

Extended Country Report

Financial Participation of Employees in the Czech Republic

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1. Background

The country which has by far granted the fewest concessions to insiders in privatization is the Czech Republic. In spite of the long tradition¹ of both financial participation of employees and employees participation in decision-making the privatization framework did not foresee special price reductions, credit facilities, or pre-emptive rights available to employees. Contrasting comprehensive approaches, e.g., that of Poland, a focused policy favouring the voucher concept was pursued, while no specific schemes for employees were developed. Management-employee-buy-outs practically did not play a role.

After the split with Slovakia in 1993, the Czech Republic continued with macroeconomic stabilization and privatization as outlined during the first two years of 1990s. However, the importance of creation of the proper institutional and legal framework that would support entrepreneurial activities and complement the transformation process was largely underrated. The resulting corporate governance and structure of enterprises was mainly driven by the pre-1993 conditions. These initial conditions were – and still are – unfavourable with respect to the evolution of various forms of employee participation and programs that allow or promote it.

Such, the existing, rather restrictive, regulations on employee share ownership and (share based) profit-sharing have only been implemented to a very limited extend and, for the time being, have not been accompanied by a comprehensive incentive system. At the same time the co-operative sector has declined in importance.

a) History

The reason for this development is mainly to be found in the different historic starting point at the beginning of ownership transformation. Other than in Poland were the attempts of political and economical reform in Czechoslovakia radically eliminated by the Soviet invasion in 1968. When Poland established self-administration of the enterprises in 1981 together with the resultant relative independence of the state enterprises Czechoslovakia was facing a strong central presence in state-owned enterprises and very weak, obedient official trade unions. Polish enterprise organs had a strong position, relatively independent from the state and the branch ministries, independent trade unions gave workers a powerful representation and even under martial law employees retained considerable influence over enterprise management. In Czechoslovakia workers had little if any power within the state enterprise, even under the partial reforms of 1988/89 the employee participation remained extremely weak, state planning authorities were still entitled to impose obligatory requirements on the enterprises.²

¹ Concerning the historical development see Kotrba (1997, reprinted 1999), pp. 120 ff.

² This explains the missing resistance of the workforce and partly also the management, who in Poland were de facto disbanding themselves through transformation.

The most significant number of companies which were controlled fully or prevailingly by employees existed in the newspaper sector in the beginning of the transition period. In these cases usually employees led by their management ‘privatized’ originally state newspapers, by collectively swapping to an employee founded publishing company announcing to their readers, to continue the newspaper under a slightly altered title. As a rule the publishers agreed to sell or lease the rest of their rights to the new publisher.³ Due to the very competitive newspaper market emerging in the early 1990s and the lack of concepts to run the companies as employee-owned on the long run, all of the important employee-owned newspapers were sold to foreign publishing groups.⁴

Large-scale privatization was the most important privatization program in the Czech Republic. Enterprises that were not privatized through restitution or small-scale privatization and were not targeted for liquidation went into this scheme. The Ministry of Privatization was established to conduct the process which was later replaced with the National Property Fund (NPF) being entitled to hold shares and execute or delegate ownership rights. Large-scale privatization comprised several privatization techniques. Smaller enterprises used to be auctioned or sold in tender; medium-sized firms were sold in tender or to a predetermined buyer in direct sales. The largest corporations were transformed into joint-stock companies and their shares were distributed either during the voucher privatization, or sold for cash or transferred for free. A combination of all approaches was possible and quite common. The result of large-scale privatization is documented in the Tables 1.

For each firm assigned to the mass privatization, the firm’s management had to submit a privatization plan depicting for how the firm could be privatized. This proposal could involve any combination of all available methods of privatization (e.g., voucher scheme, domestic direct sale, foreign direct sale, public auction or tender, free transfer, or employees’ shares). It was possible for anyone other than the firm management to submit a competing privatization plan for all or part of each enterprise. On average 4.72 projects per firm were submitted.⁵ The supervising ministry and the Ministry of Privatization decided on the winning project (foreign sales had to be approved by the government) while, as turned out, managerial proposals were most likely to be approved. In addition, privatization authorities wanted to meet their goals on the amount of property to be allocated for the voucher program. This process was conducted in two ways, the first wave was common for both Czech and Slovak Republics (as it started prior January 1st, 1993) while the second wave took place only in the Czech Republic.

³ E.g. in the case of the well known Mladá Fronta, the daily with the highest circulation.

⁴ Starting with Mladá fronta sold to French publisher Hersant, and ending with Lidové noviny sold to Swiss publisher Ringier, employees have decided to sell first part of the shares, and later majority of them to other owner. In late 1990, none of national wide dailies was controlled by employees.

⁵ This is for the first wave of voucher scheme. For more details see Kotrba (1995), selection of firms and timing is analyzed for example by Gupta et al. (2000).

Table 1 – Mass privatization through shares of the NPF (as of Dec. 1996)

	million CZK	%
1. NPF holdings total	7,137,000	100.00
From privatization projects	694,094	97.25
NPF investments via bonds	13,171	1.85
Other	4,422	0.62
2. Privatization of shares		
For sale	68,505	9.60
Public offer	12,605	1.77
Direct domestic sale	22,207	3.11
Direct foreign sale	13,713	1.92
Employees' shares	2,204	0.31
Public tender	17,776	2.49
Free transfers	431,802	60.50
Voucher privatization	341,436	47.84
Municipalities, funds	52,331	7.33
Restitution Investment Fund	19,672	2.76
Endowment Investment Fund	515	0.07
Restitutions	1,756	0.25
Guarantee Relief Fund for Agriculture	16,092	2.25
Registered capital reduction	-3,641	-0.51
RIF shares	6,148	0.86
3. Shares held by NPF	208,873	29.27
Strategic companies	170,060	23.83
Other companies	38,813	5.44
4. Shares not booked	2,013	0.28

Source: CSO (1997), p. 513.

Table 2 – Privatization projects submitted: as of December 31st, 1997

	Total	Settled	Re-jected	Ap-pro-ved	% of Appr.	% Suc-cess
# of privatization projects	28,433	26,706	19,063	7,643	100.0	28.6
Enterprise management	5,692	5,546	2,292	3,254	42.6	58.7
Works management	714	709	495	214	2.8	30.2
Prospective buyers	14,903	13,624	10,983	2,641	34.6	19.4
Original owner	644	633	465	168	2.2	26.5
Ministry	585	568	112	456	6.0	80.3
Consulting organization	538	521	413	108	1.4	20.7
District privatiz. commission	1,144	1,141	1,001	140	1.8	12.3
Other	1,723	1,702	1,583	119	1.6	7.0
Local/district authority	796	767	672	95	1.2	12.4
Trade union organization	32	32	29	3	0.0	9.4
Not stated	536	422	177	245	3.2	58.1
Enterprise employees	1,109	1,025	831	194	2.5	18.9
Lessee	17	16	10	6	0.1	37.5

Source: Ministry of Finance.

Table 2 provides one of the most illustrative reasons why the workers type of ownership has not emerged. Both trade unions and employees together proposed less than 4% of the total projects, and given their lower approval rate (less than 20% approval rate for this type compared to almost 30% overall success rate) resulted in only 2.5% share on the approved projects in total. Although the vast majority of projects containing the element of employee shares were submitted by managers of state-owned companies the average employee stake across all firms foreseen in the projects was 4.4%; not more than 7 companies planned employee holdings of more than 30 percent; only 3 of the 988 projects approved for the first wave of voucher privatization in the Czech Republic contained the proposition that employees would receive more than 50 percent of the shares. As a result out of 1,688 state enterprises transformed into joint-stock companies, 480 proposed and got approved to privatize part of their shares as employee shares.⁶

⁶ For details see Kotrba (1995).

An additional – though most probably unintended – hurdle proved to be the fact that, the shares had to be bought for a nominal price (typically 1,000 CZK) according the rules of privatization (i.e., employees had an option at guaranteed price). Thus the implementation of these approved projects turned out to be problematic: In effect only a minority of one third⁷ of the companies eventually used this option, just about 6% of the total equity of privatized enterprises was transferred free of charge to employees. The reason for this was the incorrect evaluation of the enterprises assets and, as a result, erroneous value of the enterprises equity capital. In some companies, stated equity capital exceeded real value of the firm by ten or more times.⁸ As a result, officially overvalued firms did not have an interest to buy their employee shares from the Fund of National Property.⁹ Therefore the transfer of shares to employees remained insignificant. The picture is enhanced by Table 3.

Table 3 – Employee shares in mass privatization

Employee shares	Number of shares	Number of companies
Approved in the 1 st wave	2,757,100	220
Purchased in the 1 st wave	1,112,406	82
Approved in the 2 nd wave	2,416,870	260
Purchased in the 2 nd wave	920,856	89
Approved in total	4,173,970	280
Purchased in total	2,033,262	171
All joint-stock companies privatized	748,218,044	1,688

Source: Kotrba (1995).

Finally voucher privatization in principle provided another way of creating employee ownership within the privatization process (see Table 4).¹⁰

⁷ 171 enterprises; see Kotrba (1997, reprinted 1999), p. 130.

⁸ The evaluation problem is reflected by the stock market. Some of the 1,000 CZK face value shares are traded at prices around 50 CZK, other ones for several thousands.

⁹ In some few cases undervaluated companies (e.g. Čokoládovny, partly sold to Swiss Nestlé), which were later traded at 2,000 to 4,000 CZK per 1,000 CZK face value share, exercised their right to buy all employee shares as given by the privatization project.

¹⁰ Although this second option does not correspond strictly to the definition of financial participation, under which only the workers of the company should be involved, it can lead in practice to substantial worker share-ownership.

Table 4 - Two waves of the voucher privatization

Subject	Wave 1	Wave 2
No. of state enterprises entering the voucher scheme	988	861
Book value of shares allocated for voucher in particular wave (billions of crowns)	212.5	155.0
Participating citizens (in millions)	5.98	6.16
Average accounting value of assets per participating citizen (crowns)	35,535	25,160
% of voucher points with Privatization Investment Funds	72.2%	63.5%

Source: Ministry of Finance, Ministry of Privatization; Kočenda (2000), p. 15.

Although the privatization framework did not subsidize employee ownership, by giving employees the right to acquire shares of their companies under favourable conditions, it also did not prevent employees to place their vouchers into shares of their enterprise. Some companies did explicitly encourage their employees to invest in their shares (Kotrba, 1997, reprinted 1999, p. 132).¹¹ Furthermore in the design a small portion of shares was reserved for employees (see Table 5). The allocated portion was only about 1.5% of the total shares considered. However, almost no share went to employees for the same reason as in the case of privatization projects described above. The shares had to be bought for a nominal price (typically 1,000 Kčs), however, after the trading of shares started, and employees had the opportunity to buy these from the NPF (Nation Property Fund), all shares were traded below their nominal values and hence nobody has exercised this option.

Once the privatization was over, a natural process of ownership concentration begun. As foreign investors did not extensively participate in the mass privatization, they started to appear later. This process is quite well reflected in development of foreign direct investment (FDI, described above) and privatization of remaining state holdings after year 2000. In general, the shift from state to private sector was fast compared to other countries in the region. This can be illustrated by the macroeconomic estimates of private sector's contributions to GDP in Table 6.

¹¹ E.g. ZPS Zlín, a machinery producer focused on exports to the most developed Western market. Its employees, retired employees and local citizens formed an Association of Shareholders of ZPS, which played an important role as one of the largest shareholders of the company.

Table 5 – First wave of voucher privatization, allocated distribution, Dec 31st, 1992

Method	Shares*	In %
Intermediated Sale	6,099	1.6
Vouchers	238,345	62.2
Direct Sale-Foreign	6,683	1.7
Direct Sale-Domestic	6,647	1.7
NPF Temporary Holdings	59,354	15.5
NPF Permanent Holdings	327	0.1
Free Transfer	43,406	11.3
Employee Shares	5,846	1.5
Other	16,540	4.3
Total	383,247	100

Source: Kotrba (1995). *Based on nominal value, the number is in millions of Kčs.

Table 6 – Shares of private sector on GDP, international comparison

	1990	1994	1995	1996	1997	1998	1999	2000
Czech Republic	5	65	70	75	75	75	80	80
Croatia	10	40	45	50	55	55	60	60
Hungary	20	55	60	70	75	80	80	80
Poland	25	55	60	60	65	65	65	70
Slovak Republic	5	55	60	70	75	75	75	75
Slovenia	10	30	45	45	50	55	55	55

Source: EBRD (2001).

b) Social Partners

Trade unions do not actively promote employee participation and neither consider to do so in the future. After the voucher privatization outcome the confidence in general public toward share ownership and similar programs is negligible, if not nil. They see employee participation in the near future as extremely limited in the scale as well as in scope and believe that the development of employee participation can happen only after massive state support (namely tax incentives). Also, a unified program would have

to be developed, something like ESOP in the USA to give to the firms a lucid unified model to follow.¹² A similar picture is given in the case of the Czech association of the employers / entrepreneurs SPČR (Svaz podnikatelů ČR): They have no official stand regarding employee participation models and neither possess data nor investigate how frequent it is or what its scope is among their members.¹³

The involvement of workers/employees in the decision-making within the Czech economy rests in tripartite negotiations rather than in direct participation of individuals and groups of workers/employees in companies' management. There is a group of the representatives of workers' interests within the labour union network and a group of the representatives of employers – both in sector level and whole economy level. These groups regularly meet together with the government in tripartite negotiations over crucial issues of economic policies. Individual employees of companies are generally not perceived as those who are (or should be) active in influencing their employers' business decisions.

c) Current National Policy

As described in Kotrba (1995), labour-management played a significant role in the social democratic party's election program in both the 1990 and 1992 elections, ESOPs were an important element of the 1992 program of the 'Liberal Social Union' and partly in the program of the communist party. Employee ownership was also extensively discussed in the (religiously oriented) Czechoslovak People Party in 1990 and advocated by Ota Šik, a prominent economist active in the 'Prague's Spring' economic reform in 1968 and, in 1990, an economic advisor to the president Václav Havel. And last but not least, until the summer of 1990, Employee Share Ownership Plans (ESOP) were discussed within government and employee ownership was listed as one of the privatization methods in some of the early 1990 government documents.

After the June 1990 election victory of the Civic Forum, a movement broadly oriented toward introducing a market economy, the ESOP and labour-management proposals lost part of their support as private-property based reforms gained greater popular appeal. Moreover, Civic Forum committed to the idea of voucher privatization in which everybody could have expected to become co-owner of privatized companies, not just employees of privatized companies (as described above).

¹² Such the basic line of an interview from October 2005 with Ing. Fassman, a representative of ČMKOSs (Českomoravská komora odborových svazů), the 'top' all major trade unions.

¹³ Information from an interview from October 2005 with JUDr. Hejdková, a representative of SPČR.

Today, employees' participation is not a political issue – none of the democratic parliamentary political parties includes this issue in its program. Last time it was raised as a political issue dates back to the end of the 1990s, when social democratic Prime Minister Miloš Zeman was trying to push forward the agenda of increasing employees' participation. Since that time, politicians have been silent about the issue.

2. Types of Schemes and their Legal Foundations

The Czech mass privatization scheme was not biased towards employee ownership (as opposed to, e.g., the Russian scheme) and under Czech law there exists no specific employee share ownership program or a particular law or regulation created to regulate specific issues on employee share ownership, as is available in some other countries. The only form of labour participation in ownership structures of corporations covered by the law have been co-operatives and – to a limited extent – regulations on the acquisition of shares by employees and profit-sharing in joint-stock companies.

a) Employee Share Ownership

(1) Employee Shares

Regardless of the lack of support for employee ownership in the framework of privatization concepts the Czechoslovak legal system in 1990 adopted special provisions for 'employee shares', which could have been issued also as part of privatization transactions of state-owned enterprises. The Law on Joint-Stock Companies from April 18th 1990¹⁴ supplied joint-stock companies with the possibility to issue free or discounted shares for their employees. These 'employee shares' entitled the shareholder with the same rights as regular shares except for the obligation of retiring or departing employees to sell back the shares to the enterprise. This employee friendly provision was weakened, when on January 1st 1992 the Commercial Code (CC)¹⁵ came into force, superseding the Law on Joint-stock Companies and limiting the volume of the overall value of the granted discount for the issued shares up to 5% of the enterprises equity capital. The Commercial Code also permitted rights pertaining to 'employee shares' to be different to those of regular shares, which has become the rule (Štenglová et al., 1996, §§ 155 f.).

¹⁴ Sb. 1990 No.111; effective as of May 1st 1990.

¹⁵ Law from November 5th 1991, Sb. 1991 No. 513, last amended by Law from April 3, 2005, Sb. 2005, No. 216.

2. Types of Schemes and their Legal Foundations

Finally, in 2000¹⁶ Art. 158 CC was revised abolishing the concept of genuine ‘employee shares’ as a special type of share in favour of the possibility for joint-stock companies to set in their statutes rules under which their employees may buy company’s shares granting them a discount. Previously issued ‘employee shares’ had to be converted into regular shares by decision of the general shareholders assembly until January 2003.¹⁷ Since according to Art. 186a para. 3 ff. CC dissenting shareholders have to be bought out by a public offer this gave employed shareholders de facto the opportunity to cash out (Štenglová et al., 2004, § 158).

(2) Acquisition of Shares on Preferential Conditions

The possibility of acquisition of shares on preferential conditions according to Art. 158 CC – introduced into the CC replacing ‘employee shares’ – is limited to current employees or retired employees of the company. It had its origin in the harmonisation of the Czech legal system with the *acquis communautaire* of the EU and the incompatibility of the concept of a special type of shares in some sectors of the economy where previous to the amendment a couple of specific regulations prohibited the issuing of such ‘employee shares’.¹⁸ The main reason for this change though was the problem of the repurchase obligation for the company when employees left the company and the lack for a market for the shares inhibiting employees to cash out if they so wanted (Štenglová et al., 2004, § 158).

In deviation from the general prohibition to acquire own stock, Art. 161a para. 3 CC permits that a company acquires its own shares in order to sell them – in accordance with the articles of association¹⁹ – to the employees of the company. In this case the shares shall be transferred on preferential conditions to the employees within a twelve months’ time period from the moment of acquiring them.²⁰ If the transfer is not carried out within the mentioned time period, Art. 161c CC stipulates that the shares have to be sold or the share capital will be decreased respectively; if the company does not comply, a court can order its liquidation (Art. 161c para. 2 CC). Furthermore under the current legislation joint-stock companies may issue new shares granting employees favourable conditions in the context of so called mixed capital increases, i.e. a capital increase of a company issuing new stock financed by the companies own capital. According to Art. 209a para. 3 CC 50% of the purchase price have to be paid before the registration of the increased capital with the commercial register while the remaining 50% may be paid for instalments. According to Art. 203 para. 3, 209 para. 2 lit. d) CC issuing of shares to be acquired by employees shall not be considered as public offering

¹⁶ Law No. 370, effective as of January 1, 2001.

¹⁷ According to part VIII number 25 of the amending law No. 370.

¹⁸ E.g. Art. 7 para. 6 of the Law on Investment Funds; Art. 4 para. 3 of the Law No. 42/1994 on Pension Funds and Art. 4 para. 1 of the Law No. 214/1992 on the Stock Exchange.

¹⁹ As required by Art. 158 CC.

²⁰ Interestingly the time limit in other cases of Art. 161a CC (e.g. Art. 161a para. 2 CC) is 18 months.

provided for that the concerned employees are identified in the decision of the general shareholders assembly's decision about the capital increase.

(3) Incentives

In order to facilitate the acquisition of shares by employees the legislator has provided the possibility that a company may fully pay up stock that is acquired by the employees of the company. The limits of the preferential conditions for the purchase of shares by employees are enumerated in Art. 158 para. 2 CC: As in the previous regulation the volume of the overall value of the granted discount for the issued shares may not exceed 5% of the enterprises equity capital and has to be covered by the company's own resources (Eliáš et al., 2004, § 158). Additionally with Art. 161e para. 3 CC contains a regulation permitting the company, in deviation from the general prohibition to leverage the acquisition of own stock, to do so in order to sell them – in accordance with the articles of association²¹ – to the employees of the company (Štenglová et al., 2004, § 161e).

Thus the acquisition of shares by the employees of a particular company may be leveraged through the company by discounting the purchase price in the mentioned limits, credit financing it, securing it or a combination of the three preferential conditions.

(4) Squeeze-Out

An issue to be mentioned in the context of employee share ownership is a new regulation introduced in 2005 which in the case of publicly traded joint-stock company (subject to regulation by the public securities rules), where the major share owner owning at least 90% of all shares, permits him to make a final share buyout offer to the remaining shareholders (squeeze-out).²² In such a case the minority share holders, which on some occasions may be employees of the company who acquired shares during the privatization or on preferential conditions, would have an obligation to sell the shares to the major shareholder. Therefore employees holding minority shares may be forced to sell their shares to the majority shareholder.

b) Profit-Sharing

There is no prohibition in the Czech legal system with regard to profit-sharing of companies with their employees. However, the only explicit regulation is provided for by Art. 178 para. 4 CC stating that in accordance with the articles of association employees may be entitled to a share in the company profit (cash-based profit-sharing). According to Art. 158 CC the articles of association may also stipulate that the part of profits that is allocated to the employees is used exclusively to purchase shares on pref-

²¹ As required by Art. 158 CC.

²² See Art. 183i ff. CC introduced with the last amendment from April 3, 2005, Sb. 2005, No. 216.

erential conditions or make up for the discount granted to the employees in such a purchase (Share-based profit-sharing) (Štenglová et al., 2004, § 178; Eliáš et al., 2004, § 158). Furthermore, share-based profit-sharing is mentioned in the context of capital increases. As a rule a capital increase requires the decision of the general shareholders assembly but Art. 210 CC – in accordance with the articles of association – foresees the delegation to the management board. Art. 210 para. 4 CC regulates this for a capital increase by the issuing of shares to be transferred on preferential conditions to employees. It stresses this possibility especially for the case that the general shareholders assembly previously has decided that the part of profits that it allocates to the employees is used exclusively to purchase these shares.

The legislator obviously saw the possibility of allocating companies profits to employees in both the form of cash and shares. Thus, in principle, it is possible to determine a part of the remuneration to be dependant from the profit of the company or to provide benefits in the form of premiums as well as other benefits directly connected with the profit of a particular company. All those benefits will be subject to the progressive personal income tax in the amount of 15% up to 32%. Therefore the incentive to provide additional benefits progressively decreasing with increasing personal income, i.e., benefits from profit-sharing may be up to 17% less than they would be in the case of share ownership by paying out dividends to the shareholders.

c) Co-operatives

Co-operatives are legally defined in Art. 221-260 CC. A co-operative is a voluntary association of natural and/or legal persons created with the purpose to provide an economic activity or to safeguard the economic, social or other need of its members.²³ The co-operative is a legal person and every member of a co-operative may participate in the management of the co-operative, each member having one vote in decisions.²⁴ The co-operative is liable for its obligations with all her assets; members are not liable unless the statutes of the co-operative stipulate that by decision of the general meeting some or all of its member have to cover losses up to a maximum of the triple of their share.²⁵ Each member is entitled to a share of the profit of the co-operative – unless the statutes of the co-operative stipulate other – according to the investment of the respective member; the volume of distributed profit is set by the general meeting.²⁶ Furthermore, in the case of the liquidation of the co-operative, each member receives a liquidation quota according to his share.²⁷ The profit shares from co-operatives are taxed as any capital gain, (i.e., on shares) and therefore their taxation depends on the income bracket.

²³ See Art. 221, 227 CC.

²⁴ See Art. 239, 240 CC.

²⁵ See Art. 222 CC.

²⁶ See Art. 187 para. 1 lit. f) CC.

²⁷ Art. 259 CC.

d) Tax Issues

Although discounted employee shares and profit-sharing is possible under the Czech law, there are no tax incentives for the use of these possibilities, e.g. special tax breaks for employee shares do not exist. The most important regulatory acts connected with employee financial participation in companies is the Law on Income tax²⁸ regulating both, personal income tax and enterprise income tax.

- There is a uniform 15% dividend tax rate (used to 25%),
- a uniform corporate income tax rate, which is constantly decreasing over time; it has started above 50% in the early 1990s and is now (2005) at 26% and will decrease as of 2006 to 24%,
- and a progressive personal income tax ranging from 15% to 32%.

e) Participation of Employees in Decision-Making

There are no special rules for participation of employees in decision-making concerning PEPPER schemes or privatization matters. The general rules of the CC do apply, stating that stocks as well as shares grant the right to shareholders to take part in the administration of the company, to receive dividends and, in the case of the liquidation of the company, a liquidation quota.²⁹

Furthermore, according to Art. 200 CC joint-stock companies with more than 50 employees must have 1/3 representation of employee-delegated members in the supervisory board. This regulation goes back to the mandatory 50% representation on state-owned enterprise's supervisory boards established by the reform of the Law on State-Owned Enterprises of April 19th 1990³⁰, which resulted from a reduction of the employee management participation existing prior to the collapse of the communist regime in November 1989. One of the main reasons for this reduction of codetermination was the governmental mass privatization programme which was incompatible to a strong employee representation. However, employees behave quite passively in using this device. It is rather the centralized structure of Labour Unions that attempts to affect what is going on in the economy or in a given sector (using tripartite negotiations), than the workers themselves in their companies.

²⁸ Law No. 586/1992 Sb. on Income Tax.

²⁹ For limited liability companies see Art. 114, 122, 123, 125 ff. CC, for joint-stock companies see Art. 178, 179, 180 ff. CC.

³⁰ Sb. 1990 No.111, effective as of May 1st, 1990.

3. Incidence Now and Over Time

No comprehensive information is available on the overall incidence of PEPPER schemes in the Czech Republic. Unlike the Slovak Statistical Office, the Czech Statistical Office recalculated various historical data series to reflect only the Czech lands of Czechoslovakia. Therefore, one can not only infer on the overall enterprise sector development but also the effect of the country split.

a) Share Ownership

A number of companies (former state-owned and privatized, fully private or joint ventures) have chosen to introduce some forms of employee ownership. Some of them have issued 'employee shares', others have given employees the right to buy new issues of regular shares. E.g. companies in the Czech banking sector have used 'employee shares' to improve the motivation of their employees and thereby alter the productivity of the enterprise.³¹ Such the second largest bank in the country, Komerční banka, offered its employees the right to subscribe a limited amount of a new share issue at a discount from the market price of 50%.³² With more than 60% of the employees using this option their share - less than 1% - remained insignificant. Similar proportion of shares was sold to employees in Československá obchodní banka, and in some smaller banks like the Pragobanka.

b) Profit-Sharing

In spite of the existing legal regulations allowing for profit-sharing, such schemes seem to be, in practice, rarely implemented. To our knowledge the only practised mechanism are those that allow the trade unions to negotiate a compensation formula that sets additional benefits (e.g. 13th salary) in case the firm meets agreed profit target. But this is not perceived as motivation scheme but rather as expected end of the year bonus.

c) Stock Options

In general, there are no stock-option motivation schemes with the exception of top management (especially popular in banking or network utilities). Stock options were sometimes used in small, new-technology based start-ups (especially in IT), however, no information on the scope or relative importance is available.

³¹ For a detailed report see Kotrba (1997, reprinted 1999), p. 132 ff.

³² This offer turned out to be unfavourable, due to the collapse of the Czech stock market during the period of subscription which caused the market price to fall even below the level of the subscription price for the employees.

d) Self-Entrepreneurs

In a remarkably short period of two years in 1990/1991, almost one million of self-entrepreneurs emerged, as documented in the following Table 7a. There is one important feature of self-employment, a substantial portion of self-employers still kept regular jobs and undertook the entrepreneurial activity as a part-time job. This phenomenon continued till 2004, when the effect of several administrative changes made self-employment less attractive. A similar effect had a change in 1993 that also reduced the number of self-registered entrepreneurs.

Table 7a – Number of businesses, by selected legal form, as of December 31st of each year

<i>Year</i>	<i>Selected legal forms</i>			
	<i>Total</i>	<i>State-owned enterprises</i>	<i>Joint-stock companies</i>	<i>Private entrepreneurs in business under Trades Licensing Act</i>
1990	178,993	3,505	658	¹⁾ 124,455
1991	955,647	3,737	2,541	¹⁾ 891,872
1992	1,118,637	3,272	4,076	982,075
1993	1,250,216	2,920	4,813	1,044,635
1994	1,118,534	1,522	6,017	856,509
1995	1,321,096	2,270	7,564	1,000,375
1996	1,468,940	1,886	9,255	1,103,732
1997	1,627,626	1,621	10,353	1,223,195
1998	1,781,334	1,312	11,697	1,327,891
1999	1,963,319	1,214	13,009	1,425,743
2000	2,050,770	1,117	14,092	1,471,291
2001	2,121,562	1,054	14,845	1,523,051
2002	2,223,745	995	15,260	1,607,151
2003	2,325,977	899	15,903	1,671,031

¹⁾ Those in business in compliance with Act No.105/1990 Coll., on Private Enterprise of Citizens.

e) Co-operatives

From Table 7b (see Annex), one can observe that initially the co-operatives accounted for about 4% of the total population of the registered firms but quite quickly within two years their share fell to 3% and remained quite stable over time at this lower level. As the overall development shows, the composition of firms is quite stable over time and there are no major shifts over the documented 10 years. Major private corporate

3. Incidence Now and Over Time

legal forms (joint-stock companies, limited liability companies and co-operatives) have kept the same shares since 1995 in the total numbers of registered entities despite its doubling absolute numbers from that year.

As we document in the following Table 8, the production share of co-operatives has not been an important part of the Czech economy. Out of more than 2.3 million registered units at the end of 2003, only 13 thousand (i.e., 0.6%) were co-operatives. The two sectors with the highest representation of co-operatives are agriculture (1.4% in 1996 and 1.2% in 2003) and housing (1.5% in 1996 and 2.3% in 2003). The increase in the total number of co-operatives from 0.5% to 0.6% between 1996 and 2003 has taken place almost exclusively due to the rise of co-operatives in housing. The remaining fast-rising category is a Savings & Loans boom that, unfortunately, was often nothing but a financial Ponzi scheme and most of these S&L ended up tunnelled by the management without any assets, often leaving just liabilities to the other members of the co-operatives.

Table 8 – Registered units, end-of-year

<i>Sector</i>	<i>1996</i>				<i>2003</i>				<i>CHANGE</i>	
	<i>Total</i>	<i>%</i>	<i>Coops</i>	<i>% of total</i>	<i>Total</i>	<i>%</i>	<i>Coops</i>	<i>% of total</i>	<i>#</i>	<i>%</i>
Total	1,468.94	100	6,806	0.5	2,325.97	100	13,076	0.6	6,270	92
Agricult.	120,542	8.2	1,676	1.4	133,879	5.8	1,651	1.2	-25	-1
Housing	242,940	16.5	3,618	1.5	426,402	18.3	9,598	2.3	5.98	165
S&L	10,872	0.7	38	0.3	70,379	3.0	131	0.2	93	245

The importance (or, rather unimportance) of co-operatives in the industrial production is also reflected by Courbis and Welfe (1999), see Table 9. This comparison shows not only the importance of cooperates in the industrial production (which itself accounts only for about one third of the total GDP) but also the differences between Czech and Slovak Republics at the time of their separation. These figures provide an illustrative background to the enterprise sector development and document the enormous speed of shift of production from state sector into the private one, yet the co-operatives did not happen to be the part of this shift.

Table 9 – Shares on industrial production (%), firms with more than 25 employees, 1992

<i>Ownership</i>	<i>Czech Republic</i>	<i>Slovak Republic</i>
Private	13.2	2.1
State	79.7	94.3
Foreign-owned	4.0	1.5
Co-operatives	1.5	1.6
Other	1.6	0.5

Source: Courbis and Welfe (1999), p. 36.

4. Empirical Evidence of Economic and Social Effects

There are no studies that deal with the performance of co-operatives or employee co-owned firms in the Czech Republic. The only microeconomic firm-based information is available from an investment study of Lízal and Svejnar (2002).³³ Their findings (see Table 10) are in line with the other facts presented so far. In their sample that is covering all industrial enterprises the number of co-operatives appears to have stayed steady or declined slightly between the early 1990s and 1998. In the Czech Republic, as in other Central European countries, individual, co-operative and limited liability categories tend to contain smaller firms that were started with relatively low initial capital base. Their comparison of the investment/capital, investment/labour and investment/production ratios across thirteen principal ownership/legal-form categories of firms during 1992-98 shows that (the relatively few) foreign-owned companies generally tend to invest the most and (the domestically-owned) co-operatives the least (see reproduced Table 10 on Investment/Labour ratio). The co-operatives and state-owned/state-enterprises record the lowest investment ratios for all indicators in virtually every year. In addition, Lízal and Svejnar argue that co-operatives and to a lesser extent smaller and medium-sized private firms were rationed in their access to credit, but the majority of firms, including the state-owned and larger privatized firms, were

³³ Lízal and Svejnar (2003) were interested in the effect of privatization. Naturally, as the co-operatives have not changed ownership, their performance is not evaluated in this study and the co-operatives are included in the reference category with no ownership change and hence their results do not provide additional information to their 2002 study.

4. Empirical Evidence of Economic and Social Effects

not. There is no difference between small and large co-operatives; both appear to be credit rationed.

Table 10 – Evolution and comparison of investment/labour

Type	1992	1993	1994	1995	1996	1997	1998	Total
State/J.Stock	17.1 (68.0) [2,490]	17.4 (47.6) [2,516]	17.4 (48.6) [3,225]	18.6 (41.2) [2,859]	16.3 (44.0) [416]	20.0 (71.9) [392]	26.3 (63.3) [272]	17.9 (52.6) [12,170]
Private/J.Stock	25.6 (120.3) [292]	27.2 (100.5) [331]	31.1 (190.1) [870]	27.4 (93.4) [836]	21.0 (64.7) [1,575]	22.0 (75.0) [2,817]	25.4 (123.9) [2,370]	24.4 (107.5) [9,091]
State/SOE	10.9 (34.8) [2,393]	9.9 (27.4) [2,395]	7.0 (25.8) [1,186]	8.1 (21.0) [479]	14.2 (89.9) [295]	14.7 (63.1) [280]	10.7 (19.4) [124]	10.0 (35.9) [7,152]
Private/Ltd.	10.2 (74.6) [2,079]	8.8 (32.4) [2,906]	12.7 (69.5) [5,758]	9.8 (33.4) [2,539]	11.5 (52.4) [2,593]	12.5 (52.7) [10,355]	10.9 (39.3) [2,321]	11.5 (54.5) [28,551]
Co-operative	3.7 (12.0) [959]	4.2 (11.1) [984]	4.7 (11.3) [1,026]	5.8 (12.0) [590]	5.4 (12.2) [534]	5.3 (14.3) [927]	5.9 (13.2) [431]	4.8 (12.3) [5,451]
Private/Individ.	8.2 (30.9) [393]	7.4 (16.9) [508]	13.3 (47.6) [695]	7.3 (21.2) [138]	8.6 (21.5) [123]	12.6 (51.4) [3,147]	9.4 (17.0) [208]	11.5 (45.1) [5,212]
State/Ltd.	2.9 (7.8) [78]	18.8 (69.6) [90]	13.5 (66.5) [126]	21.0 (80.4) [100]	31.5 (105.8) [80]	15.6 (32.1) [81]	13.9 (23.7) [61]	16.8 (65.8) [616]
Foreign/Ltd.	22.9 (88.2) [261]	29.9 (105.7) [358]	38.2 (119.7) [881]	39.4 (86.7) [432]	37.0 (94.1) [649]	32.7 (106.8) [2,459]	40.6 (87.8) [934]	35.1 (102.7) [5,974]
Foreign/JStock	50.6 (156.3) [124]	50.5 (142.8) [141]	38.8 (59.7) [243]	44.2 (77.6) [190]	50.8 (88.2) [420]	43.2 (81.8) [605]	54.8 (117.0) [495]	47.7 (99.6) [2,218]
Mixed/J.Stock	14.3 (38.5) [117]	13.3 (41.0) [123]	15.7 (34.2) [272]	17.3 (66.6) [231]	21.6 (53.2) [1,841]	17.5 (34.6) [1,395]	36.3 (139.0) [1,247]	23.2 (79.4) [5,226]

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Type	1992	1993	1994	1995	1996	1997	1998	Total
Mixed/Ltd.	21.1 (69.3) [34]	35.7 (84.5) [53]	10.5 (25.4) [99]	7.5 (18.7) [91]	4.2 (7.0) [84]	8.3 (22.0) [200]	9.9 (24.4) [87]	11.1 (35.6) [648]
Other	9.9 (20.7) [64]	10.7 (22.4) [74]	19.4 (49.5) [186]	46.2 (86.4) [82]	32.8 (75.9) [88]	23.0 (56.9) [251]	19.8 (31.8) [131]	22.9 (54.9) [876]
Total	12.9 (62.7) [9,284]	12.8 (46.5) [10,479]	16.0 (76.5) [14,567]	17.0 (51.6) [8,567]	19.4 (62.1) [8,698]	16.9 (63.5) [22,909]	24.5 (96.6) [8,681]	16.8 (67.2) [83,185]

Source: Lízal and Svejnar (2003).

5. Conclusions

In 1989 the former Czechoslovakia had one of the smallest private sectors in the communist world, employing only about 1.2% of the labour force and producing a negligible fraction of the national output (all estimates are well below 3% of GDP). After the fall of the communism, the necessary macroeconomic reforms took place; however, they contributed to the split of Czechoslovakia in 1993. During these reforms a privatization has started, yet its outcomes were realized after the split and therefore Czech and Slovak Republics followed slightly different paths. Nevertheless, in both countries there remained a small share of the GDP produced in the industrial co-operatives and the design of privatization was adverse to creation of significant employee ownership.

The development of employee participation was driven by the initial conditions which were set up during the privatization and the following development of the institutional infrastructure. The overall development of the private sector in the Czech Republic is characterized by a convergence to similar structures as in other EU countries; however, as it did not have advantageous provisions toward employee participation, which worked in practice, the private ownership structure which emerged is totally dominated by external types of ownership or managerial ownership. With rare exceptions, the only employee participation models in place are co-operatives, however, these are mostly agricultural ones; the industrial co-operatives are contributing only marginally. The housing co-operatives can be neither regarded as productive sector nor as really voluntarily formed as the law on housing required initially the owners of individual flats to form housing co-operative even in case they would rather not do so; now, it is as well possible to form so-called communities of owners of flat.

While the co-operatives are being treated in a separate programme and are not subject to the mass privatization, the design allowed employee shares and ownership to emerge. Nevertheless, in both countries this option was not utilized and, consequently, almost no employee ownership has emerged from privatization later. However the major hindrance to the development of employee ownership under these conditions was unintended: A selling price was set to frequently inadequate book value. Since this method for evaluation relating mainly to the book value initially applied also to direct sales and the establishment of the minimal selling price in tenders it was most probably not discriminatory (Kotrba, 1997, reprinted 1999, p. 135).³⁴

Annex

Table 7b – Court-registered legal entities (enterprises), by legal form

Legal form	1993		1994		1995		1996	
	<i>Number</i>	%	<i>Number</i>	%	<i>Number</i>	%	<i>Number</i>	%
Registered legal persons, total	116,706	100.0	153,937	100.0	196,434	100.0	230,940	100.0
Business companies & partnerships, total	60,376	51.7	88,424	57.4	112,514	57.3	130,626	56.6
General commercial partnerships	4,526	3.9	5,165	3.4	5,879	3.0	6,128	2.7
Limited liability companies	50,661	43.4	76,811	49.9	98,558	50.2	114,700	49.7
Joint-stock companies	4,813	4.1	6,017	3.9	7,564	3.9	9,255	4.0
State-owned enterprises	2,920	2.5	1,522	1.0	2,270	1.2	1,886	0.8
Co-operatives	4,617	4.0	5,214	3.4	6,172	3.1	6,806	3.0
Foundations	2,444	2.1	3,538	2.3	4,351	2.2	4,830	2.1
Budgetary organizations ¹⁾	1,631	1.4	1,451	0.9	1,217	0.6	1,104	0.5
Semi-budgetary organizations	2,843	2.4	3,022	2.0	2,973	1.5	2,972	1.3
Schools, school and health establishments	3,737	3.2	4,757	3.1	5,297	2.7	5,537	2.4
Associations of natural or of legal persons	28,446	24.4	33,618	21.8	43,473	22.1	53,734	23.2
Other	9,692	8.3	12,391	8.1	18,167	9.2	23,445	10.1

³⁴ Overvaluation due to inaccurate book value is still one of the major problems in balances of many companies, namely of Investment Privatization Funds.

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Legal form	1997		1998		1999		2000	
	<i>Number</i>	%	<i>Number</i>	%	<i>Number</i>	%	<i>Number</i>	%
Registered legal persons, total	260,087	100.0	297,377	100.0	343,357	100.0	370,601	100.0
Business companies & partnerships, total	145,859	56.1	165,123	55.5	188,058	54.8	204,075	55.1
General commercial partnerships	6,377	2.5	6,840	2.3	7,336	2.1	7,489	2.0
Limited liability companies	128,569	49.4	145,977	49.1	167,064	48.7	181,819	49.1
Joint-stock companies	10,353	4.0	11,697	3.9	13,009	3.8	14,092	3.8
State-owned enterprises	1,621	0.6	1,312	0.4	1,214	0.4	1,117	0.3
Co-operatives	7,826	3.0	9,276	3.1	10,236	3.0	11,007	3.0
Foundations	5,352	2.1	5,135	1.7	4,234	1.2	5,360	1.4
Budgetary organizations ¹⁾	1,061	0.4	982	0.3	967	0.3	857	0.2
Semi-budgetary organizations	2,938	1.1	3,006	1.0	2,981	0.9	3,100	0.8
Schools, school and health establishments	5,451	2.1	5,268	1.8	5,109	1.5	5,521	1.5
Associations of natural or of legal persons	62,764	24.1	69,494	23.4	75,369	22.0	80,450	21.7
Other	27,215	10.5	37,781	12.7	55,189	16.1	59,114	16.0

Legal form	2001		2002		2003	
	<i>Number</i>	%	<i>Number</i>	%	<i>Number</i>	%
Registered legal persons, total	389,480	100.0	406,295	100.0	443,176	100.0
Business companies & partnerships, total	214,637	55.1	220,461	54.3	232,204	52.4
General commercial partnerships	7,629	2.0	7,729	1.9	7,846	1.8
Limited liability companies	191,476	49.2	196,772	48.4	207,755	46.9
Joint-stock companies	14,845	3.8	15,260	3.8	15,903	3.6
State-owned enterprises	1,054	0.3	995	0.2	899	0.2
Co-operatives	11,536	3.0	12,085	3.0	13,078	3.0
Foundations	3,641	0.9	2,542	0.6	2,519	0.6
Budgetary organizations ¹⁾	496	0.1	500	0.1	369	0.1
Semi-budgetary organizations	4,445	1.1	5,596	1.4	12,599	2.8

Legal form	2001		2002		2003	
	<i>Number</i>	%	<i>Number</i>	%	<i>Number</i>	%
Schools, school and health establishments	4,392	1.1	3,626	0.9	189	0.0
Associations of natural or of legal persons	85,167	21.9	89,178	21.9	93,478	21.1
Other	64,112	16.5	71,312	17.6	87,841	19.8

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