the higher the probability of ESO. The analysis thus confirms the results obtained in research. The data sources provide no information on the use of ESO in start-ups.
- **The comparative situation of Europe and Germany:** There are major differences in Europe in regard to legal framework, tax incentives and attitudes of social partners, political parties and governments. From the analysis of the top group (IR, ES, FR, IT, AT, SL, UK) it can be deduced that it is important to have a consistent overall regulatory framework, which above all offer reliable and constant support measures. The targeted promotion of ESO in SMEs is, where implemented, possible and effective. With regard to the use of ESO, in a European comparison Germany is – depending on the data set – in a middle position at best, but more often in rear place.
- **ESO in small/micro enterprises, including reactivation of the unemployed:** The Spanish example of *Sociedades Laborales (SL)* shows that, contrary to common belief, ESO is also practised in small and micro-enterprises. Furthermore, it is remarkable that the reintegration of unemployed people into the labour market via the capitalisation of unemployment benefits for the foundation of an SL or for joining an existing one has been a success for more than 30 years. As this concept is not a legal form in its own right but is based on an ordinary corporation (limited liability company or joint stock company), there are no obstacles for transference to other countries.
- **Case studies and best practice:** For Europe, best practice examples are illustrated by case studies that reflect the life cycle of a company, i.e. foundation phase (Spain's *Sociedades Laborales Reform 2015*), consolidation and continuity (Austria's *Employee Participation Foundation Act 2017*) and company succession (UK *Employee Ownership Trust - EOT 2014*; the French "*FCPE de Reprise*" from 2009 and the US *ESOP*). In Germany, two individual case studies reflect experiences from the "Mittelstand" (SMEs) and start-up sector.

- **Harmonisation at EU level:** The five-point plan for the promotion of ESO, developed in a pilot project for Directorate General MARKT 2013/14 and supported by the European Parliament, is the first concrete roadmap for further action at the European level. In addition to long-term legislative measures, this plan provides for a series of "soft" measures that can be introduced in the short and medium term and are not tied to the lengthy legislative procedure. The most recent Own-Initiative Report of the EP of 23 October 2018 provides corresponding recommendations.
- **The question of tax incentives:** As the analysis of the EU member states shows, tax incentives are not a prerequisite for ESO. However, they are an effective instrument for the promotion of ESO. In general, it should be noted that the dispute over the introduction and level of tax incentives for different types of companies often obscures the view of a whole range of other important possible support measures (see below).
- **Evaluation of support measures for ESO:** In order to assess cost and benefits of support measures, the relationship between favourable conditions for ESO (a) stable legal framework, b) fiscal incentives and c) support from policymakers and social partners) and its incidence is analysed. An estimation of the potential for ESO in the population of German enterprises, i.e., the answer to the question of how many of the enterprises not yet practising ESO can be expected to introduce ESO under appropriately designed support measures follows: This is a total of just over 100,000 companies.
- **Promotion of EFP in start-ups:** In a number of EU Member States, the legislator has recently created a legal framework especially to encourage ESO in start-ups. Common to all support measures is tax relief for stock option plans. As a rule, taxation is reduced or waived when the options are issued and exercised. Employees are then only subject to capital gains tax when selling their shares.

Recommendations to policy makers: The variety of possible and significant support measures as well as the differences with regard to different types of enterprises should be emphasised. In addition to general proposals, ranging from providing better information, privileging long-term investments, increasing the tax-free allowance to harmonization at European level, the following measures for SMEs and start-ups are recommended:

- **Legislative measures to simplify the implementation of ESO and reduce transaction costs:** Italy, for example, from 2019 on exempts the transfer of limited liability companies' shares for employee shareholders from the obligation to notarise. This measure would allow for developing better standard ESO schemes for small companies via employee shareholding in limited liability companies as in Spain or Italy.
- **Promotion of ESO in SMEs using intermediary entities / business succession:** In an increasing number of EU countries, the use of trusts, foundations or special purpose vehicles as a form of indirect employee shareholding is practised (AT, IR, UK, HU, FR, SL). This is particularly important to help alleviate the business succession problem (see US ESOPs). Here, employees should be treated on an equal footing with uninvolved third-party buyers when acquiring company shares in especially with regard to taxation.
- **Creation of alternatives to "phantom stocks" in start-ups:** Introducing new forms for simple and flexible ESO (see above, facilitating ESO in limited liability companies) accompanied by attractive tax incentives tailored to this type of companies, for example, deferred taxation.