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Employee Financial Participation in Companies' Proceeds

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Abstract

This study provides an overview of the development of employee financial participation (EFP) across the EU-27 and shows its positive dynamic between 2000 and 2009 despite the recent financial crisis. A comparison of the rules and regulations on general taxation, social security contributions and specific tax incentives for EFP schemes across the EU indicates that fiscal incentives are not a prerequisite to EFP but do promote the spread of these schemes. To provide transparency with regards to fiscal treatment of EFP schemes, effective tax rates on different schemes are presented. Eight cases were selected and analysed in order to identify the best practice and the obstacles to promoting best practice. As a result, this study proposes an alternative approach to a European framework, the "28th regime on Employee Financial Participation".

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LIST OF ABBREVIATIONS

ASLE Agrupación Empresarial de Sociedades Laborales de Euskadi (Business Association of Worker-Owned Companies of the Basque Country)

CEO Chief executive officer

CGT Capital gains tax

CIT Corporate income tax

CONFESAL Confederación Empresarial de Sociedades Laborales de España (Business Confederation of Worker-Owned Companies of Spain)

CRANET The Cranfield Network on International Human Resource Management

DKK Danish krone

EBO Employee buyout

EBT Employee benefit trust

ECJ European Court of Justice

ECS European Company Survey

EFES European Federation of Employee Shareholders

EFP Employee financial participation

EMI Enterprise Management Incentives

EmpC Employer company

ES Employee share

ESO Employee share ownership

ESOP Employee Stock Ownership Plan

ESOT Employee Stock Ownership Trust

ESP Spanish peseta

EU European Union

EU-12 Member States, which joined the European Union after 1 May 2004: Bulgaria, Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Romania, Slovenia, Slovakia

EU-15 Member States, which had joined the European Union before 1 May 2004: Belgium, Denmark, Germany, Ireland, Spain, France, Greece, Italy, Luxembourg, Netherlands, Austria, Portugal, Finland, Sweden, United Kingdom

EU-27 The 27 current Member States of the European Union

EUR Euro

EWCS European Working Conditions Survey

FCPE Fonds communs de placement d'entreprise

GBP British pound

HR Human resources

HUF Hungarian forint

IntE Intermediary entity

JSC Joint-stock company

LLC Limited liability company

Ltd Limited

OMC Open Method of Co-ordination

PEE Plan d'epargne d'enterprise

PEPPER Promotion of employee participation in profits and enterprise results

PIT Personal income tax

PLN Polish złoty

PS Profit sharing

SAL Sociedad Anónima Laborales (plural: Sociedades Anónimas Laborales)

SLL Sociedad Limitada Laboral (plural: Sociedades Limitadas Laborales)

SAYE Approved Savings-Related Share Option Scheme

SIP Share Incentive Plan

SL Sociedad Laboral (plural: Sociedades Laborales)

SME Small and medium-sized enterprise

SO Stock options

SP Spółka pracownicza (plural: Spółki pracownicze)

SSC Social security contributions

TEC Treaty establishing the European Economic Community (Treaty of Rome, now Treaty on the Functioning of the European Union) of 25 March 1957, prior to the revision by the Treaty of Lisbon

TEU Treaty on European Union of 1 February 1992 as amended by the Treaty of Lisbon signed on 13 December 2007, entered into force on 1 December 2009

TFEU Treaty on the Functioning of the European Union (formerly Treaty establishing the European Economic Community of 25 March 1957) as amended by the Treaty of Lisbon signed on 13 December 2007, entered into force on 1 December 2009

UK United Kingdom

U.S. United States of America

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EXECUTIVE SUMMARY

EFP: A tool addressing the EU's most pressing challenges

Employee financial participation (EFP) is a mechanism for promoting **greater co-operation between owners, management and employees**, tending to increase workplace harmony and reduce conflict, thereby **making the enterprise more flexible, efficient and productive**, hence more economically competitive. Economic literature over more than 30 years confirms these beneficial effects. While it is important to note that both profit sharing and share ownership involve a certain degree of risk for employees, it is also important to know that some of the problems common to small and medium-sized enterprises (SMEs)—business succession, additional financing, staff retention—can be alleviated by employee share ownership plans.

In accordance with the principle of voluntariness, the **"Building Block Approach"** promoted by the EU commission includes all forms of EFP currently in practise:

- Profit sharing (in cash or shares, paid now or deferred);
- Individual employee share ownership (employee shares or stock options);
- Employee Stock Ownership Plans (ESOPs, i.e., collective employee share ownership plan, with shares acquired through an intermediary entity and financed by a share of profits allocated to employees in addition to their remuneration).

In Europe, EFP continues to expand despite the financial crisis

Though slow to take off, **EFP picked up surprising momentum** between 2000 and 2005. The PEPPER IV Report—on the basis of the European Working Condition Surveys (EWCS), the Cranfield Network on International Human Resource Management (CRANET) surveys and European Federation of Employee Share Ownership (EFES) data as well as individual country profiles—found conclusive evidence of a significant rise in EFP across the EU-27.

The most recent **(2010) cross-country surveys** again broadly confirm the earlier empirical findings, noting that EFP in Europe continues to expand despite the financial crisis, albeit at a much slower pace. This holds true for both profit sharing and employee share ownership, although the former is more widespread.

Participation in decision-making complements financial participation; the two combined may increase productivity beyond what would be the case with EFP alone, while also contributing to the quality of corporate management. **Employee shareholders are concerned with the long-term performance** of the business, not just short-term movement of share prices. This focus on the long-term interests of the company can help shift executive remuneration policy towards long-term incentives.

Assessment of measures promoting EFP

A comparison of the rules and regulations on general taxation, social security contributions and specific tax incentives for EFP schemes across the EU shows that **fiscal incentives are not a prerequisite to EFP but do promote the spread of schemes**. Thus, harmonisation of taxation is not a necessary condition for further development. However, **transparency is needed to avoid double taxation and discrimination**.

To identify the most conducive conditions for the development of EFP in the EU, the Member States have been classified according to the degree to which a country's conditions support the development of EFP. **The countries are divided in four clusters** with conditions ranging from most conducive to least conducive: (1) UK, France, Slovenia, Finland, Spain, and Ireland; (2) Denmark, Netherlands, Italy, Austria, Poland, Romania, and Belgium; (3) Germany, Hungary, Sweden, Greece, Lithuania, Malta, Portugal, Latvia, Czech Republic and Slovakia; and (4) Bulgaria, Cyprus and Estonia.

Despite the positive effect on enterprise productivity and competitiveness, with few exceptions, there are still **no measures supporting EFP specifically addressed to SMEs**.

National best practice especially with regards to SMEs

In this study, eight cases were selected and analysed in order to identify best practice and the obstacles to spreading best practice. The ultimate conclusion: to fulfil its potential, **EFP needs sustained political support, and especially a stable legal framework**. This also indicates that sustained support—even modest support—is more important than the extent of that support, e.g., that of fiscal incentives.

Problems common to SMEs—business succession, financing needs, staff retention—can be alleviated by employee share ownership plans. The cases from the UK and France exemplify how **EFP may facilitate business succession in SMEs** by means of an intermediary vehicle creating a market for shares of unlisted companies.

Share ownership schemes, whereby the shares are acquired via a trusteed fund financed by a profit share paid in addition to wages, seem to be a future trend in EFP. In these indirect schemes, either a separate **intermediary entity manages the shares held in trust for employees** (e.g., British and Irish ESOPs) or, at the firm level, a combination of a savings plan and a mutual investment fund (e.g., French FCPEs).

Share ownership plans can be **combined with labour market measures in small and micro-enterprises** to help to reactivate the unemployed. In Spain, the unemployment benefit paid out as a lump sum can be invested in a start-up or in an existing **"Sociedades Laborales"**, a special form of corporation, in which the majority of shares are owned by employees. These start-ups (totalling 13,465 and employing 74,438 individuals at the end of 2011) are assisted in their development phase.

Policy recommendations

This study proposes an entirely new approach based on the so-called "28th regime". It would provide a choice between two models of EFP; one, national, the other European. The "28th regime" would **not require compromise on the lowest common denominator**, thus preventing the lowering of standards. Parties would be offered a choice between two entire instruments, either the national or the supranational regime. "Cherry-picking" is avoided while employees are guaranteed a higher level of protection.

Since it draws basic principles and standards from existing national models, the "28th regime" would have the advantage of high political legitimacy among Member States. Avoiding a decreed "top-down" solution, it would **leave the decision on its application to the market**, making it more politically acceptable. The "28th regime" would also contribute to transparency in addition to portability across the EU.

Implementing an optional European concept for EFP also would create increased cooperation among Member States, especially through the **mutual recognition** of schemes. It could be a catalyst for business and legislative innovation.

By **eliminating barriers to the Single Market**, e.g., legal risks and costs arising from differences in national legal models, it could make the EU economy more competitive. To create a European model of EFP, the following steps are recommended:

First step: An EU Regulation on the "28th regime on EFP" defining the EFP schemes previously identified in the Building Block Approach. The "28th regime" imposes no tax incentives; national taxation rules apply.

Second step: An online tool for the calculation of the effective tax burden and the exchange of best practice accompany the "28th regime on EFP" as soft tools.[1] This provides transparency for taxation across EU-27, crucial to avoid double taxation and discrimination as well as to facilitate mutual recognition.

Fallback solution: At the very minimum, a new recommendation on EFP and the application of the Open Method of Co-ordination (OMC) is necessary in order to promote policy measures further encouraging EFP.

1. "28th regime on EFP" defining EFP schemes from the Building Block Approach

The "28th regime of EFP" as an optional European EFP regime would be **conceived as a "2nd regime" in each Member State**, thus offering employers and employees a choice between two alternative EFP schemes, one originating in national legislation and the other in European legislation. The "28th regime" would be defined at the EU level and **enacted by EU instruments, i.e., an EU Regulation**. It would ensure a high level of protection for employees, similar to those granted by the EU or national mandatory rules. In summary, the advantages are the following:

i. It would allow employers to **operate an EFP scheme throughout the EU on the basis of a single legal regulation**. Barriers to the Single Market, e.g., legal risks and costs created by differences in national law would be overcome. In firms operating these schemes, employees would be assured of full portability across the EU.

ii. It would **leave the decision on its application to the market** and would therefore only be chosen where interested parties considered it to be an advantage.

iii. The **individual legal culture of each Member State would be left intact**, making it more politically acceptable.

iv. Implemented by an EU Regulation, companies could **utilise it even in purely domestic situations**; this is of primary importance, especially in SMEs, since these plans could later easily be extended across borders as the firm grows and expands.

The optional instrument covers only private law issues not tax law; it does not affect national labour law. Of course, the Regulation on the "28th regime on EFP" may contain an "opt-out" clause for countries sceptical of this model.

[1] This dynamic tool developed under the CETREPS project (Calculating Effective Tax Rates for Employee Participation Schemes, launched at Viadrina 2010) is currently being tested by the authors. For more information on EFP visit http://www.intercentar.de/en/research/focus-financial-participation-of-employees/ (EN/DE/FR/IT/PL).

2. Calculating effective tax rates and targeted cross-country studies

In the area of tax incentives, it is crucial to **avoid double taxation and discrimination** as well as to facilitate quick dispute resolution. A calculator for effective tax rates developed for this study (Annex 3.2) should accompany the "28th regime on EFP" as a soft tool. Transparency for taxation of EFP schemes across the EU **facilitates mutual recognition**.

The **Open Method of Co-ordination** (OMC) should be employed to develop common taxation principles without necessitating a supranational arrangement based on European authorisation. Supported by social partners' dialogue this would create an increasingly favourable environment more closely aligned with countries having an advanced EFP tradition.

Finally, a Community initiative should provide funding for a regular **EU-wide, comparative, focused survey**, since no cross-country data focussed on EFP is available at present.

1. INTRODUCTION AND METHODOLOGY OF THE STUDY

1.1. Key factors for the development of employee financial participation (EFP)

1.1.1. Initiatives at EU level

Employee financial participation (EFP) has attracted rapidly growing interest in the European Union in the past two decades. It has received close attention by the European Commission since the publication of the first PEPPER[2] Report (Uvalić, 1991). With the Recommendation on EFP of 27 July 1992[3] the Council encouraged its active promotion by all Member States. Despite these initiatives, however, the PEPPER II Report of 1997[4] found no major changes in national policies with respect to the promotion of employee financial participation schemes. In an effort to move the issue forward, the Commission published a Communication on a framework for the promotion of employee financial participation in 2002.[5] Opinions drafted by the European Economic and Social Committee and a European Parliament resolution with a subsequent Parliament report further underline the importance of EFP, particularly in relation to small and medium-sized enterprises (SMEs). This assessment was extended to the new Member States and candidate countries in 2006 with the PEPPER III Report (Lowitzsch 2006).

In the European Reform Treaty[6] that came into effect on 1 December 2009, the EU expressedly commited itself for the first time to the European Social Model as one of the pillars of its policy. Thus, Art. 3 para. 3 of the Treaty on European Union (TEU)[7] states that the Union "shall work for the sustainable development of Europe based on […] a highly competitive social market economy, aiming at full employment and social progress" and that "[…] It shall combat social exclusion and discrimination, and shall promote social justice and protection […]." Financial participation of employees is seen as part of the European Social Model. In order to link various EFP models used in the EU Member States, the European Commission has promoted work on a "Building Block Approach", which includes all forms of EFP practiced. In 2009, the PEPPER IV Report (Lowitzsch et al., 2009) for the first time provided an overview on employee participation in its entirety in all Member States and candidate countries of the European Union, including comprehensive empirical cross-country data. Following the publication of this report, the European Economic and Social Committee issued its Own-Initiative Opinion SOC 371 on EFP in 2010[8] to encourage the application of EFP as a vehicle to foster economic and social cohesion.

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[2] PEPPER is the acronym for Promotion of Employee Participation in Profits and Enterprise Results.

[3] Concerning the promotion of participation by employed persons in profits and enterprise results (including equity participation), 92/443/EEC, OJ L 245, 26.08.1992, pp. 53-55.

[4] The report was designed to give a review of the effects of the previously mentioned recommendation of the Council of the European Union 92/443/EEC in the Member States; see PEPPER II Report (Commission of the European Communities, 1997).

[5] It is worth recalling the following principles formulated in the Council Recommendation of 1992 and reiterated in the Communication: regular application; calculation in accordance with a predefined formula; application complementary to the traditional remuneration system; variable participation depending on company results; benefits for all employees; application to both private and public enterprises; application to enterprises of all sizes; simple models; information and training for employees on models; voluntary introduction to and participation in models.

[6] Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, signed by the Member States on 13 December 2007, OJ C 306, 17.12.2007.

[7] For the consolidated version, see OJ C 83, 30.03.2010.

[8] CESE 1375/2010, OJ C 51, 17.02.2011, p. 1–7.

So far, the only explicit support for a framework for financial participation is to be found in the Council Recommendation of 1992 and in Part 7-II of the Action Programme for Implementing the Community Charter of the Fundamental Social Rights of Workers.[9] A rare exception with regards to the general silence in the aqcuis comunnautaire is the Second Council Directive on Company Law, which includes optional provision to encourage EFP in open and closed joint-stock companies.[10]

1.1.2. General attitudes and legal regulation – EU Member States

In the past, the comparative analysis of the general attitude of governments and social partners has shown a dearth of concrete policy measures supporting EFP schemes and limited interest on the part of trade unions and employers' organisations in about half of the countries. In particular, employee financial participation has been largely ignored and was even viewed with suspicion in the Member States, which more recently accessed the European Union (EU-12). The last decade, however, has seen a general, positive shift in attitude across the EU, with the number of passive countries decreasing to about a third. The analysis of the legislative framework in the 27 EU Member States has shown a wide variation in EFP schemes, reflecting the recent history of the countries under consideration and their different approaches and attitudes towards the role of employees. We surmise that the most recent, more general stimulus for the rise in EFP is a result of earlier Commission activities, i.e., the PEPPER Reports as well as the reviewed Lisbon Strategy.

In the EU–15, between 17 per cent (employee share ownership) and 36 per cent (profit sharing) of employees in the private sector currently participate financially in the enterprise for which they work. These existing schemes constitute a pillar of the European Social Model. A generally favourable attitude within a given country has usually led to some supportive legislation for EFP schemes, which in turn has spread their practice. This suggests a clear link between national attitudes, legislation and diffusion. But the European Union still lacks a unified legal foundation on which to build a European system of financial participation.

A quite different situation exists in the EU-12 and candidate countries (Lowitzsch 2006). Few laws specifically address employee financial participation, and these refer almost exclusively to employee share ownership; legislation on profit sharing is rare. Although employees were frequently offered privileged conditions for buying shares of their employer companies, the purpose was not to motivate employees to become more efficient and productive. Nor was there more than mild concern for social justice. Rather, this method was simply an expedient for privatising state-owned enterprises for which at the time there were no buyers. Essentially it was a decision made by default. Against the background of the different genesis of EFP in the EU-15 and the EU-12, it is important to stress that the data examined in the PEPPER IV Report seem to indicate that a West-East divide exists only with regard to profit sharing.

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[9] The Charter of 9 December 1989, which was also signed by the UK in 1998, is neither a binding legal act nor is it a treaty among the signatory states. Together with the Action Programme, which has also been approved by the Heads of State or Government, it is used by the Commission as a basis for justifying many of the Directives it proposes.

[10] See Art. 19 para. 3, 23 para. 2, 41, para. 1 and 2 of the Directive 77/91/EEC, dating back to 13 December 1976 (OJ L 26, 31.01.1977, p. 1–13, with amendments) which allow derogations from the European legal framework for joint-stock companies designed to encourage EFP (see Annex 5).

1.2. Methodology, scope and structure of the study

The objective of this study is to analyse the development of EFP in the European Union with a view to drawing policy recommendations for European policy makers based on its findings. The study covers the full range of schemes involving the participation of employees in the results of their employer company in all EU-27 Member States. The research for the study is based on quantitative as well as qualitative methods, utilising large datasets as well as detailed analysis of individual companies.

The investigation of the variety and extent of the development of EFP schemes in different EU Member States is based on (i) using several large scale datasets based on surveys of companies and employees across all EU Member States in order to be able to draw broad generalisations about the state and trend of EFP in different countries; (ii) detailed analysis of the recent changes in the legislation on employee share ownership or profit sharing, the presence of any fiscal incentive for these schemes and the attitude of governments and social partners towards financial participation of employees; and (iii) detailed case study of a number of schemes and/or companies in different countries providing examples of successful and unsuccessful EFP schemes. These case studies highlight the actual operation of financial participation schemes and identify the forces and conditions that led to their success or failure.

Using the analysis of the legal provisions and the fiscal rules on EFP and the result of the analysis of large datasets, clusters of countries with different general environment for participation have been identified.

The study is divided into six chapters. After a short introduction, Chapter 2 provides an overview of types and extent of EFP in the EU-27 followed by a review of previous research and challenges in Chapter 3. Policy measures to encourage EFP at national level are evaluated in Chapter 4 while Chapter 5 contains eight cases identifying best practice and obstacles to spreading best practice. Conclusions and policy recommendations are formulated in Chapter 6.

2. OVERVIEW OF TYPES AND EXTENT OF EFP IN THE EU-27

KEY FINDINGS

Principles and definitions of EFP schemes were formally incorporated in the 1992 Council Recommendation 92/443/EEC promoting employee financial participation. In accordance with the concept of voluntariness, the "Building Block Approach" supported by the European Commission includes all broad-based forms of EFP practised:

- Profit sharing (cash-based, deferred or in shares),
- Individual employee share ownership (employee shares or stock options),
- Employee Stock Ownership Plans (ESOPs, i.e., collective employee share ownership, with shares acquired through an intermediary entity, financed by a share of profits allocated to employees in addition to their remuneration).

A review of the more than 30 years of debate and discussion indicates that **EFP, though slow to take off, has grown over the years in most EU countries.**

The most recent (2010) round of various cross-country surveys generally show that EFP has continued to expand in Europe in spite of the financial crisis. This holds true for both profit sharing and employee share ownership, although profit sharing is more widespread.

- The EWCS surveys indicate that the proportion of company **employees participating** in EFP schemes increased between 2005 and 2010 (9.1 per cent to 13.5 per cent for profit sharing and 2.3 per cent to 3.3 per cent for employee ownership) though in recent years growth has slowed.
- This rise is to some extent reflected in the CRANET Surveys which show that between 2005 and 2010 the proportion of employees to whom **broad-based EFP schemes were offered** increased from a weighted average 17.7 to 19.9 per cent for employee ownership, with a slight decline from 33.6 to 32.5 per cent for profit sharing.
- The EFES data shows the proportion of **large, listed European firms** with broad-based employee share plans increasing with the weighted average rising by 2.6 percentage points (from 28.18 to 30.77 per cent) between 2007 and 2010 while the share of employees participating in these schemes was 14.7 per cent in 2007 and 14.5 per cent in 2010, a marginal decline of 0.2 percentage points.
- As expected, the ECS 2009 data confirm that **the size of the company** is closely associated with the incidence of EFP, especially that of employee share ownership. It indicates that large firms almost always have higher levels of EFP schemes than medium and especially small companies.

A generally favourable attitude in a given country has usually led to some supportive legislation for EFP schemes, which in turn has spread their practice. This suggests a clear **link between national attitudes, legislation and diffusion**. The last decade has seen a general, positive shift in attitude across the EU, with the number of passive countries decreasing.

2.1. Typology of EFP in the EU

In order to link the many and very diverse EFP models found in the EU Member States, the European Commission has promoted work on a "Building Block Approach".[11] The "Building Block Approach" reflects the **postulates of the 2002 Commission Communication**[12] and neither relies on nor excludes tax incentives. The different elements are voluntary for both enterprises and employees. They can be put together in any combination with the resulting building blocks being tailored to the specific needs of the given enterprise.

In accordance with the principle of voluntariness, the "Building Block Approach" includes all forms of financial participation practised:

- Profit sharing (in cash or shares, paid now or deferred),
- Individual employee share ownership (employee shares or stock options),
- Employee Stock Ownership Plans (ESOPs, i.e., collective employee share ownership, with shares acquired through an intermediary entity, financed by a share of profits allocated to employees in addition to their remuneration).

While profit sharing, employee share schemes and stock options are relatively widespread in the European Union, ESOPs are predominantly found in countries with an Anglo-American tradition, e.g., the United Kingdom and Ireland (Shanahan and Hennessy, 1998). However, ESOP-like schemes exist in other countries, e.g., in France, where enterprise mutual investment funds (FCPE) pool monies from profit-sharing schemes and voluntary employee, and employer matching contributions are made to buy shares in the employer company, take part in capital increases, or receive free shares.[13]

The three building blocks are explained in more detail below.

2.1.1. Profit sharing

Profit sharing—in the strict sense—means the sharing of profits between employers and employees by giving the latter—in addition to a fixed wage—a variable income directly linked to profits or some other measure of enterprise results. In contrast to individual incentives, this concept involves a collective scheme, which generally applies to all employees. In practice, profit sharing can take various forms. The formula may include profits, productivity and return on investment. It can provide employees with immediate or deferred benefits; it can be paid in cash, enterprise shares or other securities; or it can be allocated to special funds invested for the benefit of employees.

2.1.2. Employee share ownership

Individual share ownership provides for employee participation in enterprise results in indirect ways, by receiving dividends, by the appreciation of share values, or by both. Shares may be distributed for free or may be sold at the market price or under preferential conditions. The latter may include sale at a discount rate (Discounted Stock Purchase Plan), sale at a lower price through forms of delayed payment (usually within a capital increase), or by giving priority in public offerings to all or a group of employees.

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[11] For a detailed description in DE/EN/FR/IT/PL see Lowitzsch et al. (2008).

[12] Regularity in application; calculation according to a predetermined formula; as an addition to wages; providing variable employee benefits linked to enterprise performance; all employees as beneficiaries; all types of enterprises, both private and public; in all enterprises irrespective of size; simplicity of schemes; employee information and education; voluntary nature of schemes.

[13] In 2009, out of a total of EUR 85 billion managed in FCPEs, approximately EUR 36 billion were invested in share plans of the employer company.

To defer the valuation problem in unlisted SMEs, capital participation may initially take the form of an employee loan to the company, creating corporate debt (external capital) subsequently converted into company shares. Valuation of the shares designated for acquisition through the loan can be postponed until the moment of the actual conversion into shares (debt-to-equity) without impeding the implementation of the scheme.

There are also **employee stock options**, which—unlike executive stock options granted to reward individual performance—are broad-based and offered to all or a majority of employees. The company grants employees the option, which entitles them to acquire shares in the company at a later date, but at a price fixed at the time the option is granted. The potential gain from rising share prices is the primary reward conferred by options.

2.1.3. Employee Stock Ownership Plans (ESOPs)

In these schemes the acquisition of shares is facilitated via a separate intermediary entity usually set up by the company and financed by a profit share paid in addition to wages and—of course—dividends of the shares acquired. Essentially the structure is as follows:

i. The company establishes an employee share ownership fund in favour of its employees, which manages the shareholding (in continental Europe in the form of a limited company, foundation or association; in the UK, Ireland and North America usually a trust).

ii. The fund is financed by a combination of company contributions and loans. Company contributions to the plan are free shares or cash, usually as part of a profit-sharing agreement with the employees. The trust may borrow money directly from a bank or from the company, which in turn may take a loan from a bank or other lender.

iii. Shares are either acquired directly from the existing shareholders or by means of a new share issue. They are held collectively in trust, and are only allocated to individual employees accounts, or distributed, after a specific holding period.

iv. The loan may be repaid by direct cash contributions from the company to the fund, monies received from sale of shares to the share-based profit-sharing scheme, or dividends on the shares held in the fund.

2.2. Recent developments of EFP in the EU

Empirical cross-country evidence from 2000 until 2010 indicates that EFP has been growing rapidly in many EU countries. However, in spite of this positive trend, financial participation has grown significantly only in a handful of countries. The spread of financial and economic crisis across Europe and the increase in different types of non-standard employment contracts may exacerbate this problem in the future, as they tend to deprive employees from enjoying the benefits of EFP. In many EU-15 countries, EFP schemes have become part of a new culture of industrial relations based on innovative managerial strategies and more flexible remuneration policies. In the EU-12, there was initially a general lack of interest, strongly influenced by the legacies inherited from the communist times; however, during the past years EFP in various forms is coming to be viewed as a complementary element of social and industrial relations. At the national level, the adoption of a national framework law promoting EFP has always proved useful, as it provides a general legal framework to guide enterprises in their adoption of EFP schemes.

2.2.1. Empirical evidence on EFP 2000-2010

In 2009, on the basis of the EWCS, CRANET surveys and EFES data as well as individual country profiles, the PEPPER IV Report noted the significant rise in EFP in the EU-27 between 2000 and 2005. The most recent rounds of these cross-country surveys (2010) broadly confirm these empirical findings. This is true of both profit sharing and employee share ownership, although profit sharing is more widespread.

- The **proportion of company employees** participating in EFP schemes has been growing though in recent years growth has slowed. The availability of the new European Working Conditions Survey (EWCS)[14] 2010 makes it possible to compare the take-up of EFP schemes over the entire decade. The proportion of employees taking up profit-sharing schemes rose from 6.4 per cent in 2000 to 9.1 per cent in 2005 and then to 13.5 per cent in 2010. Over the same period, the proportion of employees participating in employee ownership schemes increased from a weighted average of 1.4 per cent in 1999/2000 to 2.3 in 2005 and 3.3 per cent in 2010.[15]
- This rise is to some extent reflected in the CRANET Surveys[16], which show that between 1999, 2005 and 2010, the **proportion of** employees to whom broad-based EFP schemes were offered increased from a weighted average of 9.0 to 17.7 and now to 19.9 per cent for employee ownership and from 23.4 to 33.6 and most recently declining to 32.5 per cent for profit sharing.

The following sections summarise the main findings of the different data sources (referring to three points in time: 2000, 2005 and 2010) as well as of the 2012 update of the country profiles. For a description of respective data sets see Annex 4.

EWCS 2000, 2005 and 2010 data: Take-up rate of EFP in the EU-27

The three rounds of EWCS clearly demonstrate that the proportion of employees participating in both ESO and PS schemes has grown in almost all countries (Figure 1). Notable exceptions for ESO schemes are Belgium, Ireland, Romania and Estonia, where the 2005 figures are higher than 2010. For PS schemes, the exceptions are Slovakia, Czech Republic, Ireland and Romania. The top countries for ESO schemes were Denmark, Sweden, France, Luxembourg and the UK where the participation rate was over 5 per cent. The lowest-ranked countries (with ESP participation rates under 1 per cent in 2010) were the Czech Republic, Hungary, Bulgaria, Lithuania and Greece.

As far as PS schemes are concerned, these schemes are much more prevalent than ESO schemes (the weighted averages are about four times higher in each year), as shown in Figure 1. The top countries (with participation rates of over 20 per cent in 2010) were Sweden, Finland, France, Slovakia, the Netherlands, Slovenia and the Czech Republic.

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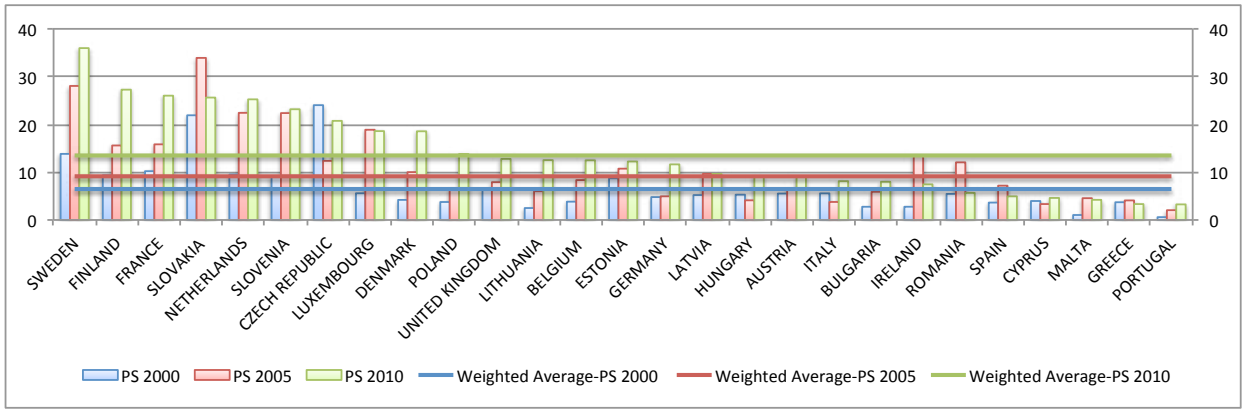
[14] The EWCS is a large-scale survey of working conditions across Europe undertaken by the European Foundation every four or five years to investigate a variety of factors influencing individuals working and living conditions. It covers some 30,000 people in 30 countries. The 1999 Survey was conducted in the EU-15. The EU-12 were surveyed in 2000. For simplicity, we refer to the two surveys as the "2000 survey". The data reported here refers to the employees of private sector companies only as the public sector does not lend itself to either employees share ownership (as there are no shares in these organisations) or profit sharing (as public sector organisations generally do not make profit).

[15] In calculating weighted averages here and in the rest of the chapter, the population of each country is used as its weight.

[16] The CRANET Survey is a large-scale survey of the human resource practices of around 10,000 companies in Europe and other countries (in 2010 it covered firms over 100 employees, in 1999 and 2005 the threshold was 200; see Annex 4). Some EU Member States were not included in all of the three rounds of the survey. The questionnaire includes a number of questions on EFP practices in thee surveyed companies. We thank partners of the CRANET Network, co-ordinated by Cranfield University School of Management, for the use of CRANET database. We are especially grateful to Professor Erik Poutsma and Dr Paul Ligthart, Institute of Management Research, Radboud University, who recalculated the data for Figure 2 and Figure 3 in this chapter.

In 2010, the number of countries with a participation rate of over 20 per cent has increased by six. The lowest-ranked countries (with participation rates under five per cent) in 2010 were Spain, Cyprus, Malta, Greece and Portugal.

Figure 1: Proportion of employees participating in employee share ownership (ESO) and profit sharing (PS) schemes in the EU Member States, 2000-2010 (in per cent)



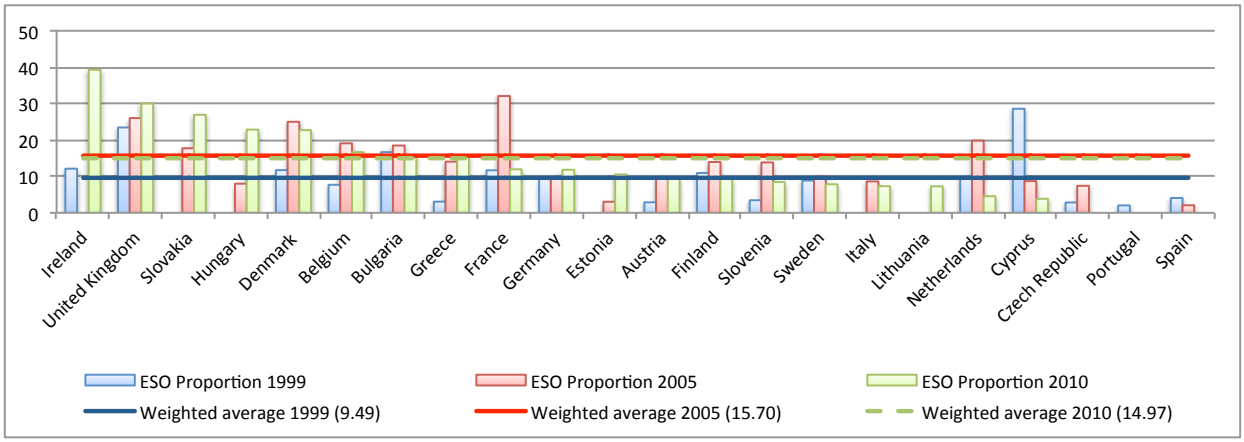
Source: EWCS 2000, 2005 and 2010.

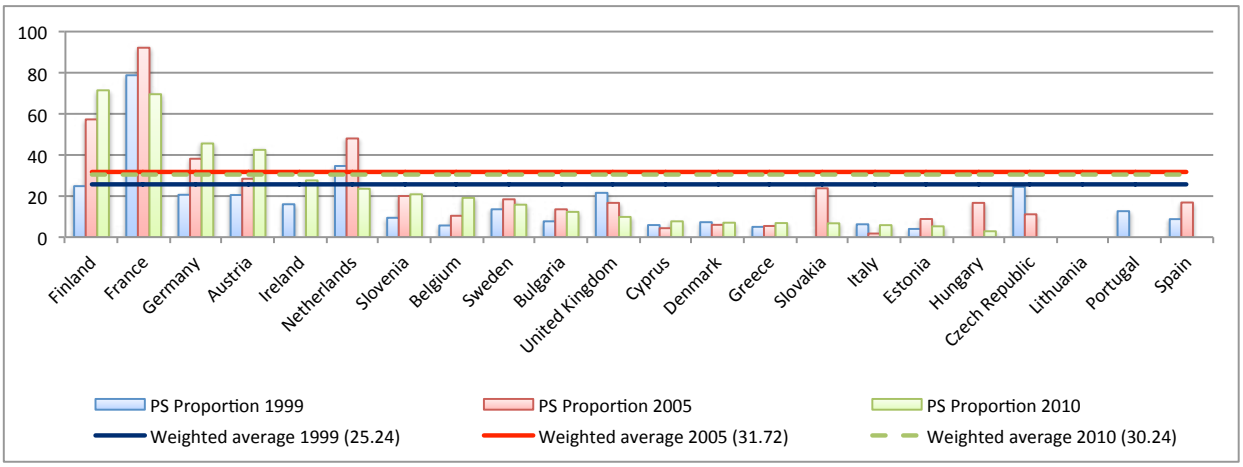
CRANET 1999, 2005 and 2010 data: Offer of EFP schemes by companies and the coverage of employees

Figure 2 shows the **proportion of firms offering broad-based financial participation** (ESO and PS) to employees in 1999, 2005 and in 2010 in 22 EU Member States. Between 1999 and 2005, the proportion of companies offering broad-based ESO schemes grew in almost every country except the UK, and marginally in Spain and Finland. Between 2005 and 2010, the proportion grew in only some countries but remained unchanged or declined in others. The weighted average for all countries included in the surveys grew from 7.6 to 15.7 and then declined to 15.0 per cent. In countries with a participation rate of over 25 per cent (Ireland, UK, Slovakia, Hungary and Denmark), the ratio generally increased in the second half of the decade. Two of these (Slovakia and Hungary) are transition countries (indeed, the absence of Slovenia in this group is surprising, as the country's privatisation programme generated a large amount of employee ownership). The two lowest-ranked countries (below 5 per cent in 2010) are the Netherlands and Cyprus.

It is interesting that Denmark is far ahead of the other two Nordic countries (Sweden and Finland), a possible indication of the heterogeneity of this group of countries. Finally, it is also interesting to note that Estonia, Slovenia and Lithuania have similar levels of offer in 2010 in spite of the different privatisation methods used in these countries. This is possibly an indicator of convergence of ownership structures in the post-transition period in these countries.

Figure 2: Proportion of firms offering broad-based employee share ownership (ESO) and profit-sharing (PS) schemes in the EU Member States, 1999-2010 (in per cent)





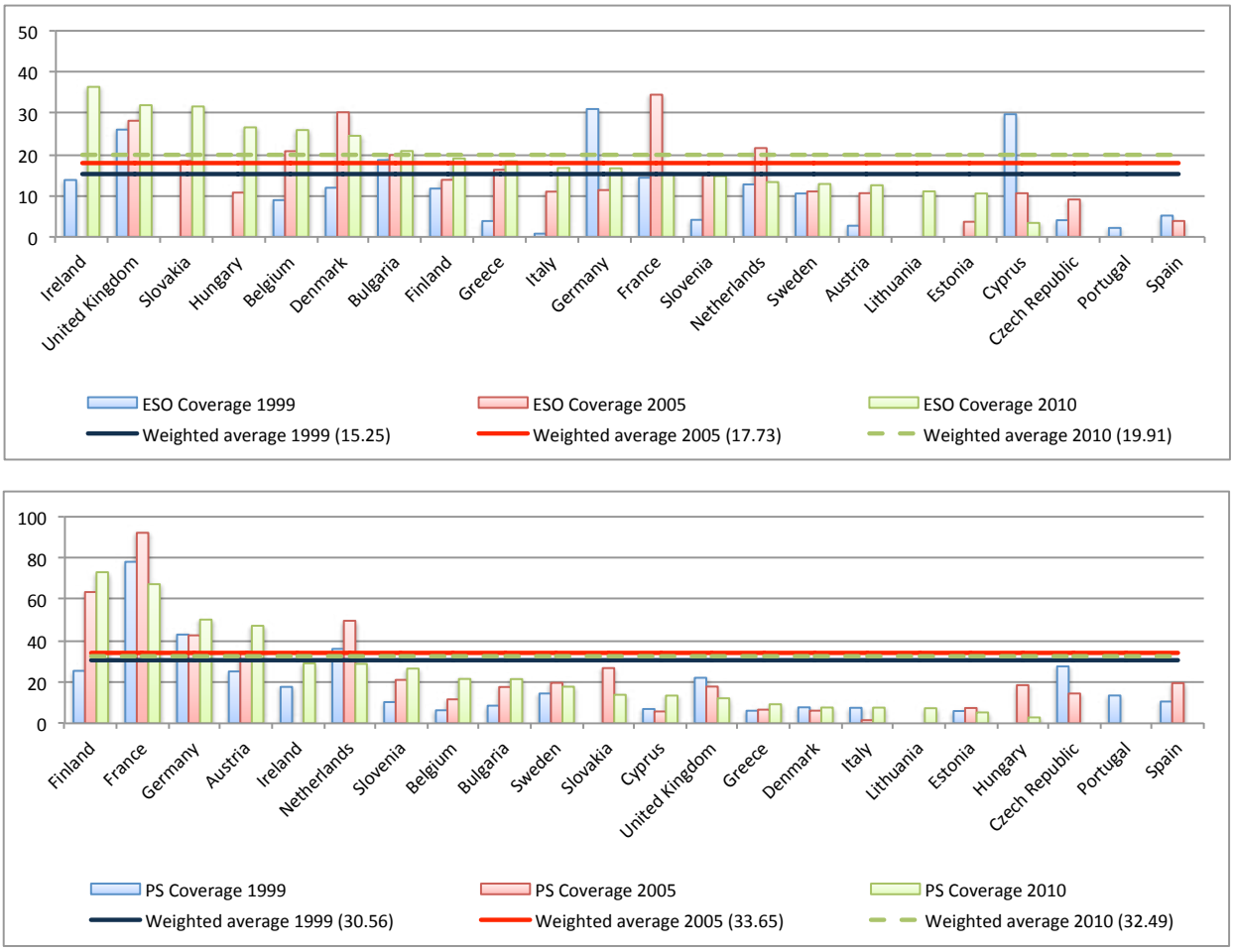
Source: CRANET Survey, 1999, 2005 and 2010 (see footnote 16).
Note: The figure for Germany in 1999 is based on an imputed data set.

Figure 2 also shows how broad-based PS has developed between 1999, 2005 and 2010 in most countries. The weighted average for all countries included in the surveys grew from 21.9 to 31.7 before falling back to 30.2 per cent. We also note a much wider range of results than in the case of ESO. For ESO, the proportion of firms offering a scheme ranges from 4 to 40 per cent; for PS from under 3 to over 70 per cent. The leading countries are Finland and France (with over 70 per cent of firms offering PS schemes), followed by Germany and Austria (with over 40 per cent).

The lowest-ranked countries (with coverage under 6 per cent in 2010) are Italy, Estonia and Hungary.

Using the CRANET survey, it is possible to calculate the **proportion of employees** in the sample **covered by broad-based ESO and PS plans** (or to whom the schemes are offered).[17] The results are presented in Figure 3.

Figure 3: Proportion of employees covered by employee share ownership (ESO) and profit-sharing (PS) schemes in the EU Member States, 1999-2010 (in per cent)



Source: CRANET 1999, 2005 and 2010 (see footnote 16).
Note: The figure for Germany in 1999 is based on the data presented in Lowitzsch et al., 2009.

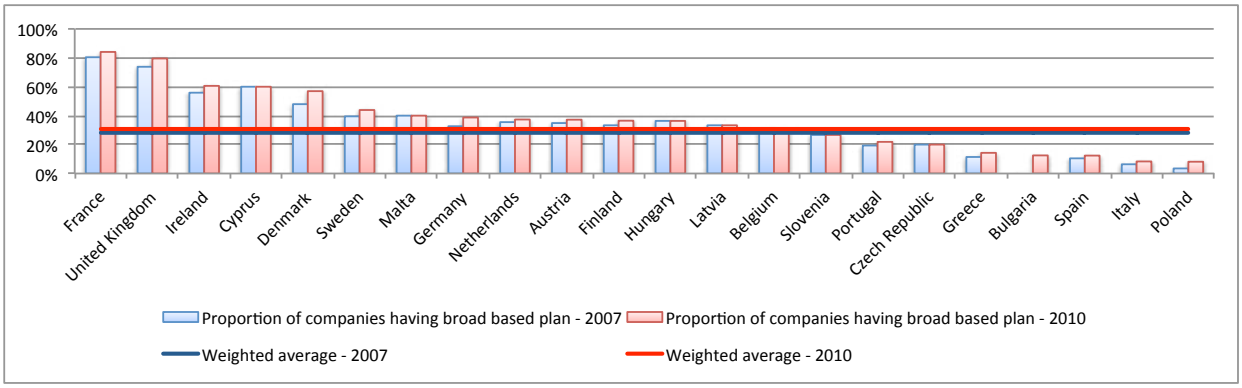
[17] The CRANET questionnaire contains questions on the proportion of different categories of employees (managers, professionals, administrative and manual) to whom FP plans are offered and on the share of these different categories in the total workforce of the company. This allows us to calculate the number of employees in each company to whom broad-based EFP plans are offered (and their share in the total number of employees in the sample for each country).

In terms of **employee share ownership**, it can be seen that the coverage of employees by these plans has been growing in a large majority of countries throughout the whole decade (the weighted country average for countries included in the surveys grew from 9 to 17.7 and 19.9 per cent between 1999, 2005 and 2010). The leaders (with employee coverage of over 25 per cent in 2010) are Ireland, the UK, Slovakia, Hungary and Belgium. Only one country, Cyprus, has coverage of less than 10 per cent. Again, Slovenia's position here is surprising, given its privatisation history. Turning to **profit sharing**, it can be seen from Figure 3 that growth has been slower than the ESO schemes, albeit from a higher starting point, and declining marginally in some countries. (The weighted average for countries included in the surveys rose from 23.6 to 33.6 per cent before falling to 32.5 per cent between 1999, 2005 and 2010). Here again we have a much wider range, from 3 to 73 per cent, against 3 to 36 for ESO schemes).

EFES 2007 and 2010 data: Offer and take-up rate for employee share plans in large (listed) firms

The European Federation of Employee Share Ownership produces annual data on employee share ownership in large, listed European firms. The data identifies the proportion of companies with broad-based employee share plans as well as the proportion of employees participating in ESO schemes in these companies.[18] Figure 4 represents the proportion of these companies offering broad-based ESO schemes to their employees in 2007 and in 2010.

Figure 4: Proportion of large, listed EU companies with broad-based employee share ownership (ESO) schemes, 2007-2010 (in per cent)



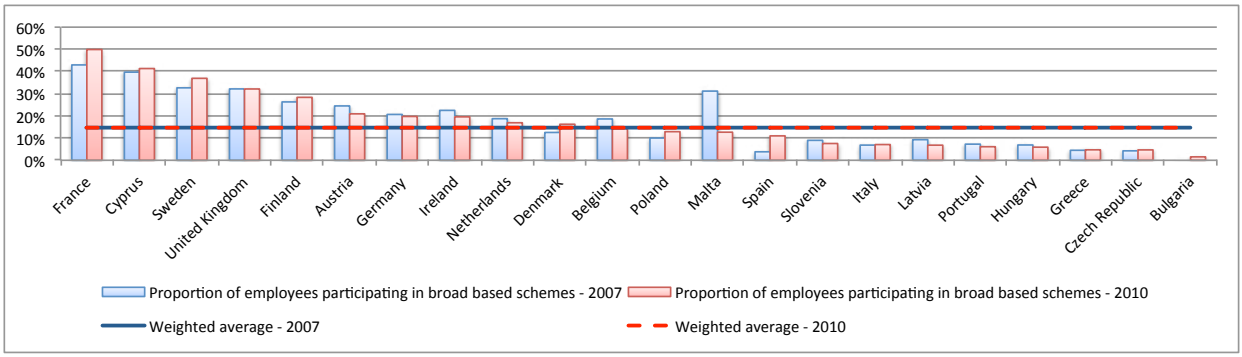
Source: EFES 2007 and 2010.
Note: Countries in which the proportion was zero in 2007 or 2010 are not shown on the diagram (Estonia, Lithuania, Luxemburg, Romania and Slovakia).

In principle, the EFES data should produce similar results to CRANET data as both sets cover large companies (market capitalisation of EUR 200 million assets for the former and employment level of 200 for the latter). In practice—of course—these two criteria do not produce similar results. Figure 4 indicates that in almost all countries in which large companies are registered, there has been an increase in the proportion of firms offering broad-based ESO, with the weighted average increasing by 2.6 percentage points (from 28.18 to 30.77 per cent). The minimum and maximum figures have also increased from 3.5 to 80 per cent in 2007 to 8.1 to 84.1 per cent in 2010.

[18] The EFES database covers companies with a market capitalisation of over EUR 200 million in at least one year between 2006 and 2010.

The importance of the EFES data is that it covers the specific period of financial and economic crisis in Europe, which did not seem to have had a significant effect on the willingness of companies to offer broad-based ESO.

Figure 5: Proportion of employees participating in broad-based employee share ownership (ESO) schemes in large, listed EU companies, 2007-2010 (in per cent)

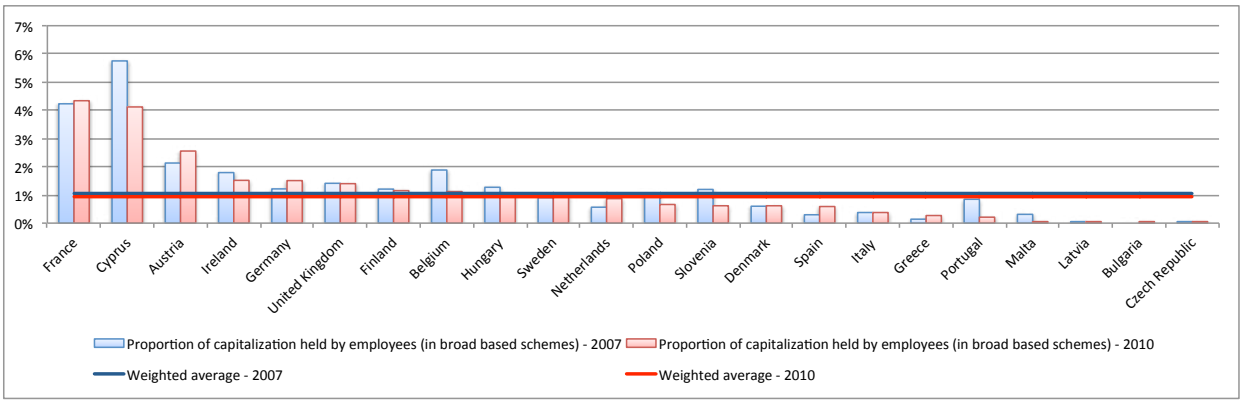


Source: EFES 2007 and 2010.
Note: Countries in which the proportion was zero in 2007 or 2010 are not shown on the diagram (Estonia, Lithuania, Luxemburg, Romania and Slovakia).

As far as the take-up of ESO schemes by employees of large firms is concerned, Figure 5 provides information on the number of employee owners as a percentage of the total number of employees in companies included in the EFES database. For the entire sample, the weighted average of the proportion of employees in broad-based ESO schemes was 14.7 per cent in 2007 and 14.5 per cent in 2010, a marginal decline of 0.2 percentage points. Unlike other sources of data, the EFES dataset also provides information on the share of capital of companies owned by employees. Here the weighted average for all countries with broad-based ESO schemes is around 1 per cent (with the 2010 average being 0.1 percentage points below the 2007 average, from 1.05 to 0.95).

Figure 6 represents the average share of total company capitalisation in each country owned by employees in broad-based schemes. France and Cyprus have the leading position with over 4 per cent, followed by Austria, Ireland, Germany, the UK, Finland and Belgium with an above average proportion. The remaining countries show a below average proportion of capitalisation held by employees. Estonia, Lithuania, Luxemburg, Romania and Slovakia had a proportion of zero; therefore they were not included in the diagram. The proportion of capitalisation held by employees has decreased slightly, with the weighted average level dropping by 0.11 percentage points.

Figure 6: Proportion of market capitalisation of large listed EU companies held by employees (in broad-based schemes), 2007-2010 (in per cent)



Source: EFES 2007 and 2010.
Note: Countries in which the proportion was zero in 2007 or 2010 are not shown on the diagram (Estonia, Lithuania, Luxemburg, Romania and Slovakia).

To sum up, these figures and the variety of data sources used in this chapter show that despite a general positive trend, the actual financial participation of the working population of EU Member States falls short of the opportunities companies offer for such participation. This shortfall can partially be explained by the fact that even under the best of regulatory circumstances not all eligible employees participate in such schemes or their existence is not well communicated to employees. But different definitions and methodologies as well as diverse perspectives also contribute to this discrepancy. None of the surveys was specifically designed to focus on financial participation. Therefore, this review represents a compromise: dealing with the limitations of the existing data without undertaking a new survey.

2.2.2. The importance of firm and employee characteristics for EFP

In order to investigate the importance of size and sector as well as characteristics of employees, a database containing firms of all size classes is necessary. CRANET and EFES databases are unsuitable for this purpose as they contain large (and occasionally medium-sized) firms only. The European Company Survey (ECS)[19] is the only comprehensive firm level survey, which provides information on the presence of EFP schemes in European companies. By its nature, this survey consists of predominantly small and medium-sized firms, where EFP schemes are less common and therefore the results are expected to be lower than that indicated by the CRANET surveys, which until the 2010 survey concentrated on companies with more than 200 employees.[20]

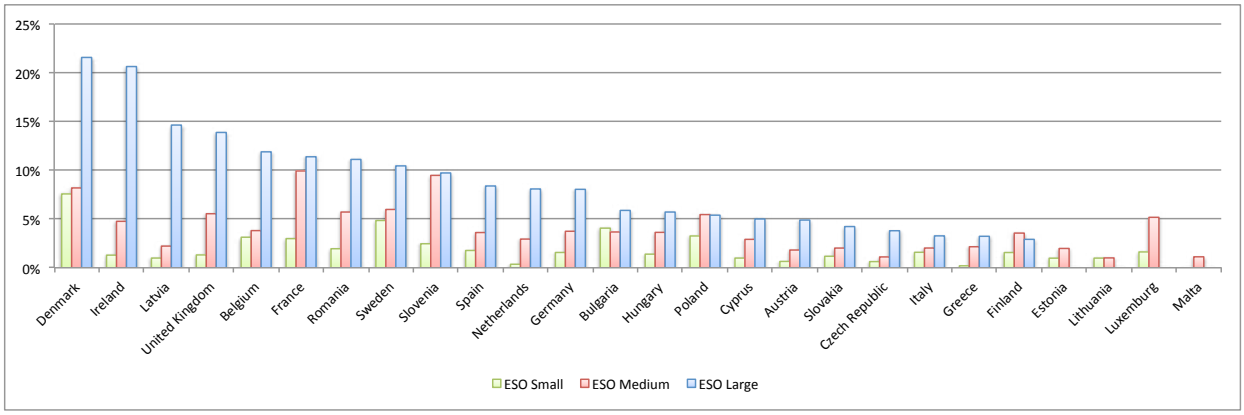
EFP in companies of different size and in different sectors of activity

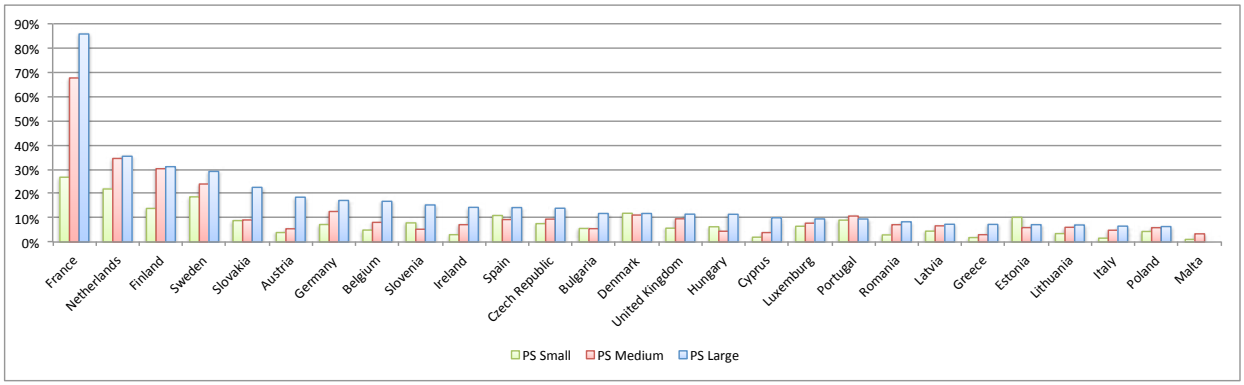
An important question in the discussion of EFP is whether these schemes are more prevalent in smaller or larger firms.

[19] The European Company Survey is a survey of all European companies conducted by the European Foundation in 2009. It covers some 30,000 companies in 30 European countries (all EU Member States and candidate countries).

[20] ECS was not used in the previous section as it is the first survey of its kind and, therefore, it is not possible to observe the dynamics of EFP in EU Member States over time.

Figure 7: Proportion of EU-27 companies of different size offering employee share ownership (ESO) and profit-sharing (PS) schemes to their employees, 2009 (in per cent)





Source: Authors' own calculations (based on ECS dataset, 2009).
Note: *Portugal is excluded from the data on employee share ownership schemes because the Portuguese data on ESO is not compatible with that in other countries (European Foundation for the Improvement of Living and Working Conditions, 2010, p. 41).

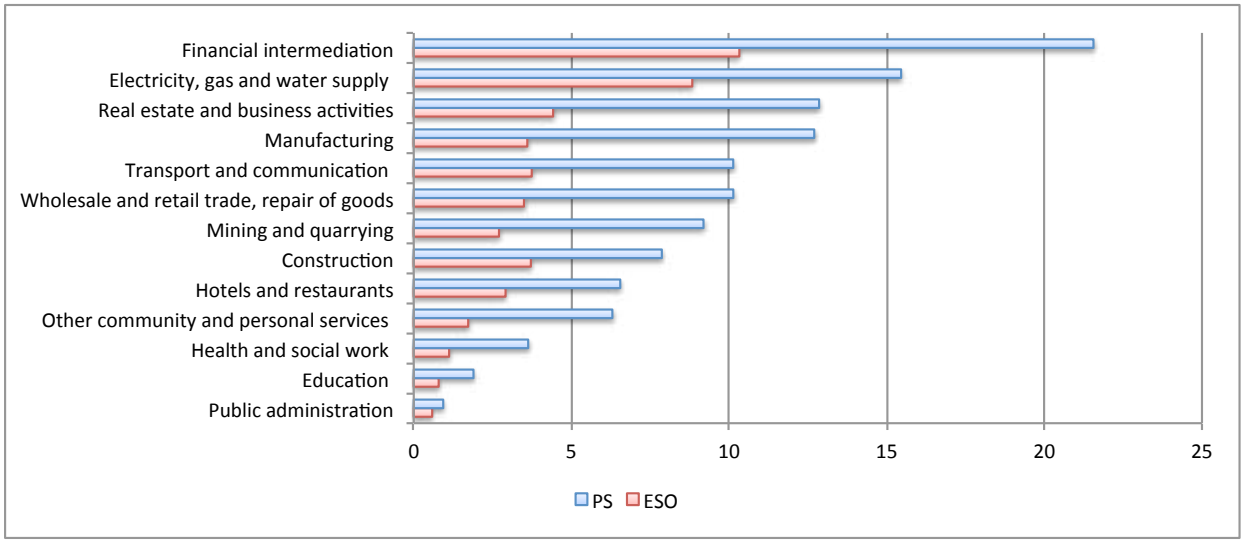
The ECS contains information on company size, which can be matched against the availability of an EFP scheme. As expected, the size of the company is closely associated with the incidence of employee share ownership. Figure 7 shows the availability and extent of EFP schemes in companies of different size groups (large, medium and small).

It indicates that large companies almost always have higher levels of employee share ownership and profit-sharing schemes than medium and especially small companies. The only exceptions in the first diagram (ESO) are Poland and Finland. Similarly, medium-sized companies exhibit higher incidence of employee share ownership than small companies (only Bulgaria is an exception to this pattern). The prevalence of profit-sharing schemes is also closely associated with company size. A higher percentage of large companies offer broad-based FP schemes to their employees than do medium-sized companies (the only exception being Portugal). Also, there are some exceptions where medium-sized companies have lower incidence of profit sharing than small ones. These exceptions concern Slovenia, Spain, Denmark, Hungary and Estonia. In the case of Spain this is probably because of the fact that the prevalent share ownership scheme, the "Sociedades Laborales" (Employee Companies) is specifically designed for small and micro-enterprises (see case studies Annex 6.2.).

In the cases of Slovenia, Hungary and Estonia, the average size of enterprises in these relatively small economies is smaller and thus captured differently by the SME definition of the survey.

The ECS study also provides data to compare the incidence of employee financial participation schemes in different sectors of the economy. This is shown in Figure 8. Dividing companies into different sectors according to NACE classification (see Annex 4) produces interesting results. Companies operating in the Financial Intermediation sector have the highest levels of profit sharing and employee share ownership schemes. Next come the Electricity, Gas and Water Supply sector and the Real Estate and Business Activities sector. The above sectors are followed by Manufacturing, Transport and Communication, Wholesale Trade and Mining. The weighted average of the incidence of EFP is 3.7 per cent for ESO and 9.17 per cent for PS. Figure 8 illustrates these findings graphically.

Figure 8: Proportion of EU-27 companies in different sectors offering broad-based employee share ownership (ESO) and profit-sharing (PS) schemes 2009 (in per cent)



Source: Authors' own calculations (based on ECS dataset, 2009).

The impact of employee and firm characteristics on the offer and take-up of EFP schemes: Econometric evidence

Econometric analysis of the available data, particularly EWCS and ECS, makes it possible to estimate the impact of firm and employee characteristics (including location) on the presence of EFP schemes. The analysis shows that the probability of an employee with certain characteristics working in a particular sector of activity and region to be in a profit sharing or share ownership scheme is positively related to employee and firm characteristics. The estimation results, based on three rounds of EWCS (2000, 2005 and 2010) indicate that gender, qualifications of employees, the nature of their employment contract (permanent against fixed term), size, location and sector of activity of the enterprise affect the probability of employee participation in an EFP scheme.

Table 1 shows a few examples of how different combinations of employee, firm, industry and location characteristics influence the chances of employees taking up either a profit-sharing (PS) or employee share ownership (ESO) scheme.

Table 1: Probability of employees taking up an EFP scheme

Examples of characteristics	PS	ESO
1. A male employee of average age and experience, with a permanent contract, in a managerial/professional position in a large manufacturing enterprise in Western Europe (Austria, Belgium, France, Germany, Luxembourg, Netherlands, Ireland, UK)	33%	12%
2. Same as 1 but a female employee	26%	8%
3. Same as 1 but in the financial and insurance sector	47%	24%
4. Same as 1 but in wholesale and trade sector	35%	13%
5. Same as 1 but in Nordic countries (Finland, Sweden, Denmark)	40%	10%
6. Same as 1 but in Central and Eastern Europe (Czech Republic, Hungary, Poland, Slovakia, Slovenia, Romania, Bulgaria)	38%	7%
7. Same as 1 but in the Baltic region (Estonia, Latvia, Lithuania)	32%	5%
8. Same as 1 but in Southern Europe (Cyprus, Greece, Italy, Malta)	18%	6%
9. Same as 1 but in Iberian Peninsula (Portugal and Spain)	18%	6%
10. Same as 1 but in a medium-sized company	26%	8%
11. Same as 1 but in a small company	21%	5%

Source: Authors' own calculations.

Broadly speaking, the table indicates that male employees, employees of larger firms, and those working in the financial sector are more likely to participate in EFP schemes. Employees in Nordic countries and Eastern Europe are also more likely to take up EFP offers. Employees in Southern European countries and the Iberian Peninsula are, *ceteris paribus*, least likely to take up EFP schemes.

Similarly, using the European Company Survey (2009), it is possible to estimate the probability of a firm offering an EFP scheme to its employees—this also would depend on the employee and firm characteristics. Table 2 summarises the **impact of factors** such as gender, the proportion of highly qualified employees in the work force, size and sector of activity and the location of the company on the probability of a firm offering an EFP scheme to its employees.

Table 2: Probability of a company offering an EFP scheme to its employees

Examples of characteristics	PS	ESO
1. A large manufacturing company operating in Western Europe with the share of female employees of 37% (mean for the sample) and the share of high-skill employees* of 21% (mean for the sample) (Austria, Belgium, France, Germany, Luxembourg, Netherlands, Ireland, UK)	31%	11%
2. Same as 1 but in the financial and insurance sector	35%	21%
3. Same as 1 but in wholesale & trade sector	32%	12%
4. Same as 1 but in Nordic countries (Finland, Sweden, Denmark)	39%	20%
5. Same as 1 but in Central and Eastern Europe (Czech Republic, Hungary, Poland, Slovakia, Slovenia, Romania, Bulgaria)	23%	11%
6. Same as 1 but in the Baltic region (Estonia, Latvia, Lithuania)	26%	7%
7. Same as 1 but in the Iberian Peninsula (Portugal and Spain)	28%	9%**
8. Same as 1 but in Southern Europe (Cyprus, Greece, Italy, Malta)	12%	6%
9. Same as 1 but in a medium-sized company	23%	6%
10. Same as 1 but in a small company	15%	3%
11. Same as 1 but with share of female employees at 47% (instead of 31%)	31%	11%
12. Same as 1 but with share of high-skill* employees at 31% (instead of 21%)	37%	14%

Source: Authors' own calculations. Note: *High-skill employees are those with university and higher degrees or qualifications. **This figure is for Spain only (Portugal is excluded from share ownership data in the ECS (2009).

Table 2 confirms many of the results of Table 1. Large companies in the financial sector are more likely to offer EFP schemes to their employees than small or medium-sized firms or firms in other sectors of activity. Companies in Nordic countries are also more likely to offer their employees both kinds of EFP schemes. Again, companies in Southern Europe, *ceteris paribus,* are least likely to offer EFP schemes. The gender ratio of the work force does not seem to strongly affect the firm's decision to engage in EFP, but the proportion of high-skill employees has a positive—though small—effect on this decision. [21]

[21] Details of econometric models used here to assess the impact of different factors are available from the authors.

2.2.3. Attitudes of government and social partners

The views between governments, trade unions, and employer associations are very diverse.

EU-15

Traditionally, trade unions have been the strongest critics of EFP schemes in several West European countries. The reasons vary with the national contexts (Uvalić, 2009).

Some have opposed financial participation because they feared it would promote more inequality in workers' earnings, or because of the dual risk that workers would lose both their jobs and savings in the event of enterprise failure. In countries like France or Germany, some trade unions have been strongly opposed primarily to employee ownership itself, regarding radical changes in the economic system as the only way to bring about a more equal distribution of wealth. In France and the UK, not only trade unions but also parties on the left have strongly opposed EFP because conservative governments in both countries are the ones that have promoted it. Trade unions in many other EU Member States accept EFP, but argue that these schemes must remain outside the framework of collective bargaining and must represent an addition to wages, not a substitute. However, the rhetoric has undergone change in recent years. Today many trade unions recognise that capital and labour may pursue similar interests. It is now acknowledged that EFP can strengthen worker motivation, improve intra-firm human relations, and increase wage flexibility.

As for the position of employer associations in the EU-15, they have usually supported voluntary EFP schemes and opposed any binding arrangements. Some employer associations have also argued in favour of tax incentives, considering EFP schemes an important instrument for improving employee motivation and commitment. Employer confederations generally accept financial participation, regarding it as a means for employees to develop a closer identification with their company, offering workers a personal stake in their company, and increasing intra-enterprise co-operation. Some employer associations, however, do not actually have a concrete position on EFP; these are primarily in those EU Member States where financial participation has not been widespread.

In many EU-15 Member States, EFP schemes have become part of a new culture of industrial relations based on innovative managerial strategies and more flexible remuneration policies. There has been an unusual convergence from opposite ends of the political spectrum. Both left- and right-wing political parties, including many trade unions, which have traditionally opposed it, have accept minority employee ownership within traditional firms. Its adherents particularly stress its coherence with the concept of a property-owning democracy, which ought to encourage wider ownership than traditional capitalism has.

EU-12

In the EU-12, the general attitudes towards EFP schemes of governments and the social partners differ markedly from those in the EU-15, particularly in the Member States of Central and Eastern Europe. The prevailing attitudes towards EFP schemes, i.e., general indifference, have been strongly influenced by the legacies inherited from the communist times and the priorities imposed by the post-1989 transition to multi-party democracy and a market economy. The word "participation" was frequently misinterpreted and its promotion confused with the desire to re-introduce outdated concepts and practices, which these countries had long abandoned. Consequently, EFP has rarely appeared on a trade union's policy agenda; only in a few Central and Eastern European countries have trade unions actually promoted employee ownership within the privatisation process, nor have they developed institutions to protect employee shareholders. As to employer associations in the Cen-

tral and Eastern European countries, their position on EFP has been passive; in most countries, a clear official viewpoint has not been developed.

However, during the past years EFP in its various forms is more frequently viewed as a complementary element to social and industrial relations.

A good example is the 2009/11 initiative of the Polish Vice-Prime Minister Pawlak, which promotes employee-owned companies and regards ESO as a factor that enhances sustainability, one that can preserve the national identity of Polish companies and thus benefit the economy as a whole. Another example is the employer association in Slovenia, which recently has successfully lobbied for tax concessions from the Government for enterprises implementing EFP schemes.

2.2.4. Legal framework

Profit sharing and employee share-ownership experience in the EU-15 clearly confirms that schemes are most diffused in countries where concrete legislative measures have been introduced to support them (e.g., France, the UK and Ireland). Conversely, the lack of specific legal provisions on employee financial participation, providing a different fiscal treatment or other type of incentive, seems to have been a major obstacle to introduction. This has also been the case in the Central and Eastern European countries, as illustrated in the PEPPER III Report (see Lowitzsch 2006).

There are, however, important differences between the former socialist countries and the mature market economies of the EU-15, and, within the former group, between those in which employees had participated in the operations of their enterprise in varying degrees (e.g., the former Yugoslavia and Poland) and those where employee participation was minimal or non-existent (e.g., Czechoslovakia). The apparent difference in legal and political priorities between Eastern and Western Europe stems from the fact that the first priority of post-socialist legislators was to transform the socialist economic system through privatisation and re-privatisation; thus, the development of EFP schemes does not represent any intention to develop the remuneration system, as in the EU-15; it is rather an accidental consequence of the transition reforms (Uvalić and Vaughan-Whitehead, 1997).

Given the absence of general support for EFP in the Central and Eastern European countries, legislation promoting EFP schemes has been limited—aside from privatisation laws, which favoured the acquisition of shares by employees. Countries having privatisation laws and which sold shares to insiders on privileged terms are also the countries that ended up with a substantial number of firms owned by employee workers and managers (e.g., Poland or Slovenia). Privatisation laws favouring share acquisition by employees under privileged conditions have been a fundamental cause for the diffusion of employee share ownership throughout Central and Eastern Europe.

Previous research on EFP suggests that there are not many legal obstacles to the introduction of financial participation schemes in the EU (Uvalić, 2009). However, national framework law promoting EFP has always proved useful as a guide to enterprises in setting up these schemes. Specific legislation on EFP is important. That was one of the main conclusions of the PEPPER Reports. Although there have been cases where enterprises have adopted EFP schemes even without specific legislation (e.g., profit sharing in Germany), the experience to date in the majority of EU Member States suggests that the adoption of schemes is greatly facilitated when there are concrete laws to promote them. Employee ownership and profit sharing have developed dynamically in those countries where there were laws to promote and support them, e.g., France, the United Kingdom and Slovenia.

3. REVIEW OF PREVIOUS RESEARCH AND CHALLENGES

KEY FINDINGS

The theoretical and empirical literature over the past three decades have largely concluded that EFP provides important benefits to firms by strengthening employee commitment to and identification with the firm, making the company **more productive and hence more competitive**.

- Financial participation also can **assist in recruiting** highly qualified and skilled employees and to retain them by providing benefits in addition to wages, especially in SMEs. Additionally, EFP offers highly skilled employees an attractive place to work.
- Studies over the years have found that firms in which **employees have an ownership stake** are more profitable, create more jobs and are better taxpayers than firms without EFP schemes.
- EFP schemes are often regarded as a **solution to some of the chronic problems** of industrial society, i.e., employee dissatisfaction, low quality of working life and declining productivity. It is argued that EFP schemes tend to decrease absenteeism and labour turnover and reduce internal conflicts.

Despite the above benefits, it has been argued that EFP schemes are associated with a number of shortcomings.

- The **free-rider problem** is one reason why the importance of participation in decision-making and complementary human resource management practices are emphasised in order for employees to develop co-operation and an ownership culture.
- Problems associated with employee share ownership and **interference with management,** which can be avoided using an intermediary entity—such as an ESOP—without direct employee involvement in the decision-making process.
- It is important to note that both profit sharing and share ownership involve a certain amount of **risk for employees**. Profit is determined not only by employees' efforts, but also by management decisions and external factors outside of their control.

Firms and employees have developed mechanisms to mitigate some of these problems. However, the implementation and the spread of plans across borders are hindered by **differences in taxation and social security contributions** across the EU-27.

EFP provides a potential **solution to the business succession problem**, effecting a smooth transition in the ownership and management of family enterprises and SMEs, thus keeping them rooted in the community and securing continuity and employment.

Participation of employees as shareholders contributes to the **long-term interests** of the company and constrains excessive risk taking by management. Employee ownership can give employees a voice, which further strengthens the relationship between them and their firm. This is an important potential for better corporate governance.

In spite of the financial crisis both the offer and take-up of employee share schemes (EWCS and CRANET data) have continued to grow. A stagnation or decline in capitalisation held by employees (EFES data) seems not to be due to a lack of confidence in the employer company. The explanation might simply be employees' lack of capital.

EFP encourages a policy shift in executive remuneration towards long-term incentives.

3.1. Potential benefits of EFP – A review of the literature

There is a rich body of academic literature on employee participation in ownership and enterprise results going back as far as the 1950s and 1960s, although the bulk of theoretical and empirical research has been conducted in the last 20 years. Research has mainly been focused on the impact of EFP on company performance and the particular mechanisms through which EFP affects performance. It is important to point out that the bulk of the empirical evidence on EFP in a variety of countries and variety of settings have concluded that EFP has a positive influence on the performance of companies. For example, a survey of 70 empirical studies on the effects of employee stock ownership, broad-based stock options, profit sharing, and employee participation by Blasi, Kruse and Bernstein (2003) found that the adoption of any of the scheme had led to an average rise in productivity by 4 per cent, return on equity (ROE) by 14 per cent, return on assets (ROA) by 12 per cent and profit margins by 11 per cent. Another survey of some 70 papers by Kaarsemaker (2006) found that 48 of the 70 reviewed studies had shown a positive effect, while only 6 studies had found negative effects. A third survey of the literature on employee- owned firms by Freeman (2007) corroborates the earlier survey results that most of the surveyed papers showed that the sample firms were more productive and profitable, survive longer, and result in better shareholder returns. Of course, the impact of EFP on company performance varies from case to case depending on multiple factors such as the extent of employee share ownership or profit sharing, the qualification structure of employees and the activity of the company.

3.1.1. Improved enterprise efficiency, labour productivity and competitiveness

In the theoretical literature, the most often cited reason for improved efficiency, labour productivity and competitiveness is that employee financial participation creates incentives for workers to be more involved in, and to identify with, their firms. Giving workers a stake in the success of the firm will motivate higher levels of effort, generate more positive attitudes and more co-operative behaviour, and also help realign employee interests with those of the firm. All of these contribute to higher labour productivity and improved overall enterprise efficiency, which make the company more competitive (Ben-Ner and Jones, 1995; Bryson and Freeman, 2007; Oxera, 2007a, 2007b; Jones et al., 2010; Kruse, Blasi and Freeman, 2010, Poutsma and Bramm, 2011 among others).

Some of these outcomes may of course be achieved through other incentive mechanisms based on individual effort, e.g., piece rates (i.e., gain sharing, which is not discussed in this study). But, compared to EFP, these mechanisms are expensive. They require information on individual effort, impose central monitoring, which is difficult, especially in large firms, and do not encourage co-operation and innovation (Pendleton, 2006; Chen et al., 2009). Financial participation imposes a cost on employees for shirking and provides them with the incentive to work more effectively since a part of their income depends on the firm performance (Pérotin and Robinson, 2003). EFP is also expected to strengthen employee commitment to the firm and identification with its goals. While share ownership is expected to generate greater long-term identification with, and loyalty to, the company, profit sharing—especially in cash form—is likely to motivate greater short-term effort as some employees are likely to be risk-averse and to value cash more than shares.

Furthermore, greater commitment—combined with teamwork and co-operation—can also improve the quality of production and work organisation, enhance competitiveness and facilitate the adaptation of new technologies. The co-operative attitude encouraged by EFP is particularly important in technology firms and R&D environments where the role of employees in product and process innovation and in improving production efficiency is critical to the company's success and survival (Chen et al., 2009).

Another group of studies have shown that EFP schemes are effective (or only effective) if they are combined with forms of employee participation in the decision-making processes of firms. Klein (1987) and Pierce, Rubenfeld and Morgan (1991) found that the presence of other forms of participation in decision-making complements the effect of improved attitudes on performance. Bryson and Freeman (2010) found positive links between employee ownership and productivity in workplaces where financial participation was combined with employee involvement in decision-making. Robinson and Wilson (2006) showed that the employee share plans have both independent and joint productivity effects in firms with representative and consultative forms of employee involvement. Pendleton and Robinson (2010) support the view that employee ownership affects productivity only if it is combined with other forms of employee involvement. Their results indicate that in employee ownership plans where employees have a minority stake, high employee participation rates are necessary for the plan to be effective. A high rate of participation in the employee ownership plan has an independent effect on productivity, implying that free riding (discussed below) is not necessarily such a major problem in practice.

There are many mechanisms through which EFP creates conditions for cost reduction or productivity improvement. Some of the more important mechanisms are discussed below.[22]

Recruiting and retaining employees

Financial participation can also help recruit and retain qualified employees, especially in SMEs, which have problems in this area (IAFP, 2010). SMEs typically lack the well developed and extensive internal labour force found in many large firms, thus opportunities for promotion can be limited or non-existent. The challenge for SMEs is to attract experienced managers and other personnel and to retain them once they have been recruited (Postletwhaite, 2004). If the company is listed on the stock market, a successful firm may offer shares to its employees as an incentive to retain existing employees and attract new ones. This is especially true of firms where employee's know-how is important, e.g., small and medium-sized high technology firms. In this case, employee share ownership can bridge the gap between the need for greater employee effort and commitment on the one hand, and potential labour turnover on the other. EFP can help retain the most valuable employees by "locking" them into the firm through these deferred reward schemes (Sengupta, Whitfield and McNabb, 2007) or by linking the reward to the business cycle (share values tend to be highest when alternative employment opportunities are greatest) (Oyer, 2004). As shareholders, employees are less likely to move to another possibly larger firm, which pays higher wages.

Training

The relationship between EFP and training is of special interest as training of employees is a basic mean for improving know-how to enhance competitiveness. Employees invest their knowledge and skills in the companies that employ them. There is an opportunity cost to remaining with one employer and receiving training specific to that employment. Better opportunities available in other firms may be foregone because the employee's higher skills will not be of use to them. Employees therefore bear the risk that management or owners may take advantage of their job-specific training and capture all or most of the benefits resulting from the employees' investment (Robinson and Zhang, 2005). EFP provides a potential solution to this problem.

[22] Caramelli (2011) has highlighted a number of other mechanisms through which the market and financial performance of firms are affected by EFP schemes. An important mechanism highlighted in this study is the enhanced ability of firms with EFP schemes to raise new capital because of the greater commitment of their employees as perceived by financial markets.

It encourages employees to remain with the firm for a longer period (reduced labour turnover) and undergo specific training without fear that management will try to capture all the benefits. Gielen (2007) found that profit-sharing schemes reduce the probability of severance from the current employer, possibly because it enhances wage flexibility, thereby providing an incentive to invest (more) in training. Similarly, Green and Heywood (2007) confirm that profit sharing is a robust determinant of lower separation rates and of greater incidence of training for sub-categories such as employer-funded, specific and general.

Commitment, absenteeism and labour turnover

Another benefit arising from EFP is reduced absenteeism and labour turnover (Robinson and Zhang 2005). The change from a fixed-wage system, where rewards are independent of efforts expended, to a system that provides an income more directly linked to enterprise performance anticipates greater employee commitment, lower absenteeism and labour turnover, greater investments in company-specific human capital and reduced conflict within the company (Festing et al., 1999). A lower turnover rate would reduce recruitment and training costs and improve firm competitiveness. Bakan et al. (2004) found that financial participation had a significant relationship with employee commitment, but only a minor effect on other attitudes such as integration and involvement. Kruse (2002)—summarising 31 studies on employee attitudes and behaviour under employee ownership—found that most of these studies showed a higher commitment to and identification with the company under employee ownership, with mixed results ranging from favourable to neutral with regard to job satisfaction, motivation and other behavioural measures. More recently, Guedri and Hollandts (2008) investigated listed French firms and found that the positive impact of employee ownership on company performance is related to positive changes in attitudinal behaviour of employees, e.g., an increase in motivation, involvement and job satisfaction, and a reduction in turnover and absenteeism rates. The general conclusion of these studies is that improved attitudes under employee ownership are almost always due to the status of being an employee-owner, rather than to the size of the employee's ownership stake.

3.1.2. Information sharing

EFP is also expected to enhance information sharing because of the alignment between individual employees and corporate interests; this is also likely to improve decisions made within the company. The company should supply the employees with extensive, independent and regular information about firm performance and its determinants in order to help employees understand the financial risks and benefits associated with joining a scheme (Pérotin and Robinson, 2002). Because company performance depends on many internal and external factors, employees may be willing to exert greater effort if they are involved in decision making, particularly on matters such as investment or strategy that strongly influence profits and share prices (Pendleton, 2009). It is therefore important that they have all information relevant to making investment decisions. Furthermore, understanding the pay system has been identified as one of the key elements affecting the success of the reward system (Kalmi and Sweins, 2008). Employees have to understand the relationship between their efforts and company performance in order for the pay system to be effectively understood. If employees know how they affect the company profits and understand the pay system, organisational effectiveness may be higher and result in greater commitment and satisfaction with levels of pay[23].

[23] Lazarova and Kroumova, 2009

The presence of EFP schemes and the involvement of employees would be critically important to managers in terms of involving employees and soliciting their suggestions concerning enterprise strategy, thus enriching the company's decision-making process. In many situations, employees have a deep and wide knowledge of the enterprise and its potential and can provide management with valuable information in this regard.

3.1.3. EFP as a source of income after retirement

One of the most important benefits EFP schemes offer employees is savings for future. It is well known that the European population is aging and that governments are finding it increasingly more difficult to maintain pensions at current levels. EFP schemes can be a source of additional income, which could be put aside in a savings scheme, to increase the income available for retirement. EFP schemes may be embedded in retirement plans or investment funds in which not only employee shares but also other contributions from profit-sharing schemes can be invested. Deferred profit sharing schemes can be allocated to savings accounts with certain retention periods or can be invested in assets, including shares in the employer company. E.g., in the U.S., 401(k) plans[24] are the most popular type of defined contribution retirement plans (IAFP, 2010).

3.1.4. Increased flexibility: EFP as a shock absorber during recessions

In addition to productivity enhancement, firms may adopt EFP schemes to introduce greater wage flexibility in the employees' remuneration package and to help stabilise employment (Weitzman, 1984; Harbaugh, 2005; Kruse, Blasi and Freeman, 2010[25]). Since wages and work conditions are derived from negotiations between employees, employers and shareholders, any change in bargaining power affects firm performance (Sylvain, 2010). Because of the divergent interests of these groups, performance of the company may be adversely affected by the market power of existing employees; their demand for higher wages in times of prosperity may negatively influence the growth of employment and affect the ability of employers to adjust the workforce in times of recession (Mcdonald and Solow, 1981). Again, the importance of remuneration flexibility becomes clear in times of recession (e.g., the recent financial crisis) or when the company is forced to restructure. When confronted with unanticipated aggregate demand or aggregate supply shocks, compensation would respond more quickly under profit sharing than under a fixed wage system set by long-term contracts. A firm utilising profit sharing would exhibit less employment variability than a firm with fixed wages (Weitzman, 1984) inasmuch as total remuneration consists of a reduced basic-wage part and a variable profit-related part.

Flexibility in the compensation package is also of great importance to employees. Flexibility can function as a guarantee to employees that by accepting a profit-share element in their remuneration they are more likely to retain their jobs in hard times and share in the benefits when the company recovers.

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[24] A 401(k) plan is a qualified profit-sharing plan allowing employees to contribute salary deferral (salary reduction) contributions on a post-tax and/or pretax basis often involving employer's matching contributions; the allocated sums are generally invested over a specific period of time until they can be withdrawn.

[25] In a survey of over 40,000 employees in 14 firms and 323 worksites, conducted as part of NBER's "Shared Capitalism" project in the U.S., Kruse, Blasi and Freeman (2010) found that EFP schemes are associated with higher job security. The companies had a variety of EFP schemes. About 90 per cent of the workers surveyed are in five Fortune 500 multinational firms where the employee ownership accounts for a minority stake of the firm's equity, where workers elect no board representatives, and where the employee ownership is combined with cash profit sharing or broad-based stock options.

Although unions, which play a strong role in wage bargaining in many countries, are usually unwilling to accept EFP schemes as a substitute for wages, their attitude towards specific forms of EFP may be less severe and they may take a more pragmatic stand towards wage reductions, especially in times of crises.[26] If this flexibility is seen as part of a broad EFP agreement, which also promises higher incomes in better times, employees and unions might more readily accept it. Empirical studies on the relationship between EFP and employment have generally arrived at positive results. Kruse (1998) reviewed 19 studies, which examined Weitzman's predictions that profit sharing would stabilise company employment levels. The majority of these found that when making employment decisions, firms view profit sharing differently than fixed wages. Of the 12 studies directed to employment stability, six found greater employment stability under profit sharing, four showed greater stability in some but not all samples, and two showed little or no difference. Blair, Kruse and Blasi (2000) found increased job stability in U.S. companies with broad-based employee ownership plans as compared to similar firms in the same industries. More recently, Kruse, Blasi and Freeman (2010) (referred to earlier) found that EFP schemes are associated with higher job security. This is true of both profit sharing and employee share ownership schemes.

3.1.5. EFP as a tool contributing to solving restructuring problems

In difficult times when restructuring is required, changes in employment and working practices intended to cut costs and maintain the level of productivity must be made to enable the firm to survive. EFP schemes can guarantee that employees—who have to make sacrifices for the good of the firm—will benefit from a successful restructuring. Employee ownership and profit sharing may play a significant role in inducing wage moderation when workers will receive a variable part of their income in the form of dividends or profit shares. If employee ownership includes a voice in decision-making—through such mechanisms as participation on company boards—the effects should be even stronger (Jones, 2004). Park, Kruse and Sesil (2004) tracked data on all U.S. public companies from 1988 to 2001 and found that companies with employee ownership stakes of 5 per cent or more were 76 per cent less likely than firms without employee ownership to vanish during this period. Out of 245 firms in which employees owned 5 per cent or more of the company in 1988, 124 (50.6 per cent) were still operating in 2001 in comparison to only 97 (41.8 per cent) of 232 non-employee-owned firms.

3.2. EFP and business succession in SMEs

As the largest employers, SMEs and micro-enterprises are crucial to economic and labour market policy. One of the flagship initiatives of the EU 2020 Strategy is to call attention to implementation of the Small Business Act, especially provisions, which improve the financial situations of SMEs. The European Commission, the European Parliament and the European Economic and Social Committee (EESC) have highlighted employee buyouts as one possible solution to the business succession problem of European SMEs.

[26] One recent example where employees agreed to pay cuts in exchange for shares is the case of pilots in British Airways who agree to a pay cut of 2.6 per cent and the reduction of 20 per cent in some allowances (Daily Mail, 14 July 2009).

3.2.1. The business succession problem of the European Mittelstand

A Commission Communication from 2006[27] stated that with the ageing of Europe's population, "one third of EU entrepreneurs, mainly those managing family enterprises, will withdraw within the next ten years". This portends an enormous increase in business transfer activity, which could affect up to 690,000 SMEs and 2.8 million jobs every year.[28] It is anticipated that as a consequence of the new forms of business finance now coming into use, transfers within the family will decrease, while sales to outside buyers will rise. The entrance of international investors into what used to be primarily domestic markets will broaden the range of potential buyers for European small and medium-sized enterprises. But these enterprises are the backbone of Europe's national economies, cultures and traditions. Their sale to impersonal private equity funds[29] and strategic investors will affect not only the working lives of Europeans, but also their material well-being and the quality of their communities. This process is likely to threaten the successful regional structure of European (family-owned) businesses (Deutsche Bank Research, 2007, p. 1) and thus will profoundly affect the European Union itself. In response to this unprecedented volume of business transfers, an appropriately designed long-term EFP model could contribute a strategic solution to strengthening regional economies and employment throughout the EU.

3.2.2. Best practice: ESOPs as a vehicle for business succession

The EESC emphasises the potential usefulness of Employee Stock Ownership Plans (ESOP models[30]), which have already demonstrated their effectiveness (see the case studies in Annex 6). An important characteristic of the ESOP model is that it is especially tailored to the needs of unquoted companies. It encourages business owners to sell their enterprise to their own employees instead of a third party and facilitates the gradual acquisition of up to 100 per cent of company stock by employees. This makes it possible to buy out one or more shareholders without forcing others to give up their equity position, which is one of its major advantages from the shareholders' perspective. Employees do not have to invest their savings since the employee stock purchase generally is financed by a profit share paid in addition to salary. Thus, employees do not incur personal debt or additional risk.

ESOPs give business owners the opportunity to diversify their investment portfolios without the costly process of going public (for U.S. ESOPs, see Ackermann, 2002). Furthermore, there is no dilution of current stockholders' equity per share since no new shares are issued and all shares are bought at fair market value. In the case where the ESOP borrows money to buy shares, the company repays the loan by combining any dividend income of the trust with its own tax-deductible contributions to the plan. As the loan is repaid, a number of shares equal to the percentage of the loan repaid that year are allocated to employee accounts, usually on the basis of relative compensation.

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[27] Implementing the Lisbon Community Programme for Growth and Jobs, on the Transfer of Businesses – Continuity through a new beginning, from 14 March 2006 COM (2006) 117 final.

[28] Calculated by extrapolations from the final report of the BEST project on the transfer of small and medium-sized enterprises, 2002, which estimated that the annual transfer potential for the EU-15 was 610,000 businesses. E.g., the transfer volume of enterprises is estimated for Germany around 354,000 over the next five years (Institut für Mittelstandsforschung, Bonn, 2005), for France around 600,000 for the next decade (Vilain, 2004).

[29] The volume of private equity transactions in Europe has been rising over the last years with EUR 126 billion in 2005 and a new peak of EUR 178 billion in 2007 (Incisive Financial Publishing, 2007).

[30] In the UK, Ireland and North America involving a trust, in continental Europe usually a limited company, foundation or association. The corresponding vehicle is, e.g., in France the so called "fonds de reprise", an ESOP-like system, which is similar with regard to both functioning principles as well as advantages. The differences are related to the legal statute of the "fonds de reprise" as compared with that of a common law trust—that is used for the British or Irish ESOP—and to the fiscal incentives that obviously differ from country to country.

In this way, the ESOP creates a market for the shares of retiring shareholders at a price acceptable to the owner—a market, which otherwise might not exist. At the same time, when a change of control is appropriate, ownership can be transferred to motivated employees who have a vital interest in the firm's long-term success.

In the U.S., these plans are the most popular form of employee share ownership, with an estimated 11,500 plans and more than 10 million participants (10 per cent of the private sector workforce) in 2011.[31] The principal reason for their popularity is the feature that facilitates business succession in non-quoted SMEs (Menke and Hanisch, 2008), which also results in increases in both productivity and profitability.[32] Approximately 330 of these ESOPs—or 3 per cent—are found in publicly traded firms[33], while the vast majority are in privately held firms. An estimated 7,000 of the 11,500 companies have ESOPs that are large enough to be a major factor in the corporation's strategy and culture; about 4,500 are majority-owned, and another 3,000 are 100 per cent owned by the ESOP. ESOPs have also been implemented in Europe[34] and Japan (Jones and Kato, 1995, pp. 391-414), but to a much lesser extent. The European Commission states, "especially when compared to the experiences in the U.S., there exists still a huge, largely unused potential for the further development of financial participation as part of an overall strategy aimed towards stimulating the growth of new, dynamic companies"[35].

3.3. Obstacles and potential pitfalls of EFP for employees and enterprises

Empirical studies, showing the positive effects of various forms of EFP on firm performance discussed above, also suggest that EFP may be associated with problems for both firms and workers.

3.3.1. Interference with management

Other authors have argued that the financial participation of employees, particularly employee ownership, can adversely affect the performance of enterprises for a number of reasons. Jensen and Meckling (1979) have emphasised the impact of the involvement of ill-informed employees on decision-making and their interference with the work of the management. Hansmann (1990 and 1993) has drawn attention to the cost of "collective governance"[36] and the impact of conflict between heterogeneous groups of employees (young and old, skilled and unskilled, etc.) with different interests and objectives. These problems can be avoided if employee share ownership is organised through an intermediary institution—such as an ESOP—without direct employee involvement in the decision-making process.

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[31] The ESOP Association (http://www.esopassociation.org/media/media_statistics.asp)

[32] For a recent, comprehensive overview of the positive economic evidence (especially for ESOPs), see Blasi, Kruse, Bernstein (2003). They find an average increase of productivity level by about 4 per cent, of total shareholder returns by about 2 per cent and of profit levels by about 14 per cent compared to firms without EFP schemes.

[33] In the U.S., over half of all the Fortune 500 companies and over 40 per cent of Inc. magazine's 100 fastest growing private companies now sponsor ESOPs.

[34] E.g., for the UK, see Walley and Wilson (1992), pp. 126-151; for Hungary, see Galgóczi and Hovorka (1998); see the concerning case studies below in Chapter 5 and Annex 6.

[35] European Commission, 2002, pp. 3,10

[36] The experience of the last decade of employee involvement in decision-making in enterprises in former Yugoslavia also provides a poor example of the large-scale involvement of employees, particularly in terms of the speed of decision-making and the excessive time spent in reaching agreements (Pendleton et al., 2001). However, the Yugoslav experience, which was conducted under state control and in the absence of competitive markets, should not be mixed up with genuine employee financial participation under competitive market conditions.

However, the potential conflict with the employer's autonomy might be less problematic if employees consider that their company has to compete with other firms in the market and that any interference in the work of management may affect the company performance, and its position in the market, adversely, resulting in losses to themselves.

3.3.2. EFP and the free-rider problem

A negative side of any group-incentive system is free riding. In EFP schemes, workers receive only a small fraction of any additional income resulting from their own efforts, but gain benefits from the collective effort. This may then result in a temptation for free riding, shirking and on-the-job leisure (Kruse, 1996). But EFP and other forms of employee involvement can help foster greater trust, co-operation, and identification with the firm, which reduces the incidence of free riding. Employees in EFP schemes also have an incentive to monitor their colleagues—as well as managers—, thus further minimising the free-rider problem (Park, Kruse and Sesil, 2004). When individual pay is computed on the basis of the aggregate performance of a group, such as profit or similar indicators, everyone has an incentive to monitor co-workers to avoid decreases in output, which would result in lower wages. Such a mechanism of decentralised monitoring within groups or teams of workers enables the firm to save on monitoring costs since co-workers will report possible shirking to the employer (Bryson et al., 2011).

Empirical studies, previously mentioned, showing the positive effects of various forms of EFP on firm performance, suggest that firms and workers have developed mechanisms to reduce free riding, which enable EFP schemes to succeed. Among such mechanisms are mutual monitoring, peer pressure and social norms (Falk and Ichino, 2006; Mas and Moretti, 2009). Furthermore, the free-rider problem is one reason why the literature emphasises the importance of participation in decision-making and complementary human resource management practices to accompany EFP in order for employees to develop co-operation and an ownership culture (Kaarsmaker, Pendleton and Poutsma, 2009).

3.3.3. Risk for employees

It is important to note that both profit sharing and share ownership involve a certain amount of risk for employees. Profit is determined not only by employees' efforts, but also by management decisions and external factors outside of the employees' control. If employees have no voice, they will be exposed to the "moral hazards" of managerial behaviour, which may affect their pay, jobs and profit share. The problem is potentially more serious with employee share ownership schemes since poor firm performance can result in lower share prices and losses for employees.

From the employees' standpoint, one of the oldest commonly cited drawbacks to employee ownership is that holding shares of their own company is a poor portfolio decision, involving the "double risk" of becoming unemployed and losing their savings—which are invested in the company—if the company experiences financial difficulties. On the other hand, employees and their representatives are likely to know the firm they work for well, which enables them to assess the investment opportunity better than would otherwise be the case, e.g., on the stock markets. Nevertheless, as employees may not be able to sell their shares at once[37] the problem of risk remains.

[37] This is also an obvious disadvantage of deferred profit-sharing plans with sometimes onerous restriction on withdrawals. Most schemes impose retention periods before benefits become available to employees.

However, in reality, shares of the company form only a small part of an employee's savings, and EFP schemes do not prevent employees from having other forms of saving (such as home ownership).

Furthermore, a recent large-scale study—covering over 35,000 employees in the U.S.—of employees' attitudes towards EFP, shows that this issue—and more broadly speaking the issue of risk aversion—is not a barrier to EFP (Kruse, Blasi and Park, 2008). Using the same dataset, Kruse, Blasi and Freeman (2010) found that employees' attitudes toward EFP schemes and preferences for variable pay depend on how secure they feel about the future.[38] The more secure employees feel, the more willing they are to participate in EFP schemes. Furthermore, employees feel secure when there is a greater sense of empowerment and involvement in the company's activities.

3.3.4. Mobility and portability: Lack of mutual recognition of EFP

One serious obstacle to the adoption of EFP throughout the EU involves the lack of mutual recognition of EFP schemes in different countries. The most common barriers are different legal frameworks and different rules for taxing benefits. The legal framework supporting a specific EFP scheme in one Member State is difficult to transfer to other Member States. Participation schemes across different Member States are also subject to different kinds of tax (e.g., income tax and/or capital gains tax) as well as different taxation rates. A related problem is the situation faced by employees moving from one country to another country with different rules on taxation and benefits. Such employees are already able to retain the tax and social security entitlements they have earned in their home Member State (Report of the High Level Group of Independent Experts, 2003). This concept could be extended by each Member State recognising plans drawn up under the laws of any Member State as the equivalent of their own plans in order to provide a practical solution to problems faced by geographically mobile employees.

3.3.5. Double taxation and discrimination between resident and non-resident employees

Diverse tax treatment of the various types of financial participation plans across the EU, linked to general differences in taxation systems, represent another very important barrier to the implementation and spread of plans as they may cause double taxation and discrimination. Combined with the existence or absence of tax-favoured plans, the differences most importantly concern the incidence and timing of taxation as well as differences in tax treatment and social security contributions for employers and/or employees. For employees who are not resident in the country in which they work (they live there less than 185 days) or who change their tax residence, this leads to uncertainty and/or complexity of their fiscal treatment possibly resulting in double taxation or double exemption.

Within one company resident and non-resident employees may be treated differently, which may lead to discrimination. Notwithstanding their broad freedom to design their tax systems according to their domestic policy objectives EU Member States are not allowed to discriminate on the basis of nationality or to apply unjustified restrictions to the exercise of the fundamental EU Treaty freedoms.[39]

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[38] They developed an "index of economic insecurity", which consists of three components: the size of each worker's fixed annual pay, the ratio of each worker's wealth (minus debt) to his/her fixed annual pay, and the extent to which each worker perceives that he/she is competitively paid by his/her firm.

[39] The Court of Justice of the EU has ruled that double taxation resulting from the parallel exercise of taxing rights by Member States, is not per se contrary to EU law. However, the Commission considers it an obstacle in the Single Market.

Furthermore, withholding tax on portfolio dividends is a potential problem for employees having shares in companies located in another EU Member State. There is already a practical difficulty of claiming entitlements to relief from foreign withholding taxes.

A further obstacle is the several layers of taxation being applied (company level, withholding tax in the source country and tax in the country of residence) for which no double taxation relief may be available despite the existence of double taxation treaties between Member States.

3.3.6. Obstacles specific to SMEs

It has been argued that introducing EFP in SMEs is quite difficult because of their limited financial resources. Financing constraints may make pay outs to employees in addition to wages very difficult. Furthermore, an employee's decision to withdraw from a share ownership plan can involve substantial costs. If the company is closely held, it may be obliged to purchase the shares of departing plan participants. A company unable to meet this liability may be forced to go public. Not only is this an expensive process, but the company may lose independence and control. In addition, implementing an EFP scheme involves considerable expenses.

With regards to share ownership schemes the central problem is that the majority of SMEs are private unlisted firms, thus it is difficult to determine their true value. This may be a disincentive for employees to acquire shares in a company of unknown market value. The company's owners may fear loss of control if outsiders are able to acquire shares from divesting employees. Share plans are bureaucratic because of the need to observe statutory and legal requirements to comply with securities legislation, etc. These complications cause SMEs to opt for cash profit-sharing schemes (rather than share ownership schemes) as a simpler alternative.

3.4. Corporate governance and sustainable development: a challenge for EFP

Participation in the decision-making process and financial participation are regarded as complementary, as previously mentioned, thus potentially increasing productivity and improving the quality of management even further than would be the case with EFP only. While financial participation may provide employees with the incentive for maximal involvement, direct participation gives them the tools to realise it. This poses an important challenge to corporate governance and the sustainable development of the firm, especially with regard to employee share ownership.

Employee shareholders represent a type of investors who are concerned with the long-term performance of the business, not its short-term fortunes, which may be fluctuating from year to year. To facilitate the development of positive attitudes and behaviours, management also needs to adopt practices such as information sharing, clarifying and strengthening the link between both individual and organisational performance, and employee participation in decision-making, as adjuncts to the incentive plan—measures which complement EFP (Pendleton and Robinson, 2010). Well-informed employees can also make a significant contribution to the operation of company boards and their important function of monitoring and overseeing management. ESO may—depending on the way it is structured—lead to participation in decision-making processes via shareholder voting rights, executed individually or collectively, via an intermediary entity. Companies, which issue large numbers of employee shares, have a group of informed, demanding but patient and loyal shareholders, their own employees, supporting them in resisting the prevailing short-termism of the financial markets.

Anyone with an important stake in a company such as his/her own job naturally wants full transparency on company accounts and participation in company decisions. In this way participation based on share ownership complements participation based on information, consultation and voting rights.

Moreover, information sharing can attract a large number of employees that might otherwise not get involved in company affairs. In this way, employees are not regarded just as another factor of production, but as shareholders and stakeholders who can contribute actively to the decision-making process and also to corporate governance. For other shareholders in the company, it is an advantage to know that they have the company's employees as fellow shareholders pursuing the same objectives. Employee shareholders can monitor and exercise oversight on management better than any other entity. They also have an incentive to monitor their fellow employees. This can potentially lead to improved corporate governance arrangements within the company. The presence of employee shareholders should assure other long-term investors, such as institutional shareholders, that long-term interests of the company would prevail.

Employee involvement also meets one of the important conditions of good corporate governance: looking after the interests of all stakeholders. Good corporate governance improves the company performance and the benefits for its shareholders.

3.5. Impact of the economic and financial crisis

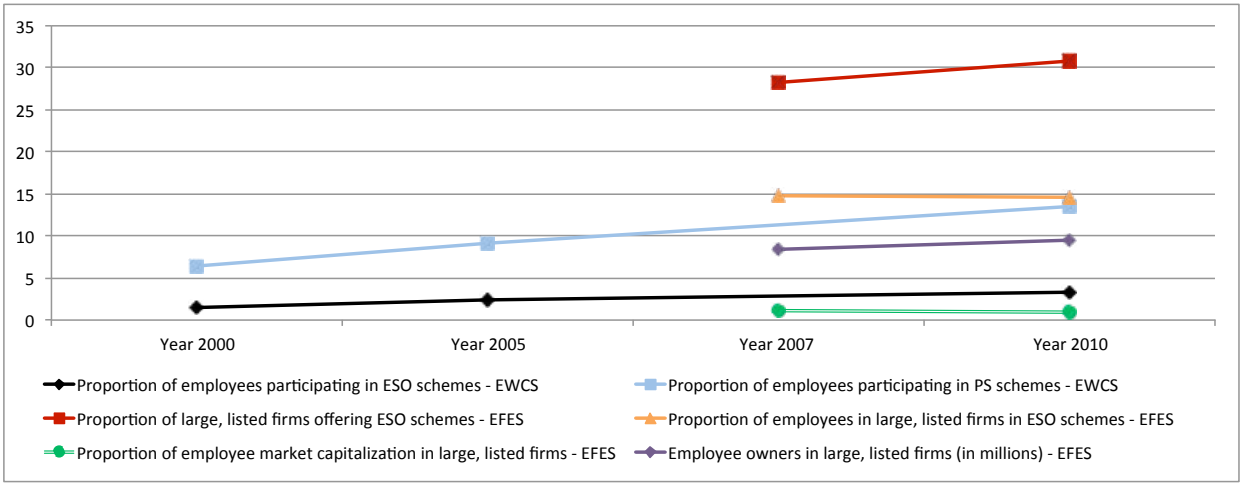
Employee ownership is a type of long-term investment that may help to stabilise capital markets, a welcome contrast to the destabilising effect of speculative short-term investment. However, European workers who, as employee shareholders, may have recently seen a disastrous decline in the value of their shares and have been affected by austerity measures across the continent may worry whether shareholding in their employer companies is a good long-term investment. A key question therefore is whether the current financial crisis has caused employees to withdraw from participation in EFP schemes in general, and in particular in the ownership of their employer company, or whether they have actually strengthened their commitment.

With the risk discussion in mind, one might expect employees under the current economic uncertainty to seek conventional pay systems and flee EFP schemes. Of course, this argument would be more relevant to share ownership schemes since market volatility affects share prices directly. Interestingly enough, as Figure 9 shows, this is not the case. The EWCS data shows that the proportion of company employees participating in EFP schemes has continued to grow in spite of the financial crisis. Comparing the take-up of EFP schemes over the last decade, the proportion of employees taking up profit-sharing schemes rose from 6.4 per cent in 2000 to 9.1 per cent in 2005 and then to 13.5 per cent in 2010. Over the same period, the proportion of employees participating in share schemes increased from a weighted average of 1.4 per cent in 1999/2000 to 2.3 per cent in 2005 and 3.3 per cent in 2010.

According to the EFES data, despite the financial crisis, the number of employee owners in large listed companies is still rising across Europe: the number of employee owners was nearly 9.5 million out of 32.6 million employees in 2010 (8.4 million in 2007). However, for the entire sample, the weighted average of the proportion of employees in broad-based ESO schemes was 14.7 per cent in 2007 and 14.5 per cent in 2010, a marginal decline (see Figure 5 above). The picture is also somewhat mixed if we look at the companies offering employee share schemes. In 2010, the proportion of large listed companies with broad based employee ownership was 31 per cent, an increase over the 28 per cent in 2007. In terms of the proportion of shares of large listed companies held by employees, for the first

time in many years there was a slight decline in 2010 from 1.05 to 0.95 per cent (see above Figure 6). However, while the "common" employees saw their share shrink during this period, the shareholdings of executives in large listed firms actually increased (Mathieu, 2010).

Figure 9: Dynamics of employee shareholding and profit sharing 2007-2010



Source: Authors' own calculations based on EWCS and EFES databases.

Against the background of the rising take-up rate previously reported (see above Figure 1) it is interesting that although more employees participated in share schemes, their overall share did not increase accordingly. A possible explanation is that executives and investors took the opportunity to buy into the market after the crash. And indeed, EFES reports that the executives have been buying up in the post crisis period and that their share in equity of large quoted firms has increased (Mathieu, 2010). Hence, in spite of the extension of both the offer and take-up of share schemes, this decline seems not to be due to a lack of confidence in the employer company's shares. The explanation for employees' smaller participation as shareholders appears simply to be their lack of capital.

3.6. Link between EU's EFP action and the recent remuneration policies newly introduced in the financial sector

As a reaction to the economic and financial crisis, the past three years have seen various recommendations to change executive compensation, particularly compensation in the financial services industry. Some of these initiatives have come from the European Commission as well as from the governments of some Member States, and others originate in the enterprises themselves. While a complete rethinking cannot be observed executive compensation schemes are undergoing important changes. These changes are closely related to broad-based, employee financial participation with regards to (i) a desired change from short to long-term incentives, (ii) higher transparency of remuneration, and (iii) the involvement of (employee) shareholders having a "say on pay".

3.6.1. Background: Main directions of reform of executive remuneration

Executive compensation structures are often named as one reason for the current financial and economic crisis. The pre-crisis executive compensation structures are criticised for putting too much emphasis on short-term variable compensation and thus leading to myopic management decisions (Teichmann, 2009). Furthermore, experts note that they led to moral hazard as taking risks and achieving a positive outcome was rewarded with high bonusses while failures due to risky management behaviour were not punished accordingly with compensation cuts.

Empirical evidence for management boards in Sweden (Oxelheim et al., 2010) as well as supervisory boards in Germany (Koch and Stadtmann, 2012) support these findings. As a consequence of these issues, changes have been proposed and/or implemented by different actors.

The **European Commission** had already passed suggestions regarding executive director compensation in a 2004 Recommendation.[40] In 2009, these were expanded as a consequence of the financial crisis by two recommendations[41], one dealing with executive director compensation across industries and the other dealing with compensation structures in the financial sectors on all hierarchical levels in special consideration of those job positions dealing with risk. Two main areas[42] can be distinguished and some example policies from both recommendations are given below:

- **Structure of remuneration**: termination payments should stay below a fixed amount and not be paid in case of failure[43]; stocks and options should vest after an ex ante defined minimum time period; a part of the shares should be held by executive directors till the end of their time in office; variable incentive pay should be connected to measurable performance criteria, which are defined ex ante; those

[40] Commission Recommendation of 14 December 2004 fostering an appropriate regime for the remuneration of directors of listed companies (2004/913/EC).

[41] Commission Recommendation complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies, COM(2009) 3177; Commission Recommendation, COM(2009) 3159.

[42] Of course, there are also special regulations related to executive compensation in banks that were granted financial state aid during the recent crisis. The law does not enforce these conditions; rather they are put as a condition to receive additional funding. These are not discussed here due to their temporary character.

[43] Thus, the so-called "golden parachutes", which can be seen as a form of "pay without performance" (see Teichmann, 2009, p. 236), should not be possible anymore.

performance criteria should promote the companies' long-term sustainable performance, bonus payments should be paid in a deferred manner[44].

- **Remuneration committee and disclosure:** To ensure the necessary expertise at least one remuneration committee member should have "expert knowledge" in the area of compensation schemes. The remuneration committee should keep contact with the shareholders by being present in the general annual meeting and reporting about its activity. Compensation policy should be better controllable by the affected stakeholders. Therefore, information about compensation such as the schemes to link pay to performance should be accessible for stakeholders. Shareholders should be encouraged to participate in the general meetings and vote regarding executive compensation issues.

An example for implementation of the Recommendation regarding general directors' pay is the German law on the adequacy of executive director compensation (VorstAG, see Law on joint-stock companies).[45] When looking at the empirical data, small changes in the compensation schedule can be observed: Analysing compensation structures in Germany, Hölz (2011) found that long-term incentive pay—as suggested by the EU Commission—has increased between 2009 and 2010, i.e. with 10.1 per cent of total pay in long-term-incentives in 2010, as compared to 3.6 per cent on 2009; nevertheless, this still represents a very small compensation component compared to the short-term incentive-pay components, which also after the crisis (2009, 2010) amount to more than 40 per cent of total payment.

As a consequence of the financial crisis, changes on the aggregate level as well as in individual companies are visible. Observing a dataset including data on 16 different Western European countries, Hüttenbrink et al. (2011) found that average executive compensation decreased by 18 per cent between 2007 and 2008 while it has been increasing by averaged 16 per cent yearly between 2005 and 2007. However, Hölz (2011) shows data from German DAX 30 executive compensation, and in this group compensation has decreased by around 24 per cent between 2007 and 2008, but has almost reached pre-crisis compensation levels in 2010.

3.6.2. EFP can contribute to remuneration policy reforms

As EFP is promoted, it gradually facilitates a change in the orientation of the remuneration system from short-term to long-term. Even if initially limited in its extent, employee shareholding can be an element supporting transparency until it eventually becomes a factor influencing compensation systems as the employees' equity share and thus their voting rights increase. If employees have small minority shareholding, as in most cases (the average shareholding of employees is around 3 per cent, although it may be slowly increasing; see Figure 6 above), then they will act as a pressure group. As discussed above under 3.1.2., if companies embrace EFP, they are more likely to be transparent, share information with employees, and therefore employees will know about executive compensation. Although, as a rule, the extent of shareholding will be too low for influencing compensation packages through votes, employee shareholders can put the issue on the agenda of the general assembly. Once employees have a significant minority of shares, they will be able to influence the compensation package as institutional shareholders sometimes are. Since

[44] The often criticised "pay without performance" should be prevented by a different way of granting bonus payments, and in case it later turns out that the basis for granting the bonus payments does not exist anymore (or never did), it should also be possible to claw back bonus payments.

[45] Examples for implemented aspects are that stock options may not be vested earlier than four years after receiving and variable payments should be granted based on perennial performance criteria and thus promote long-term performance orientation. (for a more detailed discussion, see Koch and Stadtmann, 2011).

employees—as mentioned previously under 3.4.—are more than ordinary shareholders concerned with long-term orientation, they will have an interest towards long-term value maximisation.

The vote of shareholders and higher transparency of remuneration schemes will bring employees closer to the decision about executive compensation. This should have an even more positive effect on the desired long-term orientation of executive compensation than the vote of the average shareholder as the following argument illustrates: The average shareholder might not be overly interested in the long-term profitability, low risk and surviving of the firm, but rather also in favour of short-term profits for two reasons: First, in economic theory the shareholder is seen to have a diversified position. He does not only invest in one single firm, but in several firms. With his diversified portfolio, he does not care about the performance of an individual firm, but is rather interested in an attractive relationship between risk and return (Markowitz, 1952). The second reason is that his transaction costs are low. Thus, once stocks he holds are not performing as desired, he might sell them and invest somewhere else.

For an employee shareholder the situation is different: He has a rather non-diversified position as he works for the firm and fears losing his job. Depending on the details of the EFP scheme, the employees might invest to a high extend into company shares as they often are discounted and thus per se more attractive than other firms' shares. If given as a compensation component, there might be restrictions for the time of the sale, resulting in a non-diversified portfolio. Secondly, the employee shareholder has transaction costs and thus a long-term orientation. To change his job is not so easy, and a sale of the shares might not be possible due to a holding period, depending on the share scheme. Thus, employee shareholders will tend to have a vital interest in long-term oriented executive compensation, which fosters a balanced attitude towards risk.

The fact that there will be a compensation expert on the remuneration committee and the remuneration committee will be present at the annual general meeting about compensation fills in a possible lack of expertise employees are facing. Thus, EFP can contribute to ensuring a long-term orientation of remuneration.

Examples from different countries have already shown that when employees control a significant of shares, they use their say on pay effectively. In the U.S.-based firm Wal-Mart, a group of employee shareholders placed a proxy regarding compensation (Rodgers, 2012). The employees demanded an annual analysis with which the board should ensure that Wal-Mart's compensation schemes discourage managers from making capital investments, which might lower the company's returns. Also the firm Verizon had to deal with employee concerns about the compensation topic. Other examples of shareholder (but not specifically employee shareholder) actions against certain executive pay schedules are Aviva, Trinity Mirror, Astra Zeneca as well as General Electric. In the banking sector, shareholders voted down the proposed compensation schedules of UBS and Barclays in 2012. The British ESOP Centre already refers to these series of actions as the "shareholder spring" and notes that employees—where they control a significant part of shares—might be the protagonists of "the most capitalist of the revolutions" (ESOP Centre, 2012).

4. POLICY MEASURES TO ENCOURAGE EFP AT NATIONAL LEVEL

KEY FINDINGS

Establishing EFP schemes through legislation is of primary importance

Schemes approved through legislation give companies a distinct legal framework and provide them with a clear framework for company decisions and actions. At the same time, establishing a legal framework delineates what is possible for companies without inviting sanctions from regulatory, legal or taxation authorities.

Fiscal incentives are not a prerequisite to financial participation

Financial participation schemes without tax incentives sometimes have a higher incidence than those with tax incentives. Many factors influence a firms' decision to engage in EFP, but tax incentives are not to be considered a prerequisite.

When properly designed, fiscal incentives promote the spread of EFP

Countries with a long tradition of employee financial participation (e.g., the UK and France) confirm this view, but so do countries where tax incentives are quite recent, e.g., Austria, where a substantial increase has been observed, even though the total number of schemes is still relatively low.

Tax incentives in most countries target those taxes, which constitute the heaviest burden in the national taxation system

The heaviest taxes are usually the progressive personal income tax and social security contributions. Many countries therefore provide: (i) exemptions from social security contributions for certain plans; (ii) imposing capital gains tax instead of personal income tax; (iii) imposing a special low tax in lieu of personal income tax, and (iv) tax allowances for personal income tax. Some forms of tax incentives are more feasible for certain types of schemes:

- **For share ownership and stock options**, as far as **benefit taxation** is concerned: deferred taxation (often linked to holding period) combined with generous valuation rules, and, if possible, exemption from social security contributions for both the employer company and the employee.
- **For dividends and sale of shares**: a special tax rate or capital gains tax in lieu of personal income tax and, if necessary, exemption from social security contributions.
- **For ESOPs and intermediary entities**: exemptions from income tax on share acquisition or on share sale if the profit is realised after a holding period; firms may qualify for tax relief on both interest and principal payments on loans to facilitate acquisition of shares by employees; sale of stock to an ESOP on a tax-deferred basis if the proceeds of the sale are re-invested in qualified securities (tax-free rollover).
- **For profit sharing**: a special tax rate in lieu of the progressive personal income tax as well as exemption from SSC for both the employer and the employee.

This chapter provides an overview of the different measures promoting EFP schemes that are in place across the EU-27 and classifies Member States as a result of a "success rating" of these measures. However, it has to be stressed that the notion of "success" is measured with both soft and hard criteria that are only a selection of the different factors that influence the offer as well as the take-up of these schemes. Especially with regards to the impact of the different size of enterprises, the results have to be treated with caution. To illustrate this effect, the results of this classification are set into relation with the offer selecting a dataset that is composed 50 per cent of small companies (10-50 employees, ECS 2009 data) since the specific situation of EFP in SMEs is different of that in large firms (as already discussed above 2.2.2.a)). As different measures may have a sigificantly varying incentive effect on different sizes of enterprises the conclusions are of general character. The chapter ends with a brief discussion of the significance of the use of intermediary entities in share ownership schemes and the question of what specific measures are applied with regards to SMEs.

4.1. Overview of measures: Tax, fiscal and other incentives for EFP

Of the measures in place to promote EFP the **legal framework**—being a premise to the implementation of schemes—is the most fundamental. The presence or absence of specific regulations is directly related to conducive and non-conducive legal arrangements. Although in most Member States with successful EFP models and widespread EFP schemes a special law dedicated to financial participation was adopted, the presence of a special law on EFP as such is not a prerequisite for an effective regulation, i.e., regulations may be contained in different laws. **Fiscal incentives**, on the other hand, embrace not just tax incentives but also measures such as subsidies for training or consulting on EFP, authorisation to use public unemployment benefits to set up a worker-owned company (and thus become a shareholder) or reduction of registration fees.

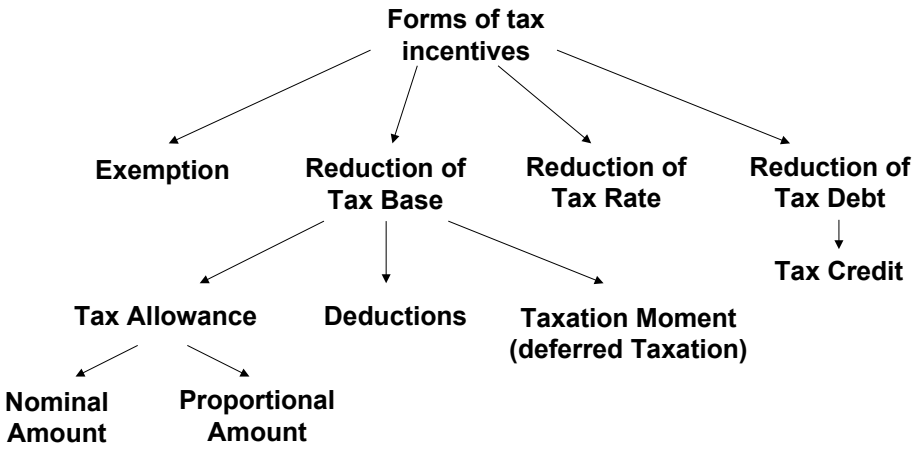
In spite of the difficulty of implementation at the European level—due to the exclusive jurisdiction of national legislation over tax law—, tax incentives remain powerful tools for enhancing and broadening financial participation. At the national level, taxation can either inhibit or support the spread of employee financial participation. At the EU level, cross-border migration of employees partaking in financial participation plans, as well as the transfer of such plans by multinational companies to subsidiaries in different Member States, involves problems caused by conflicting tax regimes. Generally, attention is centred on tax incentives, often considered the State's main instrument for promoting employee financial participation. Tax incentives, however, are relative; they need to be analysed in the context of the general taxation system in the given country. National tax systems are not easily compared; it is even more difficult to compare taxation laws governing national financial participation schemes. Moreover, compulsory social security contributions must be taken into account since they add substantially to the overall burden of state levies, especially on labour; also, in many countries, they influence the tax base of the main income taxes. A systematic overview of the situation in the EU-27 (see Annex 2) shows, on the one hand, the impact and, on the other hand, the limits of tax incentives in encouraging employee financial participation.

Specific tax incentives for EFP have been in effect until 31 December 2011 in 16 (mainly Western) countries out of the 27 Member States; these differ substantially in type and size. The effectiveness of tax regimes for employee financial participation in each EU Member State are presented in the section "Overall classification of EU Member States" (see below 4.3., Table 3). As tax incentives are the most complex form of incentives this chapter starts with a systematic overview before discussing the success rating of all the different measures investigated.

4.1.1. Systematic overview of tax incentives[46]

Aside from specific tax incentives (see Table 5 in Annex 2), most national taxation systems are more or less favourable to EFP. The only tax system, which actually hinders the development of financial participation, is that of Estonia, due to taxation of distributed profits at company level instead of general corporate income tax. National taxation systems, which exempt dividends and capital gains from taxation and social security contributions, are especially advantageous to share-based schemes. Although details differ, generally in most countries the same taxes apply to similar plans so that the important difference is the general level of the tax burden of standard income taxes and compulsory social security contributions determined by tax rates and tax bases. A substantial difference in tax rates implies differences in tax burden across countries. Thus, it is sometimes argued that low-tax countries generally have more favourable tax regimes for EFP, which makes specific tax incentives unnecessary. The example of Ireland, however, shows that the government of a low-tax country can have a focussed political interest in promoting EFP; it can offer additional tax incentives even though the low level of general taxation limits their impact. Therefore, the different instruments used to create specific tax incentives are important. Incentives may take the different forms shown in Figure 10.

Figure 10: Forms of tax incentives



Source: Lowitzsch and Spitsa, 2008, p. 85.

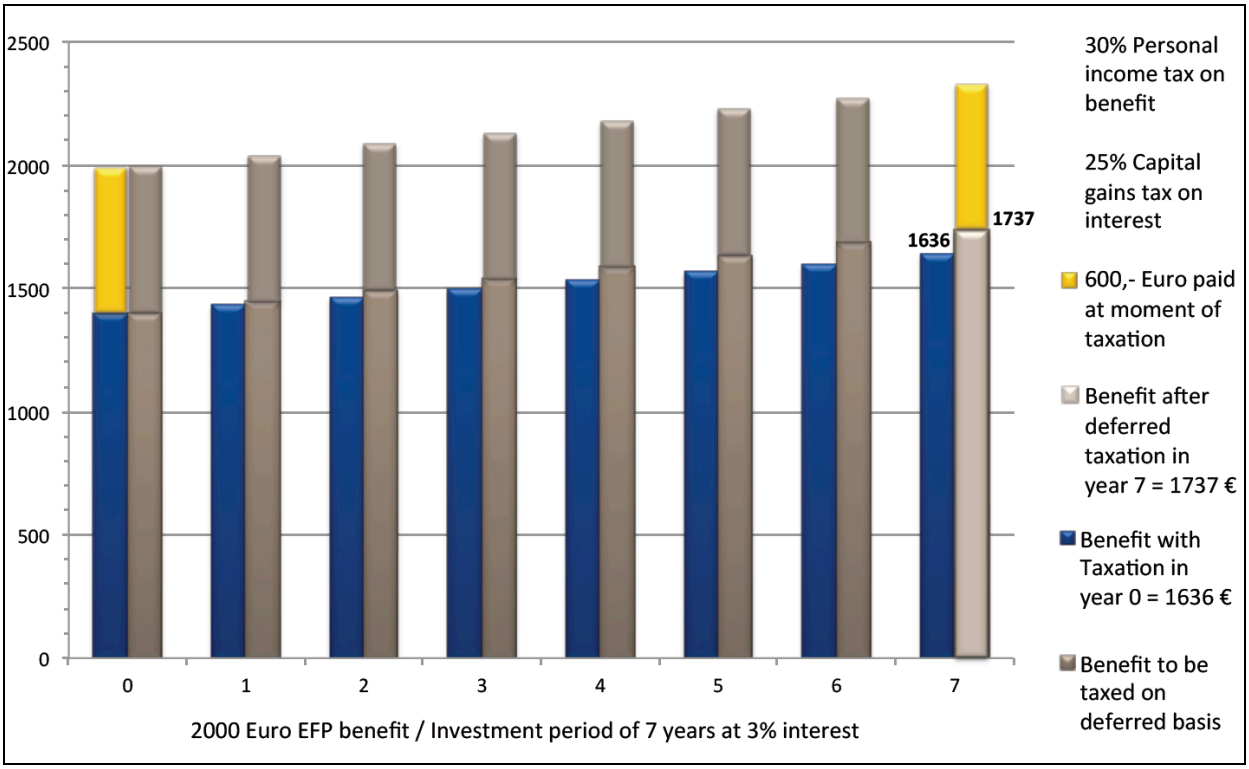
Tax rate reductions and exemptions—although most effective, because they are based on law rather than arbitrary judgments of tax authorities and confer the same advantages to all categories of income—are seldom utilised. One reason for this neglect is that such tax incentives result in heavier losses of revenue; also tax authorities have virtually no discretionary power over their use. **Deductions** favour higher incomes under a progressive system of taxation, like the personal income tax in most EU Member States; **tax credits** (direct reduction of tax liability), on the other hand, are non-discriminatory and usually more valuable than an equivalent tax deduction or tax allowance. **Tax-free allowances** benefit lower incomes whereas **nominal tax allowances** benefit the taxpayer less and therefore involve smaller revenue loss than would a proportional determination of the tax allowance. **Deferred taxation** favours share ownership schemes avoiding otherwise necessary additional liquidity at the moment of acquisition.

[46] See Lowitzsch and Spitsa, 2008, p. 85.

4.1.2. Effects of deferred taxation

The introduction of deferred taxation is the least complicated measure across the EU as this mechanism is common to all systems and does not conflict with other tax incentives in place. On the other hand, the absence of deferred taxation is an important obstacle especially to employee share schemes as employees acquiring shares free, discounted or at market price then need to have sufficient cash to pay income tax at the moment of the transfer of the share. Especially in the lower income stratum this hinders them to participate in share schemes as—given the typical blocking periods of these schemes—employees usually cannot sell the shares at once to pay the taxes but have to use their relatively low income. At the same time, they incur the risk of a depreciation of the value of the shares acquired during the holding period. In the worse case they pay taxes on an EFP benefit that at the moment of liquidation (sale of share) lost a large part of its value. Figure 11 illustrates the **additional benefit of deferred taxation for employees** resulting from the higher volume of investment over time (5 per cent increase in seven years).

Figure 11: Sample calculation illustrating the effects of deferred taxation



Source: Calculated by Lowitzsch and Glowienka.

4.2. Methodological approach to success rating

In order to define best practice principles and obstacles to the development of EFP in the EU and formulate policy recommendations for further promotion at the EU level, the EU Member States are classified measuring the degree to which they facilitate or promote EFP (success rating). The analysis here is based on objective criteria applicable to all EU Member States and measured with the following three indicators relating to the distinction of supportive measures as laid down in the introduction to this chapter: (i) legal framework, (ii) fiscal incentives, and (iii) political acceptance and inclusion in social dialogue. For each indicator a ranking on a Likert scale, ranging from 1-3 or 1-4 has been assigned. This

means that one can observe whether a Member State's score is lower or higher than the score of others (for the details of the indicators see Annex 3.1.).

For the **legal framework**, the presence or absence of specific regulations has been used as the basis for distinguishing conducive and non-conducive legal arrangements. Regulations may be contained in a special law on EFP or in different laws. It is deemed effective in our classification if it is systematic, i.e., the provisions of different laws are co-ordinated. A detailed overview of the legislation in the EU-27 is provided in Annex 1, Table 4. For the discussion, see above 2.2.3.

The indicator, which is generally quantitative, is related to **fiscal incentives**. The term "fiscal incentives" refers to not just tax incentives but all kinds of subsidies, e.g., sponsoring of training and consulting or the reduction of registration fees. A detailed overview of fiscal incentives where available is given in Annex 2, Table 5. The taxation systems of all EU-27 are summarised in Annex 3.3., Table 6. This information on general taxation, social security contributions and specific tax incentives relevant for different EFP schemes have been used to calculate **effective rates** for different taxes, personal status and situations. This is necessary to quantify tax incentives and allow for a precise and representative comparison of tax systems as well as of specific tax incentives. The steps undertaken were to:

- identify personal situations of employees for whom effective taxes and social security contributions are calculated;
- identify the EFP schemes for which effective rates are calculated;
- calculate the actual amount of taxes and social security contributions in different phases of taxation on the value of the benefit paid to the employee (the value of employee share or the share of profits);
- calculate the effective tax burden on the value of the benefit paid to the employee.

Following this procedure, the effective tax and social security burden for employees on a standard amount of benefits in a standardised scenario can be compared for different Member States.[47] The details of the assumptions and the method of calculation are described in Annex 3.2. The overview of the EU-27 is provided in Annex 3.4., Figure 15.

The **attitude of social partners, political parties and governments** is a classic soft indicator. For the success rating, negative, neutral and positive attitudes are distinguished and appropriate ranking assigned. Again Annex 1, Table 4 provides an updated detailed overview across the EU-27, for the discussion see above 2.2.4.

By comparing this success rating with the ECS 2009 data concerning the proportion of companies offering EFP schemes in a country, the presence of any relationship between the incidence of these schemes and the measures introduced by governments can be investigated. Using the ECS data, which is the only data source that includes companies employing more than ten employees (unlike CRANET, which covers companies employing more than 200 employees), we also capture the SME sector, which is of particular interest to this study. The available data, of course, only allows a comparison of current policies with the incidence of EFP schemes in 2009 (the year of the ECS survey). While many measures would have been in place for a longer time, future research should further elaborate this relationship. Although a correlation between the two may show a potential relationship, any causal links need to be explored on the basis of further evidence.

[47] The effective tax burden on the income of the company is complex and depends on the total income of the firm, which can vary considerably and—in Member States with specific tax incentives for EFP schemes—also on the number of employees in the plan, which is also variable. Therefore, it was not included in the study.

4.3. Overall classification of Member States in clusters

It is possible to develop the overall rating of EFP measures in each country by adding up the individual ranking on the three indicators and obtain an overall ranking for each country. The overall ranking varies from zero to ten; the results are presented in the form of a table (Table 3).[48] The final score for each country in the columns "Results" and "Individual results PS/ESO" are calculated by adding up the rankings in the indicator columns. The colours in indicator columns correspond to the level of support (red-passive, blue-low, green-high).

Table 3: Classification of EU Member States based on supportive measures for EFP

EU Member States	Legal framework		Fiscal incentives		Political support, social dialogue		Rating results	
EFP schemes	PS	ESO	PS	ESO	PS	ESO	PS	ESO
Belgium	2		2		1		5	
Bulgaria	0		0		0	1	0	1
Czech Republic	1		0	1	0		1	2
Denmark*	1	2	2	4	0	2	3	**8**
Germany	0	2	0	1	0	1	0	4
Estonia	0	1	0	-1	0		0	0
Ireland	2		3		3		**8**	
Greece*	0	1	2		0	1	2	4
Spain	1	2	0	3	0	2	1	7
France	3	2	4	3	3	2	**10**	7
Italy	2		1	2	2		5	6
Cyprus	0	1	0		0		0	1
Latvia	0	1	0	1	1		1	3
Lithuania	0	1	0	1	0		0	2
Luxembourg	0	1	0		0	1	0	2
Hungary	0	2	0	1	0	1	0	4
Malta	0	1	0	1	0	1	0	3
Netherlands*	2		3	4	2		7	**8**
Austria	0	2	0	3	2		2	7
Poland	0	2	0	2	0	2	0	6
Portugal	0	1	0		0	1	0	2
Romania	0	2	0	1	0	3	0	6
Slovenia	3		3		3		**9**	
Slovakia	0	1	0	1	1	0	1	2
Finland	3	1	3	1	3		**9**	5
Sweden	1	2	0	1	0		1	3
UK	1	3	1	4	0	3	2	**10**

Source: Own research. Note: * Denmark, Greece and the Netherlands abolished tax incentives starting January 2012. As the correlation with the incidence in 2009 is examined below, the changes are not included in the table.

[48] The underlying information summarised in an overview table in Annexes 1 and 2 stem from individual country profiles of each Member State, which are available online at http://www.intercentar.de/en/research/focus-financial-participation-of-employees/the-pepper-iv-report/.

The colours in the results columns correspond to the cluster. Differentiation between the level of support for employee share ownership and profit sharing is important, because the level of support for different forms of employee financial participation differs in most Member States, so that the incidence must correspond to the support for the particular form. According to the ranking of Member States in this classification, four clusters of countries may be identified. Clusters 1 and 2 comprise of the most successful EU Member States, whereas Clusters 3 and 4 comprise of less successful Member States.

Cluster 1 (overall ranking over 7): UK, France, Slovenia, Finland, Spain, and Ireland.

The Member States belonging to Cluster 1 have all introduced extensive support measures a relatively long time ago. National statistics and the data presented above (Figure 2 to Figure 5) show that the measures have led to a relatively high level of offer especially with regards to those schemes, which enjoyed specific support. A good example is employee ownership in the UK or profit sharing in Finland. In France, the level of offer is high both in profit sharing and employee ownership, although, strictly speaking, only profit sharing is linked to generous tax incentives; however, profit sharing is share-based in most cases.

Cluster 2 (overall ranking 5-7): Denmark, Netherlands, Italy, Austria, Poland, Romania, and Belgium.

The Member States in Cluster 2 are prominent in the different cross-country data sources or, at least, in the middle field of the corresponding diagrams (Figure 1 to Figure 5), with the exception of Italy and Austria. It can be explained by the fact that both countries—unlike e.g., Denmark and the Netherlands—have introduced the supportive measures quite recently, the acceptance among social partners is slowly growing with discussion at national level being recent, and the absolute numbers are still relatively low, although the increase is quite high.

Cluster 3 (overall ranking 2-4): Germany, Hungary, Sweden, Greece, Lithuania, Malta, Portugal, Latvia, Czech Republic and Slovakia.

Cluster 4 (overall ranking 1 or less): Bulgaria, Cyprus and Estonia.

The countries from Clusters 3 and 4 generally are ranking low on the corresponding diagrams (Figure 1 to Figure 5).

4.4. Comparison of the country clusters with the ECS 2009 cross-country data on the offer of EFP schemes

It should be stressed, however, that the notion of "success" measured with the three criteria used above reflects only a selection of the different factors that influence incidence of these schemes. Especially with regards to the impact of the different size of enterprises, the results have to be treated with caution. To illustrate this effect, the relationship between the ranking for individual countries and the offer of EFP (share ownership or profit sharing) according to the ECS (2009) dataset is looked upon using scatter diagrams; this database is chosen as it covers enterprises with more than ten employees, with about half of the companies in the sample being small firms with less than 50 employees.[49]

[49] In the ECS data, for profit sharing, the number of observations is 18,777, of which 10,475 are small-size companies, 5,274 are medium-size companies and 3,028 are large-size companies. For employee share schemes, the number of observations is 17,869 (as Portugal was excluded here), of which 9,954 are small-size companies, 5,003 are medium-size companies and 2,912 are large-size companies.

4.4.1. Limiting factors

Before discussing the relationship between the ranking and the ECS offer, a number of limitations to the observations should be noted. In particular, the **dynamics of the changes in legislation on EFP over time should be taken into account**, i.e.:

- Whether measures shown in the table have been enacted recently or a relatively long time ago.

The first supportive measures usually lead to the spread of financial participation plans only after a certain period of time, which is needed for spreading information on EFP and supportive measures and the gradual acceptance of EFP by the owners and managers of most enterprises. This period of time can be reduced by an information campaign, including sharing of best practice, also from other EU Member States. Once the measures are widely known and accepted, EFP develops its own dynamics and grows steadily over time as the examples of countries from Cluster 1 illustrate (see also Figure 1 to Figure 5 above).

- Whether the offer of EFP by companies in Central and Eastern European countries has its roots in previous developments, e.g., privatisation.

In all Central and Eastern European countries, mass privatisation, together with supportive measures for employees, took place during the early transition period, which resulted in some degree of employee ownership.[50] After this period, employee share ownership has not been supported in most of these countries. Thus, the level of employee share ownership does not reflect the current level of support, but is a remnant of the previous privatisation process. As far as dynamics are concerned, it should be noted that without additional supportive measures the level of the remaining employee share ownership has decreased over time and is still declining.[51] On the other hand, supportive measures after privatisation, as in Slovenia, led to a relatively high level of employee share ownership.

4.4.2. Relation between countries' classification and the offer of EFP

The results are presented below in the form of separate scatter diagrams for employee ownership and profit sharing in Figure 12 and Figure 13. The units of measure for employee share ownership and profit sharing are the percentage of companies offering such schemes to their employees (the incidence of EFP). Generally, countries with a long tradition of promoting EFP, such as the UK, France, Ireland, and Slovenia, have a high level of offer of approved schemes. The vertical axis in both diagrams shows the overall ranking of countries in the three measures discussed earlier with the rankings indicated in Table 3.

Employee share ownership

Figure 13 shows that in countries and clusters with better overall environment, firms are generally more active in offering EFP schemes to employees. In particular, Cluster 1 (with the exception of Spain and Finland) and Cluster 2 (with the exception of Italy, Austria and the Netherlands) have the highest incidence of EFP. **France** is prominent in profit sharing and in share ownership, given that profit sharing is generally share-based and—at the same time—the incentive system promotes both types of schemes.

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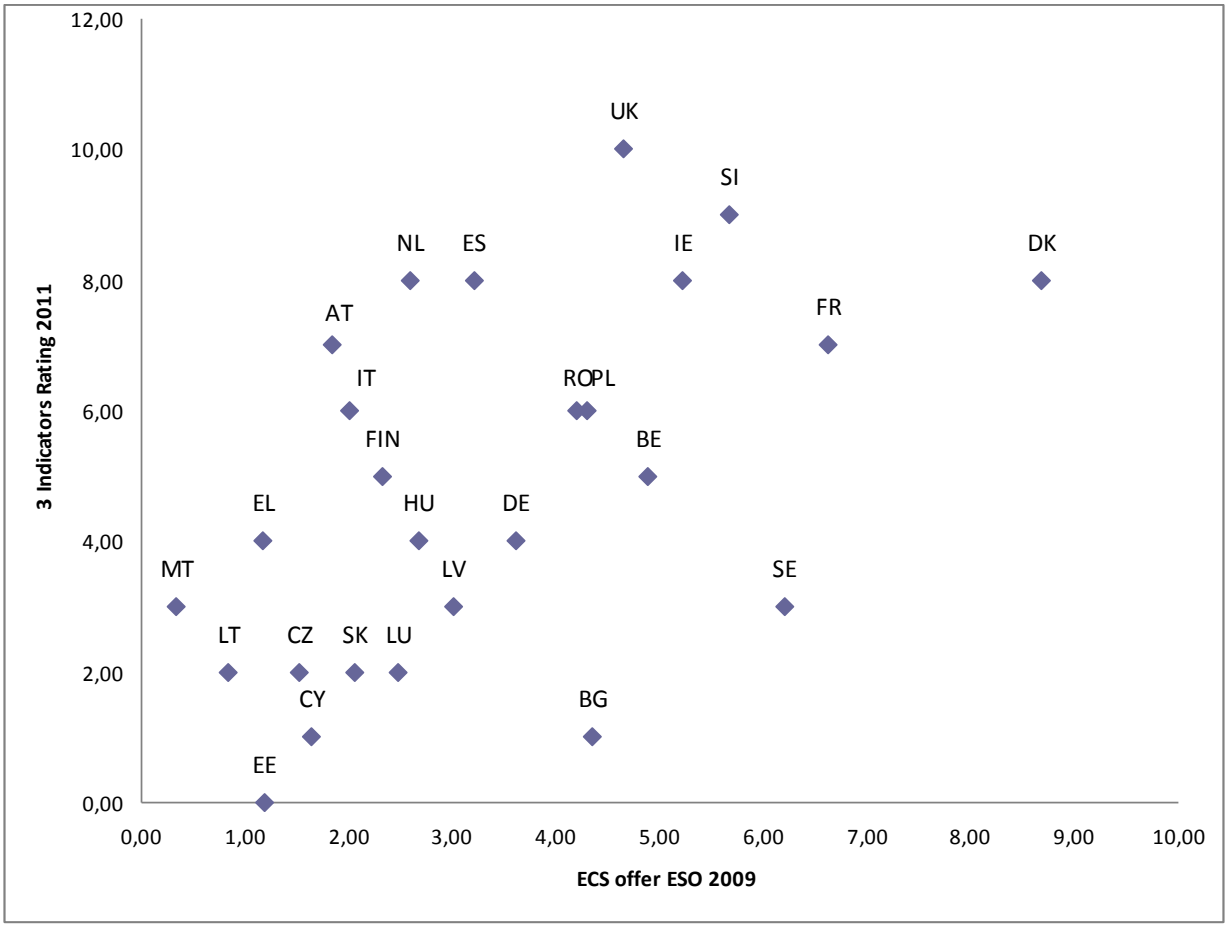
[50] In some countries, the level of employee ownership at the first stage of privatisation was exceptionally high, as in Lithuania where employees owned the majority of shares in 92 per cent of enterprises in 1994/1995 (Lithuanian Ministry of Economics).

[51] Referring again to the example of Lithuania, the number of companies with employee ownership plans has shrunk to 4 per cent in 2007. Whereas in the first phase of transition, capital constraint for restructuring and the low level of wages usually inhibited the development of employee financial participation, at a later stage lack of institutional and legal support led to a steep decline (Mygind, 2012, pp. 1614).

In **Austria,**—although belonging to Cluster 2—EFP is strongly size-related (see Figure 7 above), which explains the relatively low level both of share ownership and profit sharing in the ECS sample with half of the companies being small. The same applies to **Italy**, however, for a different reason. Here, the promotion of EFP was introduced quite recently with a vivid public discussion only in 2009 and is not yet well known and accepted by many enterprises. However, the increase of EFP is significant in both cases, even though the absolute numbers are still low.

Figure 12: Classification vs. ECS offer broad-based ESO in 2009



Source: Own research.

The incidence of EFP is higher than expected in Sweden and Bulgaria. The **UK** does not have the highest level of offer in employee share ownership, although it has the highest ranking based on support measures. This is perhaps because not all types of approved employee share ownership plans (probably only the Share Incentive Plans—SIP) were included in the ECS survey. The share ownership plan EMI, with the highest growth rate in the UK, has been developed especially for small (start-up) enterprises with few employees and is not properly reflected. In **Finland**, the funds accumulated on individual employee's accounts of personnel funds are considered as profit-sharing schemes, although they can be also used for buying shares. **Spain** shows a low incidence despite a high level of support, since the micro-enterprises (Sociedades Laborales having an average size of 4.5 employees), which are mainly addressed by the supportive measures, are largely excluded from the data on offer of EFP. **Sweden** has few supportive measures, but a long tradition of EFP since 1962.

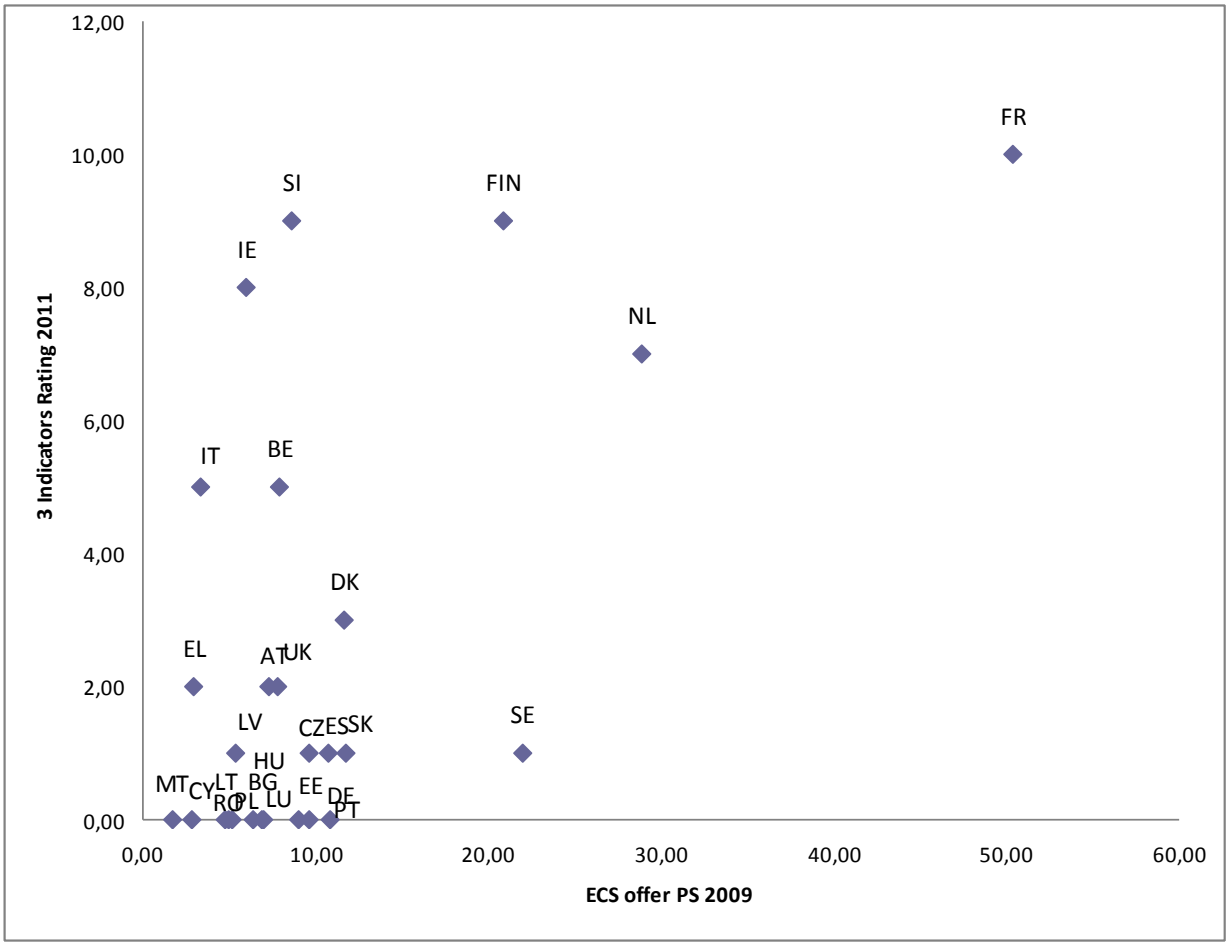
The legislation on Profit-Sharing Foundations, though dating from 1967, is still in force and employee shares can still be acquired through Profit-Sharing Foundations. **Bulgaria** seems to have a residual employee share ownership from the privatisation process, as Bulgarian companies today offer only few share ownership plans

In the cases of **Austria** and the **Netherlands**, a comparison with the national statistics clearly shows that the incidence is actually much higher. In the Netherlands, the low incidence on the basis of ECS data is probably due to a plan definition problem, since the incidence of profit sharing in the Netherlands according to ECS is much higher than according to national statistics (30 vs. 7 per cent). The Dutch plans are savings plans, which can apparently be interpreted as either share ownership or profit sharing. In the case of Austria, the reason for the deviation is not clear. According to national statistics, the incidence of share ownership in Austria amounts to 8 per cent.

Profit sharing

The corresponding figure for profit sharing, Figure 13, shows the proportion of firms offering profit-sharing schemes vs. the overall ranking of the supportive measure on different clusters.

Figure 13: Classification vs. ECS offer broad-based PS in 2009



Source: Own research.

In the profit-sharing diagram, to a limited extent, Cluster 1—with the exception of the UK, Ireland and Slovenia supporting only share ownership or share-based plans—and partly Cluster 2 (Denmark and the Netherlands) correspond to the overall ranking of different countries. In this case, a general explication for the missing correlation has to be considered. Profit sharing is less costly to implement and—among others for this very reason, as it seems—less size-related (see Figure 7 above) than employee share ownership. Consequently, as we see from the classification of countries in Table 3, profit-sharing schemes enjoy fewer support measures across the EU than share ownership schemes.

Of course there are also individual reasons. The **UK**—although prominent in share ownership—has a low level of offer in profit sharing, since HRM approved schemes in the UK are share ownership plans. **Hungarian** authorities and research institutions collect detailed and differentiated statistics[52] on the issue, which deliver an explanation for the high level of profit sharing in Hungary in the ECS data. The reason is the unlimited definition of profit sharing used in the ECS research. According to the ECS data, 13 per cent of Hungarian firms have profit-sharing plans, but national statistics show that only 7 per cent of these plans are pre-defined and linked to enterprise profit, thus are genuine profit-sharing plans.

4.4.3. Interpretation of the results

As one can see, the two diagrams convey different messages. The diagram on employee share ownership displays some degree of correlation, showing that countries with high value of one variable mostly have high value of the other variable, indicating that countries with high offer do have high ranking, too. The diagram on profit sharing, on the other hand, does not show any correlation, meaning that countries with high offer do not have high ranking, too (most of them have low ranking on the composite index).

This is consistent with the experience in many EU Member States, showing that profit sharing is less dependent on supportive measures than employee share ownership, and is often introduced without them.

For employee share ownership—especially in smaller companies, as the incidence is strongly size-related (see Figure 5 above)—the opposite is true: Only when supportive measures are in place for a long period of time without substantial changes, the employee share ownership is likely to be sustainable.

[52] Only in few EU Member States, special statistics on different forms of employee financial participation are collected by state authorities. Usually, only statistics on the volume of tax incentives are collected by the finance ministries or other tax authorities. Even if national statistics are available, they are often not comparable with the data from international surveys, because different criteria are used. However, some national statistics can help explain the unusual ECS data.

4.5. Conclusions

From the composition of the four clusters and the discussion of the importance of the two main categories of measures in place—i.e., legal framework and fiscal incentives—some general principles may be derived:

4.5.1. General principles

Establishing EFP schemes through legislation is of primary importance. Schemes approved through legislation give companies a distinct legal framework and provide them with a clear framework for company decisions and actions.

At the same time, establishing a legal framework delineates what is possible for companies without inviting sanctions from regulatory, legal or taxation authorities.

Fiscal incentives are not a prerequisite to financial participation. Financial participation schemes without tax incentives (e.g., profit-sharing plans in Austria and Germany) sometimes have a higher incidence than those with tax incentives (e.g., share ownership plans in Austria and Germany).[53] Therefore, tax incentives as such are not to be considered a prerequisite to the development of financial participation.

When properly designed, fiscal incentives promote the spread of EFP. Countries with a long tradition of tax incentives for EFP (e.g., UK, France)[54] confirm this point, but so do countries where tax incentives are quite recent, e.g., Austria,[55] where a substantial increase has been observed, even though total numbers are still relatively low.

4.5.2. Best practice with regards to fiscal incentives

From best practice examples it can further be derived that to be effective, tax incentives have to fulfil the following conditions:

First, tax incentives should (and in most countries they actually do) target those taxes, which constitute the heaviest burden in the national taxation system. Usually – with the exception of countries with flat tax systems, which at present do not offer specific tax incentives – these are the progressive personal income tax and social security. Many countries therefore provide:

- exemptions from social security contributions for certain plans (e.g., France, Belgium, UK, Ireland, Finland);

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[53] In Austria, only 8 per cent of enterprises and 6 per cent of the workforce participated in employee share ownership plans in 2005, tax incentives for which were introduced in 2001, whereas 25 per cent of enterprises operated profit-sharing plans without tax incentives. In Germany, 2.4 per cent of enterprises had an employee share ownership plan in 2001, supported by (marginal) tax incentives, whereas at the same time 8.7 per cent of enterprises operated profit-sharing plans without tax incentives (Würz, 2003, p. 59).

[54] In France, legislation on voluntary employee financial participation without tax incentives of 1959 and even legislation on compulsory employee financial participation without tax incentives of 1967 did not lead to a significant number of plans in operation. Only in 1986 when the first tax incentives were introduced, the number of plans increased rapidly; this upward tendency has been supported by the introduction of new tax incentives (Würz, 2003, p. 39). In the UK, although profit sharing has existed since the 19th century and share ownership since the early 1950s, the number of plans remained small until the first tax incentives were introduced in 1978. Since then, the system of tax incentives and economic efficiency of incentives and plans are regularly reviewed by the Government, and the number of plans is steadily increasing, especially Revenue Approved Plans (Würz, 2003, p. 130); http://www.ifsproshare.org, accessed 20 July 2007).

[55] In Austria, only 8 per cent of employee financial participation plans were implemented before first tax incentives were introduced in 1993, while 45 per cent of plans were introduced in four years after more substantial tax incentives became effective in 2001 (Würz, 2003).

- imposing a capital gains tax (e.g., UK) in lieu of personal income tax;
- imposing a special low tax (e.g., France) in lieu of personal income tax; and
- tax allowances for personal income tax (e.g., Austria, Finland, Ireland).

Second, tax incentives should be provided for both employees and the employer company, inasmuch as participation is voluntary for both parties in all EU Member States except France. However, this requirement is relative: in most countries the employer company has already been granted tax incentives in the form of deductions under general taxation law and only tax incentives for taxes involving the cost of shares and stock options are needed. In most countries, the only important incentive for the employer company is the exemption from social security contributions; this has actually been introduced in many countries (e.g., France, Ireland, Finland, Belgium). The employee is usually more in need of direct incentives as the heaviest burden of progressive taxes falls on him or her.

Third, even substantial tax incentives may prove inefficient when the pre-conditions for eligibility are too restrictive, complex or inflexible. This is the case in Greece for cash-based profit sharing and in Germany and Belgium for all types of schemes. The inflexibility problem can be solved, as in Ireland and the UK, by allowing the employer company to choose between the less flexible approved schemes combined with substantial tax incentives and more flexible unapproved schemes combined with minor tax incentives. Another interesting approach was presented in the EC Report on Stock Options (Stock Options 2003): since direct taxes cannot be harmonised under the EU Treaty, it might be reasonable to harmonise the pre-conditions for the application of tax incentives. National legislators should be authorised to introduce additional national plans and to decide on the size and form of tax incentives for these as well as for those plans encompassing all of Europe. Harmonisation can only be accomplished if the existing pre-conditions in different EU Member States are at least comparable for all types of EFP schemes, as is apparently the case for stock options.[56]

Fourth, some forms of tax incentives are more favourable for certain types of plans and also lead to higher efficiency:

- For share ownership and stock options, as far as benefit taxation is concerned: deferred taxation (often linked to holding period) combined with generous valuation rules, and, if possible, exemption from social security contributions for both the employer company and the employee.
- For dividends and sale of shares: a special tax rate or capital gains tax in lieu of personal income tax and, if necessary, exemption from social security contributions.
- For ESOPs and intermediary entities: exemptions from income tax on share acquisition[57] or on share sale if the profit is realised after a holding period or within a retirement programme; the company may qualify for tax relief on both interest and principal payments on the loan; sale of stock to an ESOP on a tax-deferred basis if the proceeds of the sale are re-invested in securities of other domestic corporations (tax-free rollover).
- For profit sharing: a special tax rate in lieu of the progressive personal income tax as well as exemption from social security contributions for both the employer company and the employee.

[56] See Lowitzsch and Spitsa, 2008, pp. 75.
[57] In Ireland, this is the case only where the ESOP comprises an ESOT working in tandem with an Approved Profit-Sharing Scheme (APSS).

However, all forms of tax incentives lead to revenue losses. Therefore, efficiency should be weighed against the revenue requirements of each country independently. Should a government wish to introduce specific tax incentives, it might well begin with "soft" tax incentives, which do not cause substantial revenue losses, e.g., tax allowances defined by nominal amount (as in Austria). Later, depending on revenue needs and the political climate, it may proceed to more effective measures: tax allowance as a proportional amount, deductions, tax credits, introduction of special low tax rates, and—finally—full exemption from taxation.

Fifth, in spite of the difficulty of their implementation at the European level (because of the exclusive jurisdiction of national legislation over tax laws), tax incentives remain powerful tools for enhancing and broadening financial participation. This is especially true when they remain optional for the Member States and not subject to a unanimous vote of approval. Countries could voluntarily offer tax incentives singly or in groups.

Such a step would create an increasingly favourable environment in which countries having an advanced tradition, such as France or the United Kingdom, would encourage emulation. Optional preferential treatment—as part of the Building Block Approach—requires distinguishing between profit-sharing schemes, share ownership schemes and Employee Stock Ownership Plans.

4.6. Potential measures to encourage EFP in SMEs specifically

The costs of designing and implementing a financial participation scheme are disproportionately high for SMEs. To these must be added the on-going costs for administration, legal services and employee communication.[58] Generally speaking,—unless a company is medium-sized—without any support these costs may outweigh possible tax advantages for small companies.[59] Therefore, support measures going beyond tax incentives, e.g., advice in administrating EFP schemes, independent counselling, business incubators or EFP lobby groups and associations are essential if SMEs are to adopt EFP plans. The role of EFP schemes in providing a solution to the succession problem in SMEs has already been discussed (see 3.2.2.). For smaller firms, access to information and advice as well as to financing can have a much greater significance than for larger firms. The following examples illustrate some of the support measures specifically tailored to the needs of SMEs.

4.6.1. Alleviating the evaluation problem through debt-to-equity-swaps

The valuation of the shares prior to the acquisition by employees may create unreasonable costs particularly in a small firm (see also 3.3.5. above). This problem is exacerbated when the valuation is repeatedly necessary for different share acquisitions not occurring simultaneously. To defer the valuation problem in unlisted SMEs, capital participation may initially take the form of an employee loan to the company, creating corporate debt (external capital), subsequently to be converted into company shares.[60] Valuation of the shares designated for acquisition through the loan can be postponed until the moment of the actual conversion into shares (debt-to-equity) without impeding the implementation of the scheme. However, these considerations—although providing a relatively simple solution to the evaluation problem—require specific expertise and advice, which in turn may be expensive. Here, a government-funded information platform or an independent organisation financed under a support programme dedicated to EFP in SMEs can be very useful.

4.6.2. Meeting the potential repurchase obligation for shares of departing plan participants

Leveraged employee share ownership, as in the case of ESOPs, involves an additional element of risk. Whereas profit-sharing plans represent a variable financial burden, leveraged schemes require fixed loan amortisation payments regardless of the company's financial performance—a condition similar to taking on debt. In fact, such loans are treated as a liability if the company guarantees the loan or commits to future contributions to service it. Thus, if a company is not growing or becomes unprofitable, the repayment obligation can threaten its ability to survive. Furthermore, closely held companies may be obliged to purchase the shares of departing plan participants because of the absence of a public market for their stock.[61] In such a case, the repurchase liability in a successful company generally

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[58] For a medium-sized U.S. ESOP company, the installation costs are about USD 40,000 with the annual administration costs, including appraisal, ranging to about USD 15,000. For smaller firms the on-going annual appraisals cost around USD 5,000. Information provided by Menke & Associates, Inc., San Francisco, CA.

[59] See Poutsma and Tillart (1996); however, set-up expenses are usually tax deductible as, e.g., in Ireland. See Shanahan and Hennessy (1998), p. 33.

[60] See the Annex of the Committee on Employment and Social Affairs Report on the Commission communication "on a framework for the promotion of employee financial participation", COM(2002)364, 2002/2243(INI); "Models for Employee Participation in SMEs", PE 316.420.

[61] This depends whether local company law, as in the U.S. for ESOPs, or bylaws of the company requires this. In contrast for Irish ESOPs, departing employees have no right to be bought out at market value.

increases over time as the appraised value of the company's stock rises, although it does not usually increase as a percentage of the company's free cash flow.

If a company does not plan adequately to meet this liability, it may be forced to make a public offering of its stock to eliminate the repurchase obligation—an expedient, which is not only very expensive, but also involves a loss of control and independence, and the loss of opportunity to future employees.[62] A better alternative is the creation of a "sinking fund", although in small companies it may be difficult to develop accurate actuarial assumptions.[63] Where a relatively large portion of the repurchase liability is attributed to a few plan participants, the use of life insurance contracts may be appropriate (Bye, 2002). Here again, expertise and know-how—often not available to SMEs at affordable cost—is needed and can be offered as a support measure specifically targeting small firms.

4.6.3. Boosting SME lending to finance business successions in SMEs

When the owner of an SME wants to retire and exit from the business, he generally has three alternatives. He can sell the business to an outsider (a strategic buyer, e.g., a competitor), to his key employees (a management buyout), or to his staff through the mechanism of an Employee Stock Ownership Plan (ESOP) or a similar scheme, see above 3.2.2. When he sells to a strategic buyer, financing for the transaction will be provided from cash previously accumulated by the buyer and from loans provided by the buyer's existing lenders. The sale of a business to a few key employees usually is leveraged, as most management buyouts are in fact buyouts that are financed by private equity groups.[64] The employee buyout, on the other hand, often faces great difficulties to finance the transaction.

Here, a public bank such as the European Investment Bank (EIB) could step in focussing its efforts more on providing senior and/or mezzanine capital for the transmission (buyout) of established mature companies.[65] Providing loans to established mature companies is by definition less risky than for example providing loans for start-ups and newer SMEs. Further, providing loans for the transmission of established mature companies would enable the EIB to invest larger sums of money. As this field of business is not well developed in Europe, yet, the EIB will have little or no competition from regular commercial banks for this type of financing. As the experience from the U.S.—where this type of lending has become part of the texture of corporate America—shows, loans made for ESOP buyouts have a much lower default rate than is the case with other types of loans.[66] A related SME loan facility could be embedded, for example in the EIB's JEREMY[67] programme.

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[62] Thus, the ESOP transaction should be modelled in advance to ascertain that the company can afford this amount of "dividend". Otherwise, there should be a limit on how large a percentage of the company's total stock may be acquired by the ESOP. A growing company may require almost all of its free cash flow to fund future growth, but a company growing this fast may well want to go public.

[63] For U.S. ESOPs, see Ackermann (2002).

[64] In practice, the private equity group provides all or most of the equity and retains all of the control. If the company is successful, management will be granted 15 to 20 per cent of the equity based upon the attainment of performance objectives. If the company is not successful, management will wind up with little or no equity.

[65] The EIB was asked to boost SME lending at the request of ECOFIN following the Nice meeting on September 12-13, 2008 and a 2007/08 EIB consultation calls for modernising its products, among them, with regard to loans financing business succession of SMEs.

[66] For case studies, see Menke and Hanisch (2008).

[67] JEREMY is the acronym for Joint European Resources for Micro to Medium Enterprises;

5. SIGNIFICANCE OF THE NATIONAL BEST PRACTICE FOR THE FURTHER DEVELOPMENT OF EFP AT THE EU LEVEL

KEY FINDINGS

Employee financial participation needs sustainable policy support to realise its potential:

- All best practice cases show that **a stable legal framework for EFP** induces individual firms to offer these schemes. This is particularly true for share schemes, as they require a more complex setting. By contrast, the experience of Lithuania and Hungary clearly shows that discontinuation of policy support leads to a rapid decline of employee share ownership.
- **Tax incentives** are not a pre-requisite but are an effective instrument of support for EFP if properly designed and maintained. Case studies from France and the UK, where tax incentives were introduced more than 30 years ago, but also the case for Austria, illustrate that progress of EFP schemes towards their goals (here transfer of ownership) accelerated by substantial tax incentives already in place.

There is a **trend towards using intermediary entities** as a vehicle for share transfer in employee share ownership plans (ESOP schemes) because they limit risk of investment for employee shareholders, allow to implement leveraged investment and to pool voting rights after the shares are acquired. They tackle problems characteristic of SMEs:

- **Business succession problems** (but also additional financing needs) can be solved through ESOP schemes. The cases from the UK and France exemplify how business succession in SMEs may be expedited by creating a market for shares of unlisted companies through an intermediary vehicle.
- Further, ESOP schemes can help to **retain highly qualified personnel**, a key problem for SMEs because of limited ability to increase salaries. Employee ownership schemes may also provide additional financing, especially at times when access to external funding sources is difficult.

EFP as it is linked to policy areas as labour market policy as well as economic, structural, and regional policy, is directly relevant to **the Europe 2020 strategy**:

- If facilitated by well-formulated support measures EFP can support productivity and growth as well as strategic stabilisation of ownership of productive enterprise.
- Share ownership plans combined with **labour market measures** revitalise employment. In Spain, unemployment benefits paid out as a lump sum may be invested in a start-up or in an existing employee owned company. These government-assisted start-ups (totaling 13,465 and employing 74,438 individuals at the end of 2011) are an important part of development policy.

Cross-border transferability especially of share ownership schemes is still limited due to lack of a common legal framework.

- Although EFP schemes from different EU Member States have certain characteristics in common, their transferability is **impeded by specific national legislation**.
- Companies in Austria and France reported that transferring their EFP schemes from the parent company to subsidiaries in other EU Member States was very difficult and prohibitively costly. Consequently, **employees in the same firm are subject to unequal treatment** where their opportunity for financial participation is concerned.

Throughout the EU, the level and forms of employee financial participation differ considerably. In order to find common features and specific elements of national systems identified as best practice eight case studies were conducted.

5.1. Introduction and relevance for the Europe 2020 strategy

The case studies selected and conducted according to pre-defined criteria are relevant in so far as they help to determine principles of and instruments for best practice for a future European framework on EFP, and to identify obstacles to the spread of best practice. EFP as an issue linked to such policy areas as macroeconomic, microeconomic, labour market and regional policy is directly relevant for the Europe 2020 strategy. On the macroeconomic level, EFP supports productivity and growth as well as strategic stabilisation of ownership. On the microeconomic level, it can contribute to solve the problem of business succession and funding, especially in SMEs and micro-enterprises. On the regional level, EFP is a factor contributing to companies remaining rooted in the community, discouraging outsourcing and hostile takeovers while enhancing the purchasing power of employee households. As far as the labour market policy is concerned, EFP may help to stabilise existing employment, especially in times of crisis, and to create new opportunities for the unemployed (see case study Sociedades Laborales, Spain, Annex 6.1.).

Thus, especially taking into account the potential benefits described in Chapter 3, EFP can help to expand the single market by stimulating economic growth and stabilising employment. However, at the same time, EFP also needs a single market in order to achieve these goals, as firms operate across borders and consequently so do EFP schemes. In other words, as EFP is positively connected to the above policy areas, it is also confronted with the problems characteristic of these areas and addressed in the Europe 2020 strategy. There are bottlenecks for cross-border application of EFP schemes or for transferability of national schemes. Whereas employees of large multinational enterprises can at least partly benefit from transferable schemes, employees of SMEs with representations in other EU Member States, as a rule, have no access to such schemes due to complexity and costs of the transfer.

5.2. Individual case studies

Individual case studies demonstrate how, outside the general framework of national legislation, individual companies can creatively use opportunities for EFP, and which criteria determine the success or failure of EFP in different countries. Most individual cases—despite their differences—represent best practice. They indicate that given even a moderately supportive legal framework, companies can make a success of EFP. This success contributes to the overall economic success of the company.

5.2.1. EFP in small firms as labour market policy (Sociedades Laborales, Spain)

The only best practice case concerning micro-enterprises is the case of Sociedades Laborales from Spain. Although micro-enterprises play an important role in the economy of most other EU Member States, no supportive measures for EFP are implemented for them as yet. The Sociedades Laborales—as an example of a successful connection between the labour market policy and EFP—make them particularly interesting for other EU Member States. In other EU Member States, similar ideas, but not related to employee ownership—e.g., in Germany, the "Ich-AG" where unemployed received subsidies to create start-ups—, were not successful.

EFP in Spain largely takes the form of **Sociedades Laborales (Worker-Owned Companies)**. This concept is probably the only EFP scheme existing across the EU applying to small and smallest companies, which makes them of particular interest for this study. A Sociedad Laboral (SL) is a specific form of corporation in Spain, with no exact parallel in other developed countries. It is an inexpensive form of incorporation, majority-owned by its permanent employees: Permanent workers must own more than 50 per cent of company shares while no single owner may own more than one third (33 per cent) of the company's stock (except for public organisations, which may own up to 49 per cent). Unlike co-operatives, it is based on share ownership and is permitted to utilise non-employee capital. Providing stable employment for their worker-owners, who control the company's directive bodies, they may be founded as SLs, or conventional companies may convert to this form.

By the end of 2011, there were a total of 13,465 worker-owned companies providing 74,438 jobs and representing 3.8 per cent of Spain's private sector companies with more than two workers. Clearly, the preferred legal form is the Sociedad Limitada Laboral or SLL (Limited Liability Worker-Owned Company), employing an average of 4.6 workers. During the past 12 years (1999-2011), the number of workers in SLLs increased by 161 per cent. The general trend followed by SLs mimics that of mercantile companies since they are basically economic equals. They face the same problems as other SMEs, mainly to become sufficiently competitive. Compared to conventional companies, SLs have grown in greater numbers, yet the net increase is negative. However, in most cases, they have converted to conventional companies (either by choice or by disqualification).

SLs have demonstrated their ability to generate stable employment and endure over time. The survival rates are slightly higher than those of conventional companies: More than 50 per cent of SLs survive the first five years. Organisations such as ASLE (Agrupación empresarial de sociedades laborales de Euskadi) and CONFESAL (Confederación Empresarial de Sociedades Laborales de España) have played a key role in the support and promotion of worker-owned companies in Spain. Despite the lack of sound fiscal incentives, SLs have flourished over the past 15 years. The reason for their success is that since 1985, unemployed persons can capitalise their unemployment benefits as a lump sum instead of monthly payments in order to start a new worker-owned company or to recapitalise an existing one. However, the number of start-ups subsequently declined when this benefit was extended to self-employed workers.

The transferability of the supportive measures is limited, since the Sociedad Laboral is a specific business form under Spanish law. However, the concept of support for micro-enterprises and the connection with labour market measures should be taken into account when designing future labour market policies at the EU level as well as when creating a European framework.

5.2.2. ESOPs as a vehicle for business succession in SMEs (Childbase, UK)

The case of Childbase illustrates how an intermediary entity can be used for a employee-buyout in an SME, which became necessary in connection with a business succession problem. However, other objectives as retaining qualified personnel and fairness in relation between the company and employees also played an important role in the development of the concept. Childbase is a good example of a SME, which was and remains successful through its employee ownership plan both in terms of financial results and human resource management.

Childbase Partnership Limited is a company with the headquarters in Newport Pagnell, UK, which operates a chain of nurseries throughout the United Kingdom, but mainly in the South of England. Originally, Sir Peter Thompson and his son Mike Thompson founded the firm as a small family company with four staff members and 20 children in 1989. Mike Thompson is still CEO and co-owner. As the company expanded, the owners introduced the "Childbase All Employee Share Plan" in 2001 to enable the employees to obtain company shares in order to increase employee motivation, to secure the succession, to provide additional capital resources for future expansion and, consequently, to achieve a sustainable progress of the company. According to the turnover in 2011, it is the largest private childcare provider in the UK. It has 1,304 employees and operates 42 nurseries. The employees currently hold approximately 64 per cent of the equity capital individually or through the **Employee Benefit Trust (EBT)**. In the ranking of best companies to work for in the Sunday Times, Childbase took the 23rd place in the category of mid-sized companies in 2011, and rose to the 13th place in 2012.

The first step in the employee financial participation programme of Childbase was to establish the Childbase All Employee Share Plan as an approved scheme, under which the employees could obtain one matching share for each share they buy from the EBT. Later, the number of matching shares was, for a certain period, increased to two in order to further motivate employees to buy shares. The core owners are committed to the goal of 100 per cent employee ownership.

The core mechanism of the Childbase All Employees Share Plan is the EBT. On the one hand, the trust sells shares to employees and provides them with matching shares under the approved scheme. On the other hand, both employees and external investors are allowed to sell their shares only to the EBT, so that the EBT also serves as the only market place for Childbase shares. Employees are obliged to sell their shares to the EBT after leaving the company. Due to this mechanism, a pool of shares for the future 100 per cent employee ownership is created within the EBT.

The share ownership plan has led to an increase of the employee share in the equity capital from zero to 64 per cent in 12 years. If the plan is implemented on the same lines in the future, the goal of 100 per cent employee ownership could be achieved in the next ten years. Consequently, the succession in the company and the protection against hostile takeovers are secured. Profit-sharing schemes, social programs and participation in decision-making flank the plan. The acceptance of the plan by the staff and the management is high and has already led to a substantial change of attitude.

Childbase is also active in spreading best practice throughout the UK. It is a member of the Employee Ownership Association. Recently, Childbase sponsored the report "All of Our Business: Why Britain needs more private sector employee ownership" by the Academic Director of the Centre of Mutual and Employee-Owned Business at the Oxford University, William Davies. The report was launched at the House of Commons in April 2012 and enjoyed cross-party support. The Government also supported the report and promised to let political measures follow.

The success of Childbase is known and widely recognised in UK, but not EU-wide. The plan as such with its particular legal features is not transferable due to the specific form of trust existing only under common law, and to specific tax incentives for such plans in UK. However, the idea and the main structure should be spread to other EU Member States as best practice, illustrating how EFP can contribute to solving SME-specific economic problems.

5.2.3. "FCPE de reprise"—the French cousin of the Employee Stock Ownership Plan

The case of FCPE de reprise is particularly interesting as it is the example of the relatively recent introduction of a new employee-buyout model for SMEs. It demonstrates how new EFP schemes targeting SMEs can be moulded around existing proven schemes (here the FCPE system). It has significance for the issue of structuring intermediary entities and transfer of ownership in SMEs.

In 2006, the so-called "FCPE de reprise" (employee buyout mutual fund) was introduced into the French system of EFP in order to allow employees to take over their employer company under preferential conditions.

In France, employee share ownership is mostly acquired by means of profit-sharing plans as part of the overall system of EFP composed of the following major plans: "intéressement" profit-sharing, "participation" profit-sharing, short-term savings plans (Plan d'epargne d'enterprise—PEE) and long-term savings plans (Plan d'epargne-retraite collectif—PERCO). Within this system, invested employee earnings and matching amounts of the employer company must be, and employee profit shares can be, transferred to mutual funds (Fonds commun de placement d'entreprise—FCPE), usually managed by assets management firms, i.e. branches of banks or insurance companies, which invest the assets on the capital markets, in shares or bonds of the employer company or of several different companies. If the employer company is not listed, the FCPE is obliged to invest one third of assets in marketable shares or bonds. There are however two exceptions: (i) "FCPE simplifié"—a mechanism guarantying the liquidity (e.g., by the enterprise) is installed or the company buys back ten per cent of its own shares, or (ii) since 2006, the "FCPE de reprise"—all assets belong to employees planning to participate in a leveraged buyout.

The new business succession vehicle is a specific form of FCPE to facilitate business succession in non-quoted SMEs: The **"FCPE de reprise" is invested in unlisted securities** with the aim to acquire shares of the employer company or of a holding company set up in view of its acquisition reserved to the employees. It can be invested up to 95 per cent in shares of the purchased company vs. 67 per cent in the case of the regular non-diversified FCPE. Thus, the liquidity reserve is limited to five per cent. The blocking period of sums allocated to the fund is until the completion of the takeover of the company but not less than five years. There are three cases of early release, i.e., disability, death and retirement, to ensure longevity and stability, in order to strengthen it as a business succession device and to reassure partners of this undertaking. A holding company is created to carry the debt needed to buy out the company. At least 15 employees—or one third of employees in firms with fewer than 50 employees—must hold shares in the acquisition vehicle (holding) created. These employees may own unequal shares of the capital, and it is not required that the operation is offered to all employees.

In essence, the "FCPE de reprise" as the new French vehicle—both, with regards to legal structure as well as financing mechanism—is very similar to its Anglo-American cousin, the Employee Stock Ownership Plan (ESOP). Both are share ownership schemes where the acquisition of shares via a trusteed fund (as intermediary entity) is financed by a profit share paid in addition to wages. Both may use borrowed funds on a leveraged basis, and both have the capacity to create substantial employee ownership and can be used to finance ownership succession plans. Just as the ESOP, which is primarily popular as a business succession vehicle for SMEs[68], the French "FCPE de reprise" creates a market for retiring shareholders' shares, which is of major importance to unlisted SMEs having no other ready source of liquidity.

[68] As of 2010, there were approximately 11,500 ESOPs in the U.S., covering approximately ten million employees, most of them originating in a business succession transaction; for details see 3.2.2. above.

The scheme of the "FCPE de reprise" is based on the traditional and successful legal framework for EFP in France. Although national law limits its transferability, it is a good example for the extension of a proven EFP scheme taking into account the needs of SMEs. Therefore, the development of this SME scheme could be taken into account if preparing new legislation on EFP in other EU Member States and especially with regards to a potential European framework.

5.2.4. Recognition of the French FCPE in Germany triggers national ESOP model for SMEs

The case of the recognition of the French FCPE by the German Ministry of Finance granting it deferred taxation has significance for the implementation of a mutual recognition procedure between Member States across the EU. It is an example showing that mutual recognition can even have a stronger impact on the development of EFP than new laws.

Despite a long standing tradition and the general acknowledgement of the positive effects on both productivity and job creation, EFP is not widespread in Germany. The new Law on Capital Participation of Employees, which came into force in April 2009, merely increased existing insignificant fiscal incentives and did not bringe the anticipated change.

However, it was neither the deficiencies of the new law nor the question of insufficient tax incentives—to date with a ceiling of a very modest EUR 360 tax exemption per year—as such that impede broad participation of employees in share schemes. A major obstacle was and still is the absence of deferred taxation of the benefits employees received as employee shares. Under German tax legislation, employees acquiring shares free, discounted or at market price need to have sufficient liquidity to pay income tax at the moment of transferral of the share, which especially in the lower income stratum hinders them to participate in share schemes. Given the typical blocking periods of these schemes, employees usually cannot sell the shares at once to pay the taxes but have to use their already scarce income while still running the risk of a depreciation of the value of the shares acquired during the holding period.

It was not until the German tax authorities' recognition of the taxation of the French FCPE outlined in the **circular released 8 December 2009 by the Federal Ministry of Finance** that this problem was alleviated. The circular grants deferred taxation of employee participation to the "Fonds commun de placement d'entreprise" (FCPE) pursuant to French law, which is similar to the Special Fund for Employee Participation introduced in Germany by the 2009 law. Furthermore, the French FCPE model is de facto recognised in Germany by defining equal treatment of similar German models. In this way, German schemes modelled according to the FCPE logic are granted deferred taxation.

Interestingly, it was the removal of the obstacle of missing deferred taxation as a result of the recognition of the French FCPE that triggered the development of a new German model similar to the French one based on the common ESOP logic. As this new German EFP model targets above all the problem of business succession in SMEs, it mimics the ESOP, successfully implemented in Ireland, the UK and above all the U.S. Such the process of mutual recognition was an important step to facilitate the creation of a new EFP scheme for SMEs. In this way, a well-known obstacle, which was ignored by the new 2009 law, was quietly removed through the recognition procedure at ministerial level.

Referring to this experience Member States could develop a mutual recognition procedure for financial participation schemes. In this way, the possibility of applying the incentives

offered in the country of origin for a scheme "imported" from abroad could apply to similar schemes in the country of recognition.

5.2.5. Strategic employee shareholding via an intermediary entity (Voestalpine, Austria)

Voestalpine introduced its EFP model as a response to the imminent privatisation process. Subsequently, the implementation and development of an employee share ownership plan using an intermediary entity holding the shares made the employees an anchor shareholder of the company. This measure stabilised the ownership structure and motivated employees. The subsequent increase in company productivity positively impacted the company image and its future development.

Voestalpine AG, headquartered in Linz, is principally engaged in the production and treatment of steel. As successful international corporate group with some 300 production and sales companies in more than 60 countries, it has nearly 40,000 employees (fewer than half in Austria). In conjunction with discussions about full privatisation of the corporate group undertaken at the beginning of 2000, the group's Management Board, in co-operation with employee representatives, developed and later implemented an employee participation scheme, which was unprecedented in Austria. The result of the application of this scheme is that a large percentage of the group's workforce, together with a small group of former employees currently holds a 13.3 per cent ownership stake (approximately 22 million shares), which is administrated by a private foundation. This foundation, **Voestalpine Mitarbeiterbeteiligung Privatstiftung**, representing the employee shareholders, has been the most stable core shareholder for years. Today, it is the second largest shareholder (13.3 per cent) after the Raiffeisenlandesbank Oberösterreich Invest GmbH & Co. (more than 15 per cent). The chairman of the foundation's governing body represents 12.4 per cent of the voting rights within the General Meeting of Shareholders. In addition, the foundation has had the power to nominate a representative to the Supervisory Board, a power it has had since 2003.

The foundation not only administers the acquired stock, but also exercises all individual voting rights due to a transfer of the ownership's civil claim, governed by integrated trust agreements. This ensures the workforce an important vote within the General Meeting of Shareholders. Individual employees, however, retain their right to receive dividends. Fully utilising tax incentives and savings on social security contributions, shares were allocated to employees up to a maximum limit of EUR 1,460 per year. Employees' shares remain within the foundation for the entire period of employment. The two principal bodies of the foundation are the Management Board and the Advisory Board. The group's Management Board and Works Councils appoint an equal number of representatives. A representative for the employees chairs both bodies and casts the deciding vote in the event of a tie. The Advisory Board makes all decisions concerning employee participation schemes (e.g., their further development, administration of the assets, etc.) and is responsible for appointing the foundation's Management Board.

The workforce's capital investment has proved its financial value. Each year since 2000, the Voestalpine AG has declared a dividend. In the period from 2000 to 2010, it distributed a total of EUR 47.3 million in dividends to participating employees. Demonstrating confidence in their capital investment, 17 per cent of them (3,576 individuals) have elected to re-invest their dividends. 3,277 individuals, either still active within the Voestalpine AG or already separated from it, exercise their option to keep their "private shares" (around 1.6 million shares).

Despite this success, the transferability of the model is limited, principally because of its particular legal structure. In practice, transfer to SMEs will hardly be an option because of high implementation and administrative costs arising from the setting up of a foundation under Austrian law. However, other types of intermediary entities, e.g., a holding Ltd, seem to be more suitable to meet the needs of SMEs.

5.2.6. SME employee buyouts in privatisation (Spółki Pracownicze, Poland)

A positive example of utilisation of employee ownership plans in the course of privatisation is the case of "Spólki Pracownicze" (Employee Companies) from Poland. The important feature of this case is that—unlike most East European countries, which ceased to support employee ownership after the privatisation was completed—Poland introduced further supportive measures. As a result companies retained majority employee ownership and also showed good performance, even during the financial crisis.

The most significant form of EFP in Poland today is employee ownership. Poland's privatisation programme was characterised by significant incentives for employee participation, especially in firms privatised by leasing and transformed into so-called **Employee Companies (spółki pracownicze)**. Contrary to expectations, ownership structures in these companies have, on the whole, been relatively stable, with non-managerial employees retaining, on average, a significant portion of enterprise shares. Although all current forms of financial participation may also be used in employee compensation schemes outside of privatisation, there are no tax incentives to encourage this.

By 2002, the most common way to manage a privatised enterprise was to lease it to an "Employee Company". From 1990 until 2010, 62.4 per cent of enterprises undergoing "direct privatisation" were transferred into private hand through a leverage-lease buyout resulting in a total of 1,563 Employee Companies that emerged from former state enterprises. However, over time, there has been a slow but steady decline of Employee Companies, some of them going public, others going bankrupt or being liquidated.

Until the end of 2010, their population decreased to 852 employing a total of 131.5 thousand workers with an average size of 150 employees. It is difficult to obtain information on the reasons for the decline of employee ownership as Employee Companies are not a specific legal form of enterprise but registered together with all other corporations. It was certainly not economic distress: In 2010, Employee Companies have achieved a positive gross profit of PLN 2,322 million (as compared to 2,106.7 million in 2009) with an average gross turnover profitability rate close to five per cent.

Reacting to this decline, in the end of 2009, the Polish Government launched the current programme to support Employee Companies entitled Supporting Privatisation Through Granting Sureties and Guarantees to Employee Companies and Civic Activity Companies. Beyond a system of guarantees for Employee Companies, the programme defines the Company of Civic Activity, a joint-stock company or limited liability company where 33 per cent shares belong to at least 30 per cent of the active employees of a privatised enterprise.

On the one hand, the Polish case is not transferable to other EU Member States due to the fact that no significant large-scale privatisations programmes are planned in the near future. On the other hand, the case is useful especially for other Eastern European countries, especially for Lithuania and Hungary, which—as their cases below will show—still have an opportunity to reactivate the support for employee ownership and thus support employee ownership in a sustainable way as in Poland.

5.2.7. Decline of Hungary's employee-owned firms failing long-term policies

The case from Hungary shows that the discontinuation of political support leads to a rapid decline of employee ownership. The specific feature of the Hungarian ESOP experience is that intermediary entities, which could be well used after privatisation was completed, declined steeply due to lack of political support.

In the course of transition, instruments for broad individual and collective participation of employees have been introduced. During the first stage of privatisation, the support of social partners and political parties, on the one hand, and the actual development of employee ownership, on the other, seemed to be promising. However, on the long run, the attempt of policy makers to turn a considerable proportion of Hungarians into owners, i.e., into small capitalists, and to establish an economic balance did not bring the desired outcome. In many ways it resulted in the opposite. Since then only about 300 ESOPs were established in total and less than one quarter is still functioning today.

The legal framework for the **Hungarian ESOPs**, which already existed in practice, was laid down in Law XLIV of 1992 on the Employee Share Ownership Programme. Deriving from the U.S. ESOP model, the Hungarian ESOP structure simulates the Anglo-American trust. It served a dual purpose: It transformed employees into owners of state-owned companies while accelerating the privatisation process. The legal framework of the ESOP today largely retains its original form, though it has been amended several times, most recently in 2003. The ESOP Act enabled employees to acquire state property under preferential conditions, which were significantly limited by Law XXXIX of 1995 on Realisation of Entrepreneurial Property in State Ownership providing (i) credit facilities of up to 50 per cent of the value of the respective property to be purchased, with a ceiling of HUF 50 million; (ii) a discount corresponding to 150 per cent of an annual minimum wage. The total equity purchased by an ESOP was not to exceed 15 per cent of the nominal value of the company. The legal incentives are based on a governmental decree of 1991 on "Egzisztencia" credit and the amendments of the ESOP Act of 1992 still in force. The fact that no ESOP loans have been granted since 1998, although the decree is still in force, shows that these conditions need revision, in particular abolishing the link of preferential credit conditions to the nearly terminated privatisation process.

After 1996, one year after the amendment of the ESOP Act, the absolute number of ESOP organisations declined continuously. Following 1998, no more ESOPs have been established, and from 1996 on the number of ESOPs shrunk until 2010 to approximately one-fourth, which is also the lowest point.

The primary cause for the failure of the ESOP model was the lack of commitment to this idea and the lack of sufficient far-sightedness of political institutions. This is even more regretful, as companies in majority ownership of employees did not perform worse than other private economic entities. The Hungarian ESOP was a premature model, because policy makers did not change the provisions early enough and thus permitted the abuse of the original concept behind it. For these reasons, ESOP schemes were not as successful as they could have been in the long run, as they lacked the necessary sustainable provisions in the post-privatisation era. Furthermore, the time window of three to four years, when SMEs were privatised, was a period too short to be able to measure the real outcomes of ESOPs and to make policy amendments to foster employee ownership.

A lack of supportive measures and inconsistent legislation led to a steep decrease in the number of ESOPs in Hungary. However, this tendency could still be changed if a comprehensive supportive legislation were developed. The European trend to implement employee financial participation schemes through an intermediary entity could give orientation to the Hungarian Government to introduce new rules. On the other hand, a European framework

could contain rules for intermediary entities giving positive impulses to those still existing in Hungary.

5.2.8. Failing sustainable support to employee shareholding in Lithuania

Given the prevailing economic conditions in Central and Eastern Europe, the EU-12 could discover that financial participation is even more important to them than to the EU-15. However, although these countries mostly introduced share ownership as a one-time incentive to employees during privatisation, they did not follow up with policies and measures that would make employee share ownership a permanent component of their new private property, free market economies. By contrast, a number of Western governments as well as the EU itself have actively promoted EFP precisely because of its beneficial long-range effects. In conjunction to the best practice of Poland presented above, the case of Lithuania, like the case of Hungary, shows that employee ownership is likely to be sustainable if political support is continuing.

The development of employee financial participation in Lithuania started in the early 1990s in the course of privatisation. Until 1994, Lithuania was in the vanguard of economic reform. Not only economic, but also political considerations of achieving complete independence from the Soviet Union led to the concept of fast privatisation. In addition, the leading politicians favoured egalitarian forms of employee ownership also supported by the trade unions. For that reason, the most popular privatisation forms were mass privatisation on the basis of vouchers and management-employee buyout, while sale to outsiders or liquidation were hardly used at all. Irrespective of the reasons for promoting employee ownership, the policy first led to a rapid growth of employee share ownership.

By 1994, more than 95 per cent of privatised firms in the programme implementing the Law on the Initial Privatisation of State-Owned Property had employee ownership, while the percentage of enterprises where employees had taken over most of the privatised assets increased from three per cent in 1991-1992, to 65 per cent in 1993 and 92 per cent in 1994-1995 (Privatisation Department at the Ministry of Economics). However, the situation completely changed during the late 1990s and early 2000s. Whereas in 1993 around 50 per cent of employees were shareholders of their enterprises, in 1999 the percentage fell to one third. According to the survey conducted in connection with the PEPPER IV Report, only four per cent of Lithuanian firms offered broad-based ownership plans in 2007, and only 1.7 per cent of employees actually participated in such scheme.

The case of Lithuania exemplifies the **importance of sustainability of legal and fiscal incentives**. Whereas sufficient legal incentives, even if they are not the typical tax incentives, can lead to a surprisingly rapid increase of employee ownership from nought to almost 90 per cent in only three years, the abolishment of the same incentives leads to a equally daramatic decline. Not the volume of incentives, but their stability can produce a long-term effect.

The case of Lithuania, at a smaller scale, can be observed in most Eastern European countries, since the increase of employee financial participation was mostly a by-product of the privatisation process and often not considered as worth of further support. In so far, the case of Lithuania is a typical case and a warning example.

5.3. Conclusions

In this study, high profile and, to some extent, typical cases were selected and analysed in order to identify best practice and obstacles to spreading best practice. Due to the great variety of EFP schemes in different EU Member States, a qualitative analysis of each case was conducted not only to determine best practice instruments, but also to achieve comparability of individual cases. Despite the fact that comparability is limited, the following common principles could be identified:

- EFP needs sustainable political support to realise its potential, especially a stable legal framework.

All best practice cases, but especially those from France and the UK, show that a stable legal framework of measures in support of EFP enables individual enterprises to achieve their goals relative to employee share schemes as vehicles for strategic employee ownership. By contrast, the less successful cases from Lithuania and Hungary clearly show that discontinuation of political support leads to a rapid decline in employee share ownership, even if the level of employee share ownership was previously high. The less successful cases also indicate that the stability of political support is more important than the number and extent of incentives.

- Tax incentives are not a pre-requisite, but effectively support EFP, when properly introduced.

The case studies from France and the UK, where tax incentives were introduced more than 30 years ago, and also from Austria, illustrate that progress of EFP schemes towards their goals (here transfer of ownership) was accelerated by the substantial tax incentives already existing. Since the main plan objectives had no connection with saving funds through tax incentives, they would probably have been introduced even if no tax incentives existed. The take-up of the plans would have been lower, however, and general progress would have been slower.

- Problems characteristic to SMEs (business succession, additional funding, staff retaining) can be alleviated by employee share ownership plans.

The cases from the UK and France exemplify how business succession in SMEs may be achieved by creating a market for shares of unlisted companies through an established intermediary vehicle. Most of family companies throughout the EU have to solve this problem, which was elegantly resolved in the UK case. For an SME with no business succession problem, this type of employee share ownership plan can help retain qualified personnel, a key problem for SMEs whose ability to increase salaries is limited. Employee ownership plans may also provide additional funding, especially at times when access to external funding is difficult, e.g., during a financial crisis or if external funding for expansion is denied. The UK case combines all of these elements: The core family owners transferred the majority share to employees thereby getting back their investment and simultaneously securing business succession; employees were encouraged to invest only a small part of this amount and enjoyed tax incentives; qualified personnel were retained, the company being considered one of the best employers in the UK, and the company successfully expanded despite the financial crisis.

- Employee share ownership schemes in small and micro enterprises can be combined with labour market measures and thus help to reinstate the unemployed.

Employee financial participation schemes in SMEs can also be combined with unemployment benefit as in the case from Spain. In other countries also, the unemployment benefit paid in as a lump sum could also be invested in a start-up (e.g., the concept of "Ich-AG" in Germany), but this has not been successful. The distinguishing feature of the Spanish model is that the unemployment benefit has to be invested in a special form of corporation in which the employees own the majority of shares.

- There is a trend towards using intermediary entities as a vehicle for share transfer in employee share ownership plans, because they limit the investment risk of employee shareholders, implement a leveraged investment and serve to pool voting rights after the shares are acquired.

The form of the intermediary vehicle depends on specific national legislation, but the basic features are similar in the cases from Austria, the UK and France. The shares are funded, acquired, administrated and represented by an intermediary entity. An intermediary entity, unlike an individual employee, can, at least partly, fund the acquisition of shares from the company's profits, dividends, and/or a bank loan. An intermediary entity pools the votes and thus adds weight to the employee vote. At the same time, it creates a market for shares of unlisted companies, especially SMEs.

- Cross-border transferability of best practice schemes, especially of share ownership schemes, is still limited by the absence of a common legal framework.

Although, as explained above, EFP schemes from different EU Member States have some similar characteristics, specific national legislation limits their transferability. The case studies from Austria and France, which sought to transfer financial participation schemes from the parent company to subsidiaries in other EU Member States, reported that this transfer is very difficult and the costs may make it prohibitive. Plans approved under the law of one EU Member State usually are not recognised by other EU Member States. Differences in corporate and tax law often make it impossible to develop a comparable plan. The consequence is that employees of the same company do not enjoy equal financial participation rights. A common legal framework is also needed for the dissemination of best practice.

6. CONCLUSIONS AND POLICY RECOMMENDATIONS

KEY FINDINGS

EFP is seen as a means of promoting greater **co-operation between owners, management and employees**, tending to increase workplace harmony and reduce conflict, thereby making firms more flexible, efficient and productive, hence more competitive.

- Economic literature over the past 30 years confirms these **beneficial effects**.
- The introduction of EFP also gives rise to a number of problems (free riding, risk for employees), and although firms and workers have developed mechanisms to mitigate these problems, the **potential pitfalls exist**.

Though slow to take off, EFP picked up surprising momentum between 2000 and 2005 (EWCS, CRANET data). The most recent (2010) two cross-country surveys again confirm these empirical findings, noting that **EFP in Europe continues to expand despite the financial crisis**, albeit at a much slower pace.

A comparison of the rules and regulations on general taxation, social security contributions and specific tax incentives for EFP schemes across the EU show that **fiscal incentives are not a prerequisite to EFP, but do promote the spread of schemes**.

- Problems common to SMEs (business succession, additional financing, staff retention) can be ameliorated by employee share ownership plans. Despite this strong record of success, with very few exceptions, there are still **no measures supporting EFP specifically addressed to SMEs**.
- **Share ownership plans can be combined with labour market measures** in small and micro-enterprises to help to reactivate the unemployed, as the "Sociedades Laborales" in Spain illustrate.

Share ownership schemes, whereby the **shares are acquired via a trusteed fund financed by a profit share paid in addition to wages**, are a future trend in EFP. In these indirect schemes, either a separate intermediary entity manages the shares held in trust for employees (e.g., British and Irish ESOPs) or, at the firm level, a combination of a savings plan and a mutual investment fund (e.g., French FCPEs).

A European framework, the "28th regime on EFP", should be developed as an optional instrument. As in other areas where the "28th regime" was considered applicable, this would **serve to deepen the Single Market**, develop cross-border activities of companies, especially SMEs, and protect employees of subsidiary companies:

- The "28th regime" **does not override the national law, but provides an alternative**. It is a tool to strengthen the Single Market: In a "bottom-up" approach, firms choose to use it or not. A race to the bottom is avoided, as the "28th regime" is not a compromise of the smallest common denominator, but a best practice option.
- The "28th regime" imposes no tax incentives; national taxation rules apply. A **calculator for the effective tax burden** (see Annex 3.2.) as a soft tool should accompany it. This provides transparency for taxation across EU-27, crucial to avoid double taxation and discrimination as well as to facilitate mutual recognition.
- A new Recommendation on EFP and the Open Method of Co-ordination may serve as a **fallback solution** to promote policy measures further encouraging EFP.

6.1. Summary of findings

Employee participation in the financial results of their employer company has become an important issue across the European Union. Though slow to take off, **EFP picked up surprising momentum** between 2000 and 2010 (EWCS, CRANET Survey, EFES).

6.1.1. EFP: A potential tool addressing the EU's most pressing challenges

EFP is a mechanism for **promoting greater co-operation between owners, management and employees**, tending to increase workplace harmony and reduce conflict, thereby **making the enterprise more flexible, efficient and productive**, hence more economically competitive. EFP schemes are often viewed as a solution to several problems of industrial societies: employee dissatisfaction, poor quality of working life and declining productivity. It is argued that they tend to decrease absenteeism and labour turnover and increase investments in company-specific training and know-how.

Economic literature over more than three decades concludes that EFP provides important benefits to businesses by motivating employees to greater commitment to and identification with the firm, thus **leading to higher productivity and greater competitiveness**. Studies over the years have found that firms in which employees have an ownership stake are more profitable, create more jobs and pay more taxes than firms without EFP schemes. Furthermore, EFP can help not only to recruit employees with high qualifications and skills but also to retain them by providing financial benefits in addition to wages.

The ageing of Europe's population portends an enormous increase in business transfer activity, which could affect up to 690,000 SMEs and 2.8 million jobs every year. Particularly with respect to SMEs, EFP provides a solution to the business succession problem. Other problems common to SMEs (e.g., financing needs, staff retention) can also be ameliorated by employee share ownership plans.

6.1.2. Obstacles and pitfalls

The implementation and the spread of plans across borders are hindered by **differences in taxation and social security contributions** across the EU-27.

Both profit sharing and share ownership involve a certain degree of risk for employees. To mitigate the free-rider problem complementary human resource management practices are emphasised. Although firms and workers have developed mechanisms to mitigate some of the problems associated with EFP**, potential pitfalls do exist**.

6.1.3. EFP and the economic and financial crisis

The 2010 round of EWCS and CRANET cross-country surveys note that **EFP continues to expand in Europe despite the financial crisis**, albeit at a much slower pace.

Participation in decision-making complements financial participation; the two combined may increase productivity beyond what would be the case with EFP alone, while also improving the quality of corporate governance. **Employee shareholders are concerned with the long-term performance** of the business, not just short-term changes in share prices. Their focus on long-term interests discourages managers from taking excessive risks. Thus, EFP can help shift executive remuneration policy towards long-term incentives.

6.1.4. Rationale to promote fiscal incentives

Despite the difficulty of implementation at the European level—due to exclusive jurisdiction of national legislation over tax laws—, tax incentives remain powerful tools for promoting, enhancing and broadening financial participation. **Fiscal incentives—while not a prerequisite—do promote EFP schemes**. The experience of countries with a long tradition of EFP, as well as those in which tax incentives are more recent, confirm their positive impact. However, although harmonisation of taxation is not a necessary condition for further development **transparency is needed to avoid double taxation and discrimination**.

Tax incentives in most countries **target those taxes, which constitute the heaviest burden taxes** in the national taxation system. The heaviest taxes are usually the progressive personal income tax and social security contributions. Many countries, therefore, provide: (i) exemptions from social security contributions for certain collective share plans (e.g., France, Belgium, the UK, Ireland and Finland); (ii) the application of a capital gains tax (e.g., the UK and Belgium on dividends) instead of personal income tax; (iii) the imposition a special low tax instead of personal income tax (e.g., France), and (iv) tax allowances for personal income tax (e.g., Austria, Finland and Ireland).

6.1.5. National best practice especially with regards to SMEs

In this study, eight cases are selected for detailed analysis in order to identify best practice and the obstacles to spreading the best practice. The ultimate conclusion is that to realise its potential, **EFP needs sustainable political support, especially a stable legal framework**. This also indicates that sustained support—even modest support—is more important than the extent of the support, e.g., fiscal incentives.

Problems common to SMEs (business succession, additional financing, staff retention) can be alleviated by employee share ownership plans. The cases from the UK and France exemplify how **EFP can facilitate business succession in SMEs** by means of an intermediary vehicle creating a market for shares of unlisted companies.

There is a **trend towards using an intermediary vehicle**, e.g., a trust, as custodian of employee shares, because this limits the risk for employee shareholders and allows for leverage and the pooling of voting rights. The shares are funded, acquired, administrated and represented by the intermediary entity, which unlike an individual employee can, at least partially, fund the acquisition from the company's profits, dividends and/or a bank loan.

Share ownership plans can be **combined with labour market measures in small and micro-enterprises** to help to reactivate the unemployed. In Spain, the unemployment benefit paid out as a lump sum can be invested in a start-up or in an existing "Sociedad Laboral", a special form of corporation in which the majority of shares are owned by employees. These start-ups (totalling 13,465 and employing 74,438 individuals at the end of 2011) are government-assisted.

Cross-border transferability of best practice schemes is still limited due to the lack of a common legal framework. Differences in corporate and tax law are substantial; often it is impossible even to develop a comparable plan. In consequence, employees of the same firm in different countries are not treated equally with respect to their participation rights.

6.1.6. Assessment of measures promoting EFP

A comparison of the rules and regulations on general taxation, social security contributions and specific tax incentives for EFP schemes across the EU shows the positive effect of fiscal

incentives where in place. The calculation of effective tax rates enables a **like-with-like comparison of the fiscal treatment of EFP** and the incentive system across the EU-27.

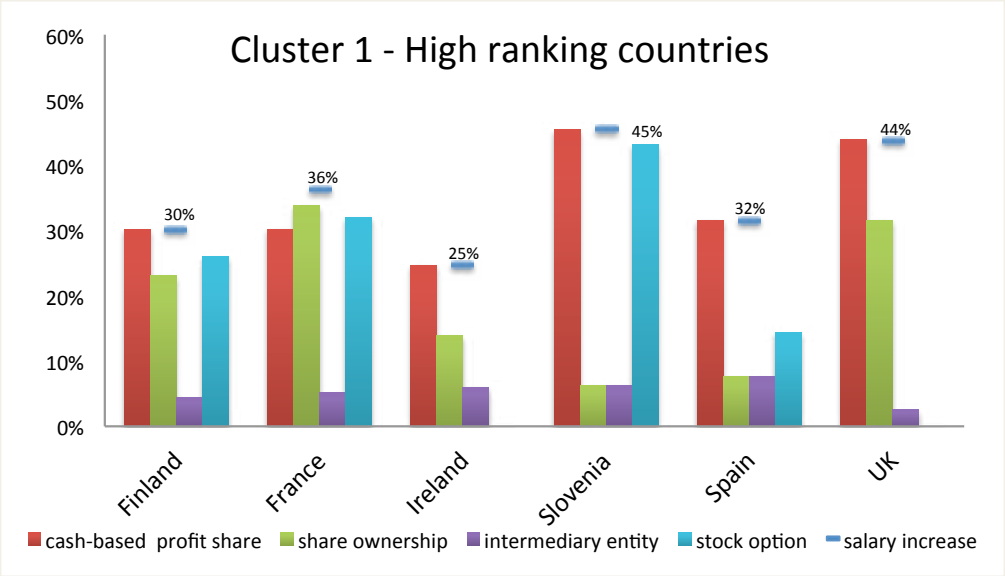
To identify the most conducive conditions for the development of EFP in the EU, the Member States have been classified according to the degree to which a country's conditions are supportive of EFP. The **countries are divided into four clusters**: (1) UK, France, Slovenia, Finland, Spain and Ireland; (2) Denmark, Netherlands, Italy, Austria, Poland, Romania, and Belgium; (3) Germany, Hungary, Sweden, Greece, Lithuania, Malta, Portugal, Latvia, Czech Republic and Slovakia; and (4) Bulgaria, Cyprus and Estonia.

Despite the potential of EFP, with few exceptions, there are still **no EFP measures specifically addressed to SMEs**.

6.1.7. Intermediary entities as a future trend of EFP

Forms of share ownership where the acquisition of shares via a trusteed fund, is financed by a profit share paid in addition to wages can be seen as the future trend in EFP.[69] These indirect share ownership schemes usually employ a separate intermediary entity, which manages the shares held in trust for employees (e.g., in British and Irish ESOPs) or, at the enterprise level, uses the combination of a savings plan and a mutual investment fund (e.g., in French FCPEs).

Figure 14: Effective tax burden on EFP schemes (including social security contributions and other levies) in per cent of the final amount of the benefit in five EU countries



Value of financial participation from gross salary:	10%	**Single person from**	**median annual gross income**
Interest for calculation:	3%	Finland	EUR 20,000
Yearly interest for profit share*:	3%	Ireland	EUR 22,500
Yearly increase in value for share ownership:	8%	France	EUR 21,000
Total period in years:	7	Spain	EUR 16,000
* Average interest fixed long-term investment		Slovenia	EUR 11,000
		UK	EUR 22,500

Source: Annexes 1 and 2 as well as the author's own calculations. EFP benefit is equivalent to the median monthly income in each country. This may be a profit share (in cash or shares) or in shares under share ownership plans.

[69] See also the 2010 European Economic and Social Committee Own-Initiative Opinion SOC 371 on EFP, CESE 1375/2010, OJ C 51, 17.02.2011, p. 1–7.

Support for this trend is provided by the effective tax rate analysis. The calculation in Figure 15 shows that EU Member States with a long EFP tradition, strong political support for, wide spread use of EFP and significant economic success of enterprises with EFP (Cluster 1 from the rating) provide the most effective tax incentives for share ownership schemes using intermediary entities. In France and the UK, for example, the effective burden on direct share ownership plans as compared to that on share ownership plans with an intermediary entity is 25 per cent higher.

6.2. The context for a Europe-wide framework for EFP

EFP schemes can potentially contribute to economic growth, employment and social cohesion and thus may play an important role in fulfilling the social and economic goals of Europe 2020, the European growth strategy.

They can help to improve company performance and corporate governance, can be regarded as part of the EU's flexicurity approach, and can provide an appropriate vehicle for business succession of SMEs, where a large share of Europe's wealth and employment stability is created. Furthermore, EFP can help make the European economy more competitive by removing barriers to the Single Market. But to unfold this potential, as shown earlier, a European framework is needed.

6.2.1. Different contexts, different approaches – The Building Block Approach

Financial participation has traditionally been optional. Enterprises have been free to introduce or not to introduce EFP schemes.[70] The Commission has emphasised this **principle of voluntariness**. Although tax incentives are most commonly used to encourage financial participation schemes, a common European legal framework imposing such tax incentives would collide with national legislative sovereignty over taxation. Under the European Union Treaties, each Member State retains exclusive power over all matters involving taxation; any Directive involving taxation requires the unanimous consent of all Member States. Thus, a supranational concept may suggest a wide range of incentives as long as they are to be granted voluntarily at the national level.

Therefore a European approach to this problem must, above all, offer a legal framework leaving the issue of fiscal incentives to the Member States. A promising solution is to create **elements made up of each Member States' best practices**, culled from national legislation and customs but suitable for use throughout the European Union. Combined into a single program with alternative options, these best practices lead to a "Building Block Approach", with different but mutually complementary elements. Thus:

- Establishing a European **framework through legislation is of primary importance**, as it delineates what is possible for companies to do without inviting sanctions from regulatory, legal or taxation authorities.
- Fiscal incentives are to be dealt with separately at a later point in time.

6.2.2. Different areas of law are concerned

A European concept for EFP schemes will touch upon different areas of legislation—e.g., contract law, company law and tax law—at the different levels, i.e., European and national.

[70] Rare exceptions are France (firms with more than 50 employees are required to establish a participation fund) and Romania (compulsory profit sharing in the public sector); see the country profiles in the PEPPER IV Report, 2009, pp. 98 and pp. 146.

There might also be company law rules that influence EFP, which are mandatory for all companies in the EU (e.g., the rules for open or closed joint-stock companies to acquire own shares in the Second Council Directive on Company Law). Other rules are provided by the individual state without any choice of law (e.g., tax incentives as a rule are state law only). A part of the Member States' contract law can be subject to a number of minimum rules of the EU (e.g., anti-discrimination law).

The concept of an optional European EFP regime implies that **EU rules and national rules co-exist for a significant part of the legal areas concerned**, and that the parties, i.e., employers and employees, have the right to make a choice between them (the principle of voluntariness). However, such a concept does not imply that all EU rules have to be optional; there may be legal rules, which are mandatory and uniform for the entire EU. As in the case of contract law, where a similar initiative has recently been launched, the main idea of an optional European EFP regime with parallel EU and national rules is to make the EU economy more competitive by **strengthening the Single Market**.

Since these are essentially contractual problems for employers and employees as private parties, the approach needs to respect the freedom of choice of both parties.

6.2.3. Dealing with the issue of fiscal treatment separately

Should policy makers wish so, European harmonisation of fiscal incentives for EFP could be supported at a later point in time. Also in this area a supranational approach offers several advantages over single national incentives. Defining only basic aspects, e.g., **general European guidelines** would provide flexibility in choosing appropriate means follow previously agreed standards. This would be a move towards a common European fiscal treatment of EFP not previously available, enabling further political integration.

This process could then be supported by succeeding regulations. This approach is particularly apropos for the issue of tax incentives, since they are subject to national sovereignty. Therefore, a European Framework Directive **regulating minimum standards for tax incentives**, e.g., deferred taxation, a lowered level of capital gains tax, exemptions or lower compulsory social security contributions for benefits from EFP schemes, must not collide with national legislative sovereignty. Rather it would work as a binding letter of intent designed to inject basic principles into the system. Accordingly, the legislative implementation of tax incentives—once the optional European concept of EFP based on the Building Block Approach is established—at the European level would require in any event unanimous consent within the Council.

An alternative move towards acceptance and recognition of the importance of tax incentives in promoting EFP, could be a **recommendation** according to Articles 288, sentence 1, alternative 4 and sentence 5 and 292 Treaty on the Functioning of the European Union (TFEU)[71]. The downside of such a solution, however, is that Recommendations according to Article 288, sentence 5, TFEU as a weaker legal instrument have no binding force on the Member States; thus implementation would be far from certain. Notwithstanding, a recommendation does have political weight in advising Member States to take first measures to prepare favourable legislation towards tax incentives and EFP in general.

[71] For the consolidated version, see OJ C 83 of 30.03.2010.

6.3. Policy recommendations to the EP

This study proposes an **alternative approach based on the so-called "28th regime"**. This approach gives a choice between two models of EFP; one national and the other European. As the choice regards the entire instrument "cherry-picking" is avoided while providing a high protection level for employees. Furthermore, the "28th regime" would not require compromise on the lowest common denominator, thus preventing a lowering of standards. By deriving basic principles and standards from existing national models, the 28th regime has the advantage of a high degree of legitimacy among member countries. It does not follow a "top-down" process, thus it is more acceptable in the political arena. At the same time, it provides transparency and portability across the EU.

The implementation of an **optional European concept for EFP** provides a favourable legislative framework opening the door for further exchange of best practice and mutual recognition among Member States. It could serve as a catalyst for new developments and legislative dynamism at the national level in the future. Removing barriers to the Single Market associated with legal risks and costs for firms created by the differences in national legal models, the 28th regime contributes to increased competitiveness of the EU economy. With regard to a European solution to EFP, the following steps are thus recommended:

First step: An EU Regulation on the "28th regime on EFP" defining the EFP schemes previously identified by the Building Block Approach (see above 2.1.). The "28th regime" imposes no tax incentives; national taxation rules apply. An explanatory section can recommend tax incentives as identified from best practice across the EU-27.

Second step: An online tool for the calculation of the effective tax burden and the exchange of best practice accompany the "28th regime on EFP" as soft tools. This provides transparency for taxation across EU-27, crucial to avoid double taxation and discrimination as well as to facilitate mutual recognition (see Annex 3.2).

Fallback solution: A new recommendation on EFP and the open method of co-ordination is the minimum in policy measures further promoting EFP.

6.3.1. The options: Minimum EU rules or an EU option parallel to national law

At present, in the absence of mandatory EFP legislation at the EU level, **mandatory rules are provided only by individual states** (traditional decentralised solution). There are two ways to further promote EFP at the EU level using legislative instruments[72]:

i. **EU minimum requirements for Member States' national laws:** The laws governing EFP are state law, but they have to fulfil EU minimum requirements (minimum harmonisation), e.g., a Directive on EFP.

ii. **EU law and national law parallel:** Legislation governing EFP schemes is offered both by the EU and the Member States. With regard to the choice of the employer and employee, one needs to distinguish:

- **Extent of choice:** Can the private parties choose only between the EU law and their national law, or can they also choose one of the other national laws of the EU Member States (or even legal rules from outside the EU)?

[72] Differentiation of EU vs. state law developed after W. Kerber / S. Grundmann (2006), p. 219 f.

- **Opt in/Opt out:** If the default rules are the national rules, private parties have the right to opt into the EU law. If the EU rules are the default rules, then private parties have to opt out if they want to choose their national law.
- **Cross-border/domestic:** For domestic and cross-border transactions different options for EFP schemes might be useful.

6.3.2. A EU framework: Introducing the 28th regime on EFP

Given the above-described difficulties in finding a European solution that does not conflict with national laws, the most feasible way seems to be the so-called "28th regime".[73] Such an optional European EFP regime would be conceived as a **"2nd regime" in each Member State with national legislation remaining the default rules**. It provides employers and employees with an option between two regimes for EFP schemes, one originating in national legislation and one—i.e., the 28th regime—in European legislation. The 28th regime would be defined at EU level and enacted by EU instruments, i.e., an EU Regulation. At the same time by containing provisions of a mandatory law it would provide a high level of protection for employees, similar to those granted by the EU or national mandatory rules. Of course, even as an optional instrument, the 28th regime requires a set of general principles of private law.

Advantages

Briefly, the advantages of this optional EU concept for EFP are:

i. It would allow employers to **operate an EFP scheme throughout the EU on the basis of a single legal regulation**. Barriers to the Single Market, such as legal risks and costs associated with the differences in national laws would be avoided. Amongst firms implementing these schemes, employees would be ensured full portability across the EU.

ii. It would **leave the decision on its application to the market** and would therefore only be chosen where interested parties consider it to be advantageous;

iii. The individual legal culture of each Member State would be left untouched, making it more acceptable in the political arena;

iv. Implemented by an EU Regulation, companies could **utilise it even in purely domestic situations**; especially in SMEs, this is of primary importance as these plans could later be easily expanded across borders as the firm grows and expands its operations.

v. The parties to a legal dispute would not need to plead or prove the law that applies to their case; the principle "iura novit curia" ("the court knows the law") applies, courts could not treat it as a chosen "foreign" law and **access to national Supreme Courts as well as the ECJ would be unrestricted** - this is often not the case when foreign law or general principles are applied.[74]

Limits of application of the 28th regime

An optional instrument covering only private law issues cannot cover problems of tax law. Although tax incentives are an important instrument to promote EFP; tax issues have to be dealt with at a later stage (see below). Furthermore, the "28th regime on EFP" does not

[73] See the own-initiative opinion INT/499 of 27 May 2010 of the European Economic and Social Committee on „The 28th regime – an alternative allowing less law making at Community level".

[74] Equally, institutions offering out-of-court complaint and redress mechanisms could not refuse to hear a case using the argument that it would be submitted to foreign law; See the own-initiative opinion INT/499 ibidem.

apply to labour law or employment contract law in force in the Member States. **In addition to the "28th regime on EFP" existing EU legislation should be amended**. Since employee share ownership fits into the framework of company law, rules to implement it could be proposed as an amendment to the "European Company" legislation. Like the European Company Statute (ECS), which provides an option for forming a supranational company, there could be an amendment to the ECS permitting such companies to create "European Employee Shareholding" as an option.[75] This option could be easily extended to other companies, which do not fall under the ECS, provided that national legislation would then be adapted to the requirements of the supranational statute. Of course, the Regulation on the 28th regime on EFP may also contain an "opt-out" clause for countries sceptical of this model.

6.3.3. Providing transparency for taxation to facilitate mutual recognition

In the area of tax incentives, it is crucial to **avoid double taxation and discrimination** as well as to facilitate quick dispute resolution. A calculator for effective tax rates developed for this study (Annex 3.2) should accompany the "28th regime on EFP" as a soft tool.[76] Transparency for taxation of EFP schemes across the EU **facilitates mutual recognition**.

As mentioned earlier, a common European legal framework imposing tax incentives would collide with the national legislative sovereignty over taxation. In this area the open method of co-ordination (OMC), which is now also codified for social policy in article 156 TFEU, could be employed **to develop common taxation principles for EFP** without necessitating a supranational arrangement based on European authorisation. The OMC, which largely forgoes binding legal instruments, is ideally suited for situations, such as the current one, arising from political need, to undertake measures in policy areas at a European level where no authority exists to adopt such legal acts.

The Council should recommend that all EU Member States apply the best practice principles of providing tax incentives in promoting EFP. In this context the following measures, which are fundamental elements of OMC, should be implemented:

- The exchange of experiences and best practices among individual states (referring to the four PEPPER reports from 1991, 1997, 2006 and 2009);
- Establishment of EU guidelines by the Council that take into consideration the national policies of Member States (see recommendation of 1992);
- Review whether the Members States will reach the objectives outlined in the guidelines (see Pepper IV report 2009) using empirical data.

However, this calls for reliable cross-country data focussed on financial participation, which is not available at present. To facilitate a discussion of individual country scores on different indicators vis-à-vis comparable scores of other EU Member States, and to obtain a sound overall picture, a more comprehensive and consistent database is indispensable. **Additional funding should support research** specifically designed to fill this gap.

The Council can then upon proposal from the Commission provide detailed, unbinding recommendations for reaching these objectives. This will be supported by dialogue between social partners in the Member States and **promoted by the governments' mutual**

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[75] As proposed in the report of the *Committee on Employment and Social Affairs* of 5 May 2003 (A5-0150/2003), pp. 11 and 14 and expressed in the European Parliament Resolution of 5 June 2003 (P5-TA (2003) 0253), 31. IV; like the Council Directive 2001/86/EC of 8 October 2001 "supplementing the Statute for a European company with regard to the involvement of employees", but with regard to financial participation.

[76] This dynamic tool, developed under the CETREPS project, is currently being tested by the authors. CETREPS (Calculating Effective Tax Rates for Employee Participation Schemes) was launched at Viadrina in 2010.

recognition of existing best-practice models. OMC instruments would thereafter contribute directly to the standardisation of policies in the Member States. Countries could voluntarily offer tax incentives singly or in groups. Such a step would create an increasingly favourable environment where countries having an advanced tradition, such as France or the United Kingdom, would encourage emulation.

ANNEXES

ANNEX 1: OVERVIEW TABLE ON EFP IN THE EU-27

Table 4: Governments and social partners' attitudes, legal framework and incidence of EFP in the EU-27

	General attitude [A] Social partners [B] Government	Legislation and fiscal or other incentives	Schemes and their incidence: CRANET: Offer in firms > 200 employees EWCS: Take-up rate of employees
EU-15			
Belgium	**[A] Trade unions** opposed, but relatively more support for PS; **employer associations** in favour; **[B]** Since 1982, legislation for ESO; amendment 1991; since 1999 legislation for SO; since 2001 new law on ESO and PS.	**All plans:** EmpC up to 20% of after tax profit per annum; up to 10% of total gross salary; **ESO**: discounted ES in JSC, financing by firm possible; in capital increases: up to 20% of equity capital, ES discount limit 20%; (restricted stock grant) value reduced by 16.7%, taxation deferred if 2 years not transferable, 15% tax on benefit, no SSC; (stock purchase plan) benefit tax base 83.33% of fair market value; **SO:** since 1999 taxed at grant on a lump-sum basis, no SSC; **PS:** tax 15% for PS in an investment savings plan, 25% for other plans.	2010 Cranet: **ESO** 16.7%, **PS** 19.1%; 2010 EWCS: **ESO** 4.2%, **PS** 12.5%; firms involved mainly from financial sector, large firms and multinationals; **SO** 2005 Cranet: 2%; EU Report 2003: 75,000 employees benefit; most of 20 largest Belgian firms operate plans; 40% of firms with more than 50 employees.
Denmark	**[A] Trade unions** indifferent to EFP; **employer associations** opposed to any extension of EFP; **[B]** Employee funds discussed in 1970-80s, PS popular; later support for ESO and SO; in 2000s Government support for share-based schemes.	**ESO:** ES in JSC: discounted, up to 10% of salary per annum, 7-year holding period, free maximum of DKK 8,000 per annum; financing by firm possible if qualified plan; in capital increases deviation from subscription/pre-emption rights possible; deferred taxation of benefit; EmplC: discount tax deductible **PS:** Share-based profit sharing; up to 10% of annual salary; **SO:** exemption from PIT/SSC: broad-based if up to DKK 8,000, 5-year holding period; individual if up to 10% of annual salary or up to 15% difference exercise price/market price. From 1 January 2012 on all tax incentives repealed.	2010 Cranet: **ESO** 22.7%, **PS** 7%; 2010 EWCS: **ESO** 9.1%, **PS** 18.6%; **SO** 2005 Cranet: 2%; EU Report 2003: 20% of 500 largest firms by 1999, one third of quoted firms 2000.

	General attitude [A] Social partners [B] Government	Legislation and fiscal or other incentives	Schemes and their incidence: CRANET: Offer in firms > 200 employees EWCS: Take-up rate of employees
Germany	**[A] Trade unions** partly sceptical/partly hostile because of "double risk", recently growing support; **employer associations** support individual firms; **[B]** Traditional focus on savings plans (total capital higher than that of ES company plans); EFP since 2006 on political agenda of all parties. New law 2009.	**ESO:** discounted ES in JSC, financing by EmplC possible; state savings bonus of 20% of up to EUR 400 (EUR 80 per annum) invested in EmplC, 6 year blocking period; no tax/SSC on up to EUR 360 EmplC matching contribution per annum; no PIT on salary reduction contributions; since 2009 Special Employee Participation Fund; **SO:** in capital increase, nominal amount restricted to 10%, that of increase to 50% of equity capital. **PS:** none.	2010 Cranet: **ESO** 11.8%; **PS** 45.6%; 2010 EWCS: **ESO** 1.9%, **PS** 11.6%; 2005 IAB: **ESO** 3%, **PS** 12%; 2003 WSI: **PS** in one third of firms; **SO:** EU Report 2003, in over two-third of DAX-listed firms; **ESO:** 2006 AGP, 3,000 firms, 2.3 million employees, EUR 19 billion; until end of 2012 Special Employee Participation Fund not accepted by markets.
Ireland	**[A] Employer associations** strong support; **trade unions** support if financial and intrinsic reward to employees; managers/employees pragmatically motivated; lobby groups/institutions for example banks for **ESO;** **[B]** Support in privatisation; improvements in 1995 and 1997; promoting voluntary adoption of share-based profit sharing, e.g. Approved Profit-Sharing Scheme.	**ESO:** PrivL—14.9% ESOT-stock paid for by loan/by state; ES/share-based profit sharing in JSC, financing by EmplC possible; new shares: limited PIT tax base deduction for EmplC, no SSC; tax incentives abolished from 08.Dec.2010 **SO:** Savings-Plan: bonus/interest on savings tax-free, no PIT on grant/ exercise, no SSC; approved plan: no PIT at exercise, no SSC; **ESOP:** Trust Act—taxed 15% interest/10% investment; ESOT: tax incentives as Approved Profit-Sharing Scheme if ESOT in Approved Profit-Sharing Scheme; **PS:** Approved Profit-Sharing Scheme: at transfer no PIT, no SSC up to limit; salary foregone—up to 7.5% of gross salary deductible.	2010 Cranet: **ESO** 39.3%, **PS** 27.6%; 2010 EWCS: **ESO** 3.9%, **PS** 7.5%; **SO:** 2002 IBEC: 90 firms with Save-As-You-Earn Schemes, 15 firms with Approved Share Option Schemes; **PS:** 2002 IBEC: 400 firms with APPS; **ESOP:** n.a.
Greece	**[A] Trade unions** moved from scepticism to support in 1980s; **employer associations** indifferent, low priority not a current topic; **[B]** Some regulations on cash-based profit sharing (1984) and ESO (1987); since 1999 more attention on SO; not a current issue.	**ESO:** ES in JSC free/discounted; within capital increase for 3 years not transferable, up to 20% of annual profit; no PIT/SSC on benefit; **SO:** free/discounted; taxable at exercise; tax exempt if qualified plan; **PS:** up to 15% of firsm profits, 25% of employees' gross salary; no PIT, but SSC. From 1 January 2012 on all tax incentives repealed except for special 25% tax on ESO but full SSC.	2010 Cranet: **ESO** 15.7%; **PS** 6.9%; 2010 EWCS: **ESO** 0.2%, **PS** 3.3%; **SO:** 2005 Cranet 2%; EU Report 2003: only a limited number of firms.

	General attitude [A] Social partners [B] Government	Legislation and fiscal or other incentives	Schemes and their incidence: CRANET: Offer in firms > 200 employees EWCS: Take-up rate of employees
Spain	**[A]** Low priority: **Trade Unions** oppose income flexibility; **employer associations** ambivalent, fear information disclosure requirements; **[B]** Long tradition of social economy: COOPs (new law 1997) and **EBO**; **PS** supported in 1994 then shift to **ESO/SO**; active support.	**ESO:** ES/SO in JSC, financing by firm possible; tax benefits on PIT after 3-year holding period; **PS:** national labour legislation; **SO**: after 2-year holding period 40% reduction of taxed plan benefit; **EBO:** "Workers' Companies" with more than 51% ESO, 25% of profits in reserve fund; protected co-operatives 30% of profits in two reserve funds; "Workers' Companies" tax exempt from: capital transfer tax, tax on formation/capital increase, notary fees; protected co-operatives—corporate income tax reduced by 50%; National Social Benefit law: unemployed can receive unemployment benefit as a lump sum, if they invest it into a workers' company or a protected co-operative.	2005 Cranet: **ESO** 2.5%, **PS** 16.8%; 2010 EWCS: **ESO** 1.6%, **PS** 4.9%; **SO:** 2005 Cranet: 19%; EU Report 2003: plans in 40 firms of which 50% in IBEX 35; **ESO**: 2003 CNMV 20% of large firms with share purchase plans; **EBO:** 2011 13,465 Workers' Companies
France	**[A] Trade unions** show mixed attitudes: sceptical but actively involved, favour if not substitute to pay; **employer associations** generally in favour, especially if voluntary; **[B] PS/ESO** strong continuous support since 1959; also in privatisations; climate friendly toward EFP, focused policy.	**ESO:** PrivL—5% ES reserve, up to 20% discount; discounted ES in JSC, financing by firm possible, also capital increase; Save-As-You-Earn Schemes; reduced SSC of 8% and 13,5% tax on returns; **SO:** capital increase; tax on exercise gain 26-30% after 4-year holding period; **ESOP/EBO:** Law on Trusteeship 2007; special reserve for EBO possible; **PS:** deferred profit sharing compulsory/cash-based profit sharing voluntary; reduced SSC 8% and 13,5% tax on returns if paid to company savings scheme/fund after 5-year holding period.	2010 Cranet: **ESO** 11.9%, **PS** 69.5%; 2010 EWCS: **ESO** 7.7%, **PS** 26%; 2011 AFG: deferred profit sharing covered 12.3 million employees in non-agriculture private sector firms; **SO:** 2005 Cranet 3%; SO EU Report 2003: approximately 50% of quoted firms and 28% of limited companies, total approximately 30,000 employees. **ESO/PS in savings plans:** AFG 2009: 230,000 companies with 11.8 million employees; 84.8 billion Euro assets in 2009, of which 41 per cent shares of EmplC and 59 per cent in diversified funds.

	General attitude [A] Social partners [B] Government	Legislation and fiscal or other incentives	Schemes and their incidence: CRANET: Offer in firms > 200 employees EWCS: Take-up rate of employees
Italy	**[A] Trade unions** mixed attitudes, recently interested in topic**; employer associations** mostly supportive; **[B]** Trilateral agreement 1993 supported **PS**; then shift to support **ESO/SO**; recently discussed on political agenda; new law planned 2010/11.	**ESO:** CivC—discounted ES in JSC, financing by company possible; in capital increases deviation from pre-emption rights and preferential ES possible; PIT and SSC exemption up to EUR 2,065 after 3-year holding period; in limited liability companies free share up to EUR 7,500 tax exempt; **PS:** no SSC on up to 5% of total pay; **SO:** SSC exemption after 5-year holding period.	2010 Cranet: **ESO** 7.3%, **PS** 5.8%; 2010 EWCS: **ESO** 2.1%, **PS** 8.1%; **SO:** 2005 Cranet 1%; EU Report 2003, approximately 6% of employees involved.
Luxembourg	**[A] Trade unions / employer associations** growing interest in 1990s, not supportive of share schemes; **employer as-sociations** support **PS**; **[B]** EFP not a current issue.	**ESO:** ES in JSC, financing by company possible; **SO:** "Tradable Option Plans" reduced tax burden; **PS:** none.	2010 EWCS: **ESO** 7%, **PS** 18.5%; **SO:** EU Report 2003, estimates 25% of firms, mainly financial sector; **PS:** PEPPER II, 1995 cash-based profit sharing in 25% of firms, mainly banks.
Netherlands	**[A] Trade unions / employer associations** generally in favour; **trade unions** support if supplement to pay, prefer **PS** to ESO; **[B]** Traditional focus on savings plans; support for SO in 2003.	**ESO:** ES in JSC, financing by company possible; up to EUR 1,226 from pre-tax salary after 4 years in a savings plan 15% flat tax, no SSC; **PS:** up to EUR 613 from pre-tax salary after 4 years in a savings plan 15% flat tax, no SSC; **SO:** no; **Intermediary entities:** Qualified Savings Funds. All tax incentives abolished from 1 January 2012 on.	2010 Cranet: **ESO** 4.6%, **PS** 23.5%; 2010 EWCS: **ESO** 4.9%, **PS** 25.3%; **ESO:** 2009 Kaarsemaker for SNPI 3.6% of all companies have broad-based ESO plans; 2009 Poutsma/Braam for SNPI 13% of all AEX companies have broad-based ESO plans **SO:** 2005 Cranet 4%; EU Report 2003, more than 80% of all listed firms; 2009 Kaarsemaker for SNPI 1% of all companies have broad-based SO plans; 2009 Poutsma/Braam for SNPI 16% of all AEX companies have broad-based SO plans **PS:** 3 million participants (2000); 2009 Poutsma/Braam for SNPI 7% of all AEX companies have broad-based PS plans.
Austria	**[A] Trade unions / employer associations** currently support EFP and co-operate; different views about participation in decision-making; **[B]** Legislation since 1974; first tax incentives since 1993; more active support since 2001.	**ESO:** discounted ES in JSC; financing by company possible; PIT/SSC allowance for benefit; CGT or 1/2 PIT for dividends; tax exemption for share sale gain; **Intermediary entities:** Employee Foundation: EmpC buys own stock, sheltered in intermediary entities, dividends paid out; EmpC: contribution to intermediary entities, setting-up/operation cost deductible; intermediary entities: tax allowance on contributions; Empl.: CGT on dividends;	2010 Cranet: **ESO** 9.4%, **PS** 42.4%; 2010 EWCS: **ESO** 1.6%, **PS** 9.1%; 2005 WKÖ/BAK: **ESO** 8%, **PS** 25%; **SO:** 2005 Cranet: 2%; 2005 WKÖ/BAK: 1%

	General attitude [A] Social partners [B] Government	Legislation and fiscal or other incentives	Schemes and their incidence: CRANET: Offer in firms > 200 employees EWCS: Take-up rate of employees
		SO: capital increase: nominal amount up to 10%, increase up to 50% of equity capital; up to 20% of equity capital for total amount of shares receivable; 10% of benefit/year, up to 50% of total benefit tax-free and carry forward of taxation for the remaining amount; **PS:** none.	
Portugal	**[A] Trade unions / employer associations** indifferent, low priority: **Trade unions** prefer **PS** to SO; **[B] ESO** mainly supported in privatisation, especially around 1997; not on the agenda; EFP is generally ignored.	**ESO:** PrivL—discounted ES; ES in JSC, financing by firm possible; in capital increase: suspension of pre-emptive right of shareholders for "social reasons" possible; **PS:** national labour legislation—not considered remuneration, no SSC; **SO**: 50% of share sale gain liable to PIT.	2008 PEPPER IV: **ESO** 5.3%, **PS** 28% 2010 EWCS: **ESO** 1.7%, **PS** 3.3%; **SO:** EU Report 2003, from 60 firms listed at Euronext Lisbon Stock Exchange, about 22% have implemented SO.
Finland	**[A] Trade unions / employer associations** generally support EFP, especially desire to improve the environment for personnel funds; other forms not discussed; **[B]** Discussions on EFP since 1970s; 1989 Law on Personnel Funds (major form until now); 2010 amendments to the Law on Personnel Funds.	**ESO:** discount tax-free, no SSC; tax relief for dividends; **SO:** none; **PS:** cash-based none; share-based "Personnel Funds": in firms with more than 10 employees, if all participate, registration with Ministry of Labour, maximum of 15% per annum can be withdrawn; 20% of payments to employee tax-free; earnings of fund tax-free.	2010 Cranet: **ESO** 9.3%, **PS** 71.4%; 2010 EWCS: **ESO** 2.1%, **PS** 27.3%; **SO:** 2005 Cranet 5%; 2003 EU Report: 84% of companies listed at Helsinki Stock Exchange; **PS:** 2007 54 Personnel Funds with 126,000 members.
Sweden	**[A] Trade unions** neutral/opposed, advocated Wage Earners' Funds; **employer associations** favour **PS** for wage flexibility, but no active support; **[B]** From 1992–97 tax incentives for PS in firms; since then no support.	**ESO:** ES in JSC, financing by company possible; in capital increase suspension of pre-emptive right of shareholders possible; **PS:** cash-based none; share-based "Profit-Sharing Foundations": one third of employees on similar terms, after dissolution assets to be distributed; for the employer 24.26% payroll tax instead of 32.28% SSC; **SO:** none.	2010 Cranet: **ESO** 7.8%, **PS** 15.8%; 2010 EWCS: **ESO** 8.2%, **PS** 35.9%; **PS:** 2003 Heissmann: 15%; Wage Earners' Funds created in 1983, abolished in 1991.

	General attitude [A] Social partners [B] Government	Legislation and fiscal or other incentives	Schemes and their incidence: CRANET: Offer in firms > 200 employees EWCS: Take-up rate of employees
UK	**[A]** Climate friendly and supportive toward EFP; **trade unions** involved, but reservations: prefer SO to PS; **employer associations** positive, favour flexibility with regard to form of schemes; employees interested; **[B]** Long tradition of EFP, especially ESO and ESOP; now more active support for SO that is Save-As-You-Earn Schemes and Sharesave; 2000 introduction of Enterprise Management Incentives; very little participation in decision-making.	**ESO:** Share Incentive Plans discounted: no PIT/SSC; no dividend tax if dividends re-invested in shares, generally no SSC; no CGT, if sale immediately after taking shares out of the plan; **SO:** Savings-Related SO-Plan, Firm SO Plan: generally no PIT at grant or exercise, no SSC; Save-As-You-Earn Schemes: tax bonus on savings; Enterprise Management Incentives: no PIT, no SSC at grant or exercise; (Employee Benefit Trust); **ESOP:** maximum of GBP 125 per month shares for pre-tax salary in Trust, EmpC maximum of 2 matching shares / share worth up to GBP 3,000 per annum; shares exempt from income tax and SSC after 5 years; EmpC contribution to trust tax deductible; **PS:** approved PS; tax benefits abolished in 2002.	2010 Cranet: **ESO** 30%, **PS** 9.8%; 2010 EWCS: **ESO** 5.2%, **PS** 12.8%; **ESO/SO:** 2006 ifsProShare: approved plans in 5,000 firms, some with **ESOP**s; Share Incentive Plans in 830 firms; **Share-based Profit Sharing:** 2002 1 million employees under approved schemes, average per head less than GBP 700; **ESO:** 2010 HM Revenue and Customs: Share Incentive Plans in 840 companies; **SO:** 2005 Cranet: 2%; 2006 ifsProShare: Save-As-You-Earn Schemes in 1,300 firms, 2.6 million employees; Company Share Option Plans in 3,000 firms; Enterprise Management Incentives in 3,000 firms; 2010 HM Revenue and Customs: Save-As-You-Earn Schemes in 600 companies; Company Share Option Plans in 1,490 companies; Enterprise Management Incentives in 10,610 companies.
EU-12			
Bulgaria	**[A] Trade unions** open to EFP, **employer associations** indifferent; not a current topic on either of their agendas; **[B] ESO** strong support 1997-2000, then ignored; in 2002 PrivL incentives abolished; EFP generally ignored.	**ESO:** none; uniform 7% dividend tax; **PS:** none; share-based profit sharing personal income tax exempt.	2010 Cranet: **ESO** 15.8%, **PS** 12.3%; 2010 EWCS: **ESO** 0.7%, **PS** 8%; **SO:** 2005 Cranet 14%; **ESO:** 10% mass privatisation, 4-5% cash privatisation; low, decreasing; **Management-employee buyout:** 1,436, 28% privatisations; managers took over most; **PS:** anecdotal information only, few cases survey evidence.
Czech Republic	**[A] Trade unions / employer associations** indifferent to EFP, not a current topic on their agendas; **[B] ESOP** discussed in 1990; EFP ignored after introduction of voucher concept.	**ESO:** discounted ES/share-based profit sharing in JSC; not considered public offering; ES discount limit: 5% of equity capital, financing by firm possible; uniform 15% dividend tax; **PS:** Cash-based profit sharing/share-based profit sharing in JSC; negotiable in collective bargaining agreements.	2005 Cranet: **ESO** 7.4%, **PS** 11.1%; 2010 EWCS: **ESO** 1%, **PS** 20.7%; **SO:** 2005 Cranet: 3%; **ESO:** insignificant; 0.3% of the privatised assets; **PS:** anecdotal information only, insignificant.

	General attitude [A] Social partners [B] Government	Legislation and fiscal or other incentives	Schemes and their incidence: CRANET: Offer in firms > 200 employees EWCS: Take-up rate of employees
Estonia	**[A] Trade unions** indifferent to EFP; **employer associations** opposed to any extension of employee participation; **[B]** PrivL supported **ESO** until 1992; after 1993 EFP ignored.	**ESO:** rights attached to shares issued before 1995 remain valid; no public prospectus for ES needed; Emp.: no income tax on dividends from resident firms; EmpC: 22% on distributed profit, only "bonus issue" in capital increase exempt; **PS:** none.	2010 Cranet: **ESO** 10.5%, **PS** 5.3%; 2010 EWCS: **ESO** 1.2%, **PS** 12.2%; **ESO:** 2005 2% (1995 after privatisation 20%) of firms majority employee-owned, 20% minority; **PS:** anecdotal information only, survey evidence, very few cases.
Hungary	**[A]** EFP for managers means to avoid external control, for employees to preserve workplace; **trade unions** lobbied **ES**/**ESO** in privatisation, recently passive; **employer associations** indifferent; **[B] ESOP**/**ES** strong support in PrivL until 1996; climate friendly toward EFP but lack of concrete economic policy decisions.	**ESO:** PrivL—preferential sale; discount maximum of 10% firms assets and 150% of annual minimum pay, instalments; Decree "Egzisztencia" Credit; specific "ES" in JSC, discounted/free, up to 15% of equity capital, financing by company possible; since 2003 tax-qualified stock plans, first HUF 0.5 million free, then 20% tax, 3-year holding period; **SO:** PIT base is value at exercise; **ESOP:** ESOP Law 1992; preferential credit; corporate tax exempt until end 1996; contribution to plan up to 20% tax deductible; tax base lowered; **PS:** none.	2010 Cranet: **ESO** 22.9%, **PS** 2.9%; 2010 EWCS: **ESO** 0.9%, **PS** 9.2%; **SO:** 2005 Cranet 27%; **ESO:** 2010 HWERS 7% of companies; 2009 Labour Force Survey of the Hungarian Central Statistical Office 0.4% of employees; **ESOP:** initially 287 companies employing 80,000, in 2010 79 ESOP-companies left; **PS:** 2010 HWERS 7% of companies (plan pre-defined and broad-based).
Cyprus	**[A]** EFP not an issue on **trade unions** / **employer associations** agendas; **[B]** EFP so far ignored.	**ESO:** discounted ES in JSC; financing ES by company possible; dividends/gains from share sale tax-free; **PS:** none.	2010 Cranet: **ESO** 3.9%, **PS** 7.7%; 2010 EWCS: **ESO** 2.2%, **PS** 4.6%; **SO:** 2005 Cranet: 4%; **ESO/PS:** anecdotal information only, insignificant.
Latvia	**[A] Trade unions / employer associations** indifferent to EFP, not a current topic on their agendas; **[B]** Little support for **ESO** in PrivL; EFP so far ignored.	**ESO:** PrivL—up to 20% ES, but abolished in 1997; specific "ES" in state / public firms; preferential ES in JSC free/discounted, in capital increases up to 10% of equity capital non-voting stock; **PS:** none.	2010 EWCS: **ESO** 1%, **PS** 9%; **ESO:** PrivL 110.6 million vouchers to 2.5 million people; anecdotal information only, 1999 16% of 915 firms dominant ESO but falling over time; **PS:** anecdotal information only, 7% of firms; mostly IT, consulting, real estate.

	General attitude [A] Social partners [B] Government	Legislation and fiscal or other incentives	Schemes and their incidence: CRANET: Offer in firms > 200 employees EWCS: Take-up rate of employees
Lithuania	**[A]** Climate EFP friendly; **trade unions** interested, lack of actions; **employer associations** support individual firms; **[B] ESOP/ES** strong support in PrivL until 1996; now EFP not on political agenda of Parliament and Government.	**ESO:** PrivL—5% ES deferred payment up to 5 years; in corporations ES for 3 years non-transferable/non-voting, financing by company possible; uniform 15% dividend tax; after holding period profits from sale of shares not taxed; **PS:** none.	2010 CRANET: **ESO** 7.3%; 2008 PEPPER IV: **ESO** 4%, **PS** 36%; 2010 EWCS: **ESO** 0.6%, **PS** 12.5%; **ESO:** low and decreasing; anecdotal information only, 2000 36% (1995 92%) privatised firms dominant ESO, falling over time; **PS:** anecdotal information only; cash-based PS mostly foreign (IT, consulting, advertising, etc.); deferred PS few cases 2005 linked to employee savings plan.
Malta	**[A] Trade unions** support schemes in practice; EFP not a current topic in national tripartite dialogue; **[B]** EFP collateral effect of nationalisation (1980s) and privatisation (1990s) not a current issue.	**ESO:** ES in corporations, exempt from prospectus/investment rules; up to 10% discount, financing by company possible; SO only taxable at exercise; tax limited to 42.85% of the tax rate on the excess of share market value at exercise over the option price; **ESOP:** Trust Act refers to EFP; taxed 15% interest / 10% investment; **PS:** mentioned in national labour legislation.	2010 EWCS: **ESO** 1.5%, **PS** 4.2%; **ESO:** anecdotal information only; banking sector: ES, Save-As-You-Earn scheme, SO; **ESOP:** anecdotal information only, trust funds in Bank of Valetta / Malta Telecom; **PS:** anecdotal information only; 2004 public sector (shipyard 1,761 employees); private (foreign) firms, mostly reserved for management.
Poland	**[A] Trade unions / Employer Associations** indifferent to EFP; managers/ employees pragmatically motivated; lobby groups/financial institutions supportive to **ESO;** **[B]** EFP supported in early privatisation period; **ESO** in most privatisations, since mid-1990s more and more ignored; **PS** increased emphasis in the context of collective bargaining agreements; 2009-11 discussed on political agenda.	**ESO:** PrivL—15% ES for free, 2 years non-transferable, up to value 18 months minimum pay, National Investment Funds 1995, shares for symbolic fee; ES/share-based PS in JSC, financing by company possible; uniform 15% dividend tax; **EBO:** PrivL—leveraged lease buyout, anticipated ownership transfer possible; interest 50% of refinance rate; interest part of lease payments are costs; Insolvency Law—buyout right; 2009 Government programme "Supporting privatisation through granting sureties and guarantees to employee companies and civic activity companies"; **PS:** cash-based PS/share-based PS in JSC.	2008 PEPPER IV: **ESO** 40%, **PS** 26%; 2010 EWCS: **ESO** 1.5%, **PS** 13.8%; **ESO:** low and declining; anecdotal information only in privatised firms, 2000 approximately 11.4% (1998 12.7%); NIF adult citizens 1 share in 15 funds; **EBO:** leveraged lease buyout 2002 one third of privatisations, most frequently used single method, 1,335 firms employing 162,000, 14% over 250 employees; **PS:** anecdotal information only, limited to management.

	General attitude [A] Social partners [B] Government	Legislation and fiscal or other incentives	Schemes and their incidence: CRANET: Offer in firms > 200 employees EWCS: Take-up rate of employees
Romania	**[A] Trade unions** support individual cases; **employer associations** avoid topic; tripartite council tackled EFP sporadically; collective labour contract 2007-10 social partners committed to sustain employees' shareholder associations in privatisation. **[B] ESO** supported until 1997 especially **management-employee buyout**; then support declined; current government gives little support.	**ESO:** PrivL—aim 30% of privatised assets vouchers/ES; vouchers free; 10% discount ES; ES in JSC, financing by company possible; 10% dividend tax; **ESOP:** PrivL on Employee Shareholder Associations; leveraged transaction, preferential credit, up to interest rate 10%; **PS:** Ordinance—cash-based profit sharing compulsory in state/municipal firms.	2008 PEPPER IV: **ESO** 6%, **PS** 42%: 2010 EWCS: **ESO** 2%, **PS** 5.7%; **ESO:** ES 10% of shares issued at privatisation, decreasing; **ESOP:** 1998 one third of privatisations, most frequently used single method 2000: 2,632 firms, average 65% ESO, 1,652 majority ESO; **PS:** estimated 1.2 million employees in public sector covered.
Slovenia	**[A] Trade unions / employer associations** very supportive to EFP; Employee Ownership Association lobbies legislation; active support by Works Councils/Managers Association; **[B]** Strong political support to EFP; draft laws 1997/2005 in parliament rejected; new Law on EFP in 2008.	**All schemes:** since 2008 70% tax relief for PS and ESO with 1-year holding period (100% relief with more than 3-year); up to 20% profits or 10% total salaries per annum and up to EUR 5,000 per employee; **ESO:** PrivL—up to 20% ES for vouchers; vouchers free, shares for overdue claims; ES /share-based PS in corporations; discount/financing by company possible; **EBO:** up to 40%, shares 4 years non-transferable; worker association proxy organisation under Takeover Law; **PS:** PrivL—share-based PS in internal buyout.	2010 Cranet: **ESO** 8.5%, **PS** 20.8%; 2010 EWCS: **ESO** 3.7%, **PS** 23.2%; **SO:** 2005 Cranet 4%; **ESO/EBO:** 90% of privatised firms; CS 1998 60% majority; ESO while only 23% of capital (2004 18% strong decline); **PS:** CS, in statutes of 32% of firms, but unexploited in 22%; for board members 20% of listed firms.
Slovakia	**[A] Trade unions / employer associations** indifferent to EFP, not a current topic on their agendas; **[B] ESOP** discussed in 1990; **EBO** concept failed 1995; EFP now generally ignored.	**ESO:** discounted ES and share-based PS in JSC; up to 70% discount and financing by company possible; **PS:** cash-based PS/share-based PS in JSC.	2010 Cranet: **ESO** 26.9%, **PS** 6.7%; 2010 EWCS: **ESO** 3.3%, **PS** 25.6%; **SO:** 2005 Cranet 10%; **ESO:** insignificant; anecdotal information only, banking sector / new privatisations; **EBO:** anecdotal information only, in privatisation, usually management-led.

Source: PEPPER I-IV and: CNMV, 2003; CRANET, 2010/05 (firms with more than 200 employees); EU Stock Options Report, 2003 (European Commission, 2003); EWCS, 2010 (Eurofound, 2012) (take-up rate); AFG, 2011; Heissmann, 2003 (Würz, 2003); IAB, 2005 (Bellmann and Möller, 2005); IBEC, 2002; ifsProShare, 2006; WKÖ/BAK, 2005 (Vevera, 2005); WSI (Wirtschafts- und Sozialwissenschaftliches Institut), 2003; please note that the country data of the different surveys is incoherent due to inconsistencies in methodology and definitions. *Excluded from studies*: Management Buyout, General Savings Plans, Consumer and Housing Co-operatives.

Abbreviations: CGT = Capital Gains Tax; CivC = Civil Code; CS = Case Studies; EBO = Employee Buyout; EmpC = Employer Company; ES = Employee Shares; ESO = Employee Share Ownership; ESOP = Employee Share Ownership Plan; EFP = Employee Financial Participation; JSC = Joint-stock Companies; PIT = Personal Income Tax; PrivL = Privatisation Legislation; PS = Profit Sharing; SO = Stock Options; SSC = Social Security Contributions.

ANNEX 2: OVERVIEW TABLE ON FISCAL INCENTIVES FOR EFP IN THE EU-27

Table 5: Tax and fiscal incentives for employee financial participation in the EU-27[77]

Country	Employee	Company
Belgium **ESO**	**ES:** Since 2001: 15% tax on benefit, no SSC if 2-5 years blocking period; tax base: quoted shares market value—costs, non-quoted shares purchase price—net asset value of shares; sale of shares: tax-free up to 25% of equity; sale during blocking period 23.29% punitive tax; **SO:** Since 1999: taxation moment—at grant; taxation base: lump sum value = 15% of stock value at grant plus 1% for each year before exercise, value reduced by half (7.5% plus 0.5%) if options cannot be exercised within 3 years from grant, exercise period within 10 years from grant, no guarantee against fall in value, strike price determined at option offer; no SSC; **IntE:** Do not exist.	**ES:** Discount deductible from tax base of CIT; **SO:** Difference between market price of stock and exercise price of options deductible from tax base of CIT only if not EmpC, but a foreign company provides shares for employees at exercise and cross-charges the cost to EmpC; **IntE:** Do not exist.
PS	**General:** Since 2001: 15% tax for participation in the framework of an investment savings plan; 25% tax in other cases; but full SSC; **IntE:** Do not exist.	**General:** No SSC; **IntE:** Do not exist.
Denmark **ESO**	All tax incentives abolished from 1 Jan. 2010 on (individual plans), from 1 Jan. 2012 on (broad-based plans); before: **ES:** Since 1987 (broad-based plan): no PIT, no SSC on discount, if value does not exceed 10% of annual salary, 5-year blocking period and shares deposited in trust with a bank; **SO:** (1) Broad-based plan (since 1987): no PIT, no SSC if value of options does not exceed 10% of annual salary and 5-year blocking period; (2) Individual plan under § 7H (since 2003): no PIT, no SSC if value of options does not exceed 10% of annual salary or exercise price less than 15% lower than market price of underlying shares; (3) Individual plan under § 28: no incentives. **IntE:** Do not exist.	**ES:** Discount deductible from tax base of CIT; **SO:** (1) Option costs deductible from tax base of CIT; (2) No; (3) Option costs deductible from tax base of CIT; **IntE:** Do not exist.
PS	Tax incentives abolished from 1 Jan. 2010 on (individual plans), from 1 Jan. 2012 on (broad-based plans); before: **General:** (1) Broad-based plan (since 1987): up to DKK 8,000 tax-free if blocking period 7 years and shares deposited on trust with a bank (2) Individual plan under § 7H (since 2003): no PIT, no SSC on benefit if value does not exceed 10% of annual salary; **IntE:** Do not exist.	**General:** (1) Costs of shares deductible from tax base of CIT; (2) No; **IntE:** Do not exist.
Germany **ESO**	**ES:** No PIT, no SSC on benefit, up to Euro 360 annually; no PIT but SSC on contributions from salary reduction; savings bonus of 20% on investment up to EUR 400 per annum, if annual income up to EUR 20,000 and 6-year blocking period; **IntE:** Special Fund for Employee Participation – same as for ES. **SO:** No;	**ES:** No SSC on employer matching contribution up to Euro 360 annually; **IntE:** Special Fund for Employee Participation – same as for ES; **SO:** No.
PS	**General:** No; **IntE:** Do not exist.	**General:** No; **IntE:** Do not exist.

[77] The table comprises data on those of the 27 Member States (16 countries) where tax and financial incentives have been granted until 31 December 2011.

Country	Employee	Company
Ireland **ESO**	**ES:** (1) Purchase of new shares: tax incentives abolished from 8 December 2010 on; before: at sale of shares no PIT, no SSC, only CGT on issue price, if full price paid, 3-year blocking period and not exceeding lifetime ceiling of EUR 6,350; (2) Restricted Stock Scheme: deduction from tax base of PIT on benefit from 10% for 1-year blocking period to 55% for 5-year blocking period; **SO:** All tax incentives abolished for stock options granted from 24 Nov. 2011 on; before: (1) Since 1999 SAYE: no PIT at grant or exercise, if plan broad-based, SAYE contract with a bank for 3, 5 or 7 years, exercise price of shares up to 25% under the market value of underlying shares at option grant, plan approved by tax authoritie, but full SSC; (2) Since 2001 Approved Share Option Scheme: no PIT, no SSC at grant or exercise, if plan broad-based, 3-year blocking period, plan approved by tax authorities; **IntE:** ESOT enjoy incentives only if combined with Approved Profit-Sharing Scheme (see below).	**ES:** (1) No SSC; (2) No; **SO:** (1) No SSC; (2) No SSC; **IntE:** ESOT enjoy incentives only if combined with Approved Profit-Sharing Scheme (see below).
PS	**General:** No; **IntE:** (1) Since 1986 Approved Profit-Sharing Scheme: no PIT, no SSC on benefit not exceeding EUR 12,700, if plan broad-based, 3-year blocking period in trust, plan approved by tax authorities; sale of shares: CGT; sale during blocking period PIT at top rate on proceeds of sale less market value and CGT on increase in value; (2) Since 1997 ESOT: incentives only if combined with Approved Profit-Sharing Scheme trust.	**General:** No; **IntE:** (1) Costs of setting up and operating the plan deductible from tax base of CIT, no SSC; (2) EmpC: incentives only if combined with Approved Profit-Sharing Scheme trust; IntE: no tax on dividends if dividends used for qualifying purposes.
Greece **ESO**	All tax incentives abolished from 1 Jan. 2012 on; before: **ES:** Since 1987: (only for JSC) no PIT, no SSC on benefit—if shares issued in a capital increase 3-year blocking period; dividends: tax on movable assets (10%); **SO:** (1) Since 1999 "Qualified plans": no PIT, no SSC at grant or exercise; (2) Since 1988 "Non-qualified plans": gift tax can be applied instead of PIT at discretion of tax authorities; **IntE:** Do not exist.	**ES:** Discount deductible from tax base of CIT, no SSC; **SO:** (1) No; (2) Costs of distributed shares deductible from tax base of CIT; **IntE:** Do not exist.
PS	All tax incentives abolished from 1 Jan. 2012 on; before: **General:** (for JSC, usually cash-based) no PIT, but SSC on benefit if not exceeding 25% of annual gross salary; **IntE:** Do not exist.	**General:** Distributed amount deductible from tax base of CIT, but SSC; **IntE:** Do not exist.
Spain **ESO**	**ES:** (1) Since 2003: no PIT, no SSC on benefit up to EUR 12,000, if plan regular, each employee and his family own not more than 5% of equity capital, 3-year blocking period; (2) Since 1997 for "Workers' Companies" (Sociedades Laborales), if reserve for loss compensation 25% of annual profits tax credit of 99% on transfer tax and following tax exemptions on: tax on company formation and levies for notarial deeds on transfers to the company, debts, bonds and debenture bonds; public unemployment benefit can be paid out as a lump sum if it is invested in a "Workers' Company"; **SO:** 80% tax relief on up to 2 x (annual medium wage x number of years before vesting), if vesting period not exceeding 2 years, options granted not annually, 3 years between option grant and share sale, plan broad-based; **IntE:** Do not exist.	**ES:** No; **SO:** No; **IntE:** Do not exist.
PS	**General:** No; **IntE:** Do not exist	**General:** No; **IntE:** Do not exist.

Country	Employee	Company
France **ESO**	**ES:** No; **SO:** No; **IntE:** Do not exist.	**ES:** Training of employees on EFP: tax relief EUR 75 per hour p.p. up to EUR 5,000 per company for 2 years (2007); **SO:** No; **IntE:** Do not exist.
PS	**General:** Since 1986/1994 (intéressement): no SSC, but full PIT, if transferred immediately; tax incentives only if combined with savings funds (PEE, PPESV); since 1967/1986/1994 (participation—profit sharing): no PIT, reduced SSC of 8% on benefit if blocking period 5 years, the amount does not exceed 25% of gross salary; returns tax-free if accumulated, 13.5% special flat tax if paid out during blocking period; **IntE:** Since 1986/1994 (PEE—short-term savings plan): no PIT, reduced SSC of 8% if blocking period 5 years and EmpC match does not exceed the ceiling; Since 2001: (PPESV—long-term savings plan): like short-term, but blocking period 10 years; if EmpC match exceeds the ceiling for short-term, but is under the ceiling for long-term—flat tax of 8.2%; returns: flat tax of 13.5%.	**General:** Since 1986/1994 (intéressement—gain sharing): no SSC; tax incentives only if combined with savings funds (PEE, PPESV); Since 1967/1986/1994 (participation—profit sharing): no CIT, reduced SSC of 8% on benefit if blocking period 5 years, the amount does not exceed 25% of gross salary; returns tax-free if accumulated, 13.5% special flat tax if paid out during blocking period; **IntE:** Since 1986/1994 (PEE—short-term savings plan): no CIT, reduced SSC of 8% if blocking period 5 years and EmpC match does not exceed the ceiling; Since 2001: (PPESV—long-term savings plan): like short-term, but blocking period 10 years; if EmpC match exceeds the ceiling for short-term, but is under the ceiling for long-term—flat tax of 8.2%; returns: flat tax of 13.5%.
Italy **ESO**	**General:** sale gain taxed with 12,5 CGT instead of 40%; **ES:** Since 1999: no PIT, no SSC on benefit up to EUR 2,066 if 3-year blocking period; in LLC free share up to EUR 7,500 tax exempt; **SO:** Since 1999: no PIT, no SSC if 5-year blocking period between option grant and sale of shares, unless proceeds of the share sale invested in securities with the value equal to the difference of shares value at option grant minus share purchase price; PIT exemption abolished in 2008; **IntE:** Do not exist.	**ES:** Discount deductible from tax base of CIT; **SO:** No; **IntE:** Do not exist.
PS	**General:** Since 2007: 23% deduction of PIT up to EUR 350 annually, no SSC; max bonus value EUR 6,000 with income ceiling of EUR 35,900 annually, but regional and municipal tax of 10%; **IntE:** Do not exist.	**General:** Since 1997/2007: 5% tax exemption for contributions distributed to employees, 25% deduction of SSC; **IntE:** Do not exist.
Hungary **ESO**	**ES:** Since 2003 "Approved Employee Securities Benefit Programme": no PIT and tax relief for voluntary insurance on benefit, if not exceeding HUF 1,000,000 per annum and programme approved; **SO:** Since 2003 "Approved Employee Securities Benefit Programme": incentives same as for ES; **IntE:** Since 1992 ESOP: no PIT on shares transferred via ESOP; contributions to ESOP deductible from tax base of PIT.	**ES:** No; **SO:** No; **IntE:** Contributions to ESOP deductible from tax base of CIT.
PS	**General:** No; **IntE:** Do not exist.	**General:** No; **IntE:** Do not exist.

Country	Employee	Company
Nether-lands **ESO**	All tax incentives abolished from 1 Jan. 2012 on; before: **ES:** Since 1994, usually JSC: tax incentives only in combination with a savings plan—no PIT, no SSC, instead 15% flat tax, if plan broad-based, 4-year blocking period, annual ceiling of the savings plan EUR 1,226; **SO:** No; **IntE:** since 1994, usually LLC: regulation of tax incentives as for direct employee share ownership.	**ES:** No; **SO:** No; **IntE:** No.
PS	All tax incentives abolished from 1 Jan. 2012 on; before: **General:** Since 1994/2003: tax incentives only in combination with a savings plan—no PIT, no SSC, instead 15% flat tax, if plan broad-based, 4-year blocking period, annual ceiling of the savings plan EUR 613; **IntE:** Do not exist.	**General:** No; **IntE:** Do not exist.
Austria **ESO**	**ES:** Since 2001: Amount free of taxes and SSC up to EUR 1,453.46 per annum, if 5-year blocking period, plan broad-based, shares deposited with a domestic credit institution; **SO:** Tax incentives abolished on 1 April 2009, before: since 1999: tax allowance (10% of the benefit per year, but not more than 50% of the total benefit tax free) if options non-tradable, plan broad-based, value of underlying share at option grant not exceeding Euro 36,400 plus carry forward of taxation for the remaining amount (taxation optionally at sale or at termination of employment, but at the latest at the end of the 7th year after grant) if options deposited with a domestic credit institution; **IntE:** Since 2001: up to EUR 1,453.46 per annum CGT; if more PIT; no SSC.	**ES:** The book value of transferred shares deductible as personnel costs; **SO:** Costs of share purchase or the amount not contributed to the equity in the case of capital increase deductible from CIT; **IntE:** Payments to IntE and costs for IntE deductible from CIT; up to EUR 1,453.46 annually per employee tax-free; if more CGT; dividends on shares tax-free.
PS	**General:** No; **IntE:** Do not exist.	**General:** No; **IntE:** Do not exist.
Poland **ESO**	**ES:** No; **SO:** No; **IntE**: Do not exist.	**ES:** Leveraged lease buyout, CIT Law allows to include interest part of lease payments as costs reducing the tax base; **SO:** No; **IntE:** Do not exist.
PS	**General:** No; **IntE:** Do not exist.	**General:** No; **IntE:** Do not exist.
Portugal **ESO**	**ES:** No; **SO:** No SSC; **IntE:** Do not exist.	**ES:** No; **SO:** No SSC; IntE: Do not exist.
PS	**General:** Since 1969 (usually cash-based): no PIT, no SSC, if individual agreement concluded and effective; **IntE:** Do not exist.	**General:** Profit distributed to employees deductible from tax base of CIT; **IntE:** Do not exist.
Slovenia **ESO**	**ES:** Since 2008: 70% deduction from PIT on benefit not exceeding EUR 5,000 annually per employee, if 1-year blocking period, 100% deduction, if 3-year blocking period; **SO:** No; **IntE:** Do not exist.	**ES:** Value of distributed shares deductible from tax base of CIT in the year, when the blocking period ends; **SO:** No; **IntE:** Do not exist.
PS	**General:** Since 2008 (for share-based PS): same as for ES; **IntE:** Do not exist.	**General:** Same as ES; **IntE:** Do not exist.

Country	Employee	Company
Finland **ESO**	**ES:** Since 1992: no PIT, no SSC on discount, if it does not exceed 10% and plan broad-based; dividends: in public companies 30% tax-free; in private companies 100% tax-free if earnings per share less than 9% and the total amount less than EUR 90,000; **SO:** No: **IntE:** Do not exist.	**ES:** Discount deductible from tax base of CIT; **SO:** No; **IntE:** Do not exist.
PS	**General:** No; **IntE:** Since 1989/1997: Personnel Funds no PIT, no SSC on 20% of payouts from the Fund, if 5-year blocking period.	**General:** No; **IntE:** EmpC: no CIT, no SSC on profits transferred to IntE; IntE: earnings tax-free.
UK **ESO**	**ES:** No; **SO:** (1) Since 1980 SAYE: no PIT, no SSC at grant or exercise, if plan broad-based, exercise price of shares up to 20% under market value of underlying shares at option grant, SAYE contract with a bank, plan approved by tax authorities; (2) Since 1984/1996 CSOP: no PIT, no SSC at grant or exercise, if value of outstanding options up to GBP 30,000 per employee, exercise price not lower than market value at grant, exercise period 3 to 10 years after grant, plan approved by tax authorities; (3) Since 2000 Enterprise Management Incentives: no PIT, no SSC at grant or exercise, if value of options granted annually not exceeding GBP 100,000 per employee and GBP 3 million per company, tax authorities notified; **IntE:** Since 2000 SIP: no PIT, no SSC on benefit, if plan broad-based, 5-year blocking period in trust, value of shares up to GBP 3,000 (free shares), up to GBP 1,500 (partnership and dividend shares) annually per employee, plan approved by tax authorities; sale of shares: no tax, no SSC if sold immediately after withdrawal.	**ES:** No; **SO:** (1)-(3) Costs of setting up and operating the plan; since 2003: costs of providing shares to the plan deductible from tax base of CIT, generally no SSC; **IntE:** Costs of setting up and operating the plan; since 2003: costs of providing shares to the plan deductible from tax base of CIT, generally no SSC.
PS	**General:** No; **IntE**: Do not exist.	**General:** No; **IntE**: Do not exist.

Source: Own research.

Abbreviations: CGT = Capital Gains Tax; CSOP - Company Share Option Plan, DKK = Danish krone; EmpC = Employer Company; ES = Employee Shares; ESO = Employee Share Ownership; ESOP = Employee Share Ownership Plan; ESOT - Employee Share Ownership Trust; EFP = Employee Financial Participation; JSC = Joint-stock Companies; LLC - Limited Liability Companies; PEE = Plan d'Epargne d'Entreprise; PIT = Personal Income Tax; PPESV = Plan Partenerial d'Epargne Salarial Volontaire; PS = Profit-Sharing; SAYE - Approved Savings-Related Share Option Scheme; SIP - Share Incentive Plan; SO = Stock Options; SSC = Social Security Contributions.

ANNEX 3: CLASSIFICATION OF SUPPORTIVE MEASURES AND EFFECTIVE TAX RATES

3.1. Methodology for Indicators of Classification

The analysis is based on objective criteria applicable to all EU Member States and—at least generally—measurable. The three indicators are: (i) **legal framework,** (ii) **fiscal and other incentives**, and (iii) **political acceptance and social dialogue**. However, this task is complex as most potential values of the indicators are not quantitative.

3.1.1. The legal framework

The legal framework as an indicator is not easily quantifiable, but the presence or absence of regulations can be used as a basis for distinguishing conducive and non-conducive legal arrangements. Regulations may be contained in different laws, but it is deemed effective, if it is systematic, i.e., the provisions of different laws are co-ordinated.

-1 The Member State has no systematic regulation of EFP and its general legal regulations inhibit the development of EFP.

0 The Member State has no systematic regulation of EFP and its general legal regulations neither promote nor inhibit the development of EFP

+1 The Member State has an isolated regulation of one aspect of EFP (usually company law).

+2 The Member State has a systematic regulation of more than one aspects of EFP.

+3 The Member State has a systematic regulation of more than one aspects of EFP (usually tax and company law) and one or more additional aspects (connection to securities law, labour law, social legislation, etc.).

3.1.2. Fiscal incentives

The indicator, which is generally quantitative, is connected with fiscal incentives. Usually, the term "fiscal incentives" refers to not just tax incentives but also measures such as subsidies for training or consulting on EFP, authorisation to use public unemployment benefits to set up a worker-owned company (and thus become a shareholder) or reduction of registration fees. The following grades were given to the EU Member States for fiscal incentives:

-1 The Member State has no special tax incentives on EFP and its general system of taxation inhibits the development of EFP.

0 The Member State has no special tax incentives on EFP and its general system of taxation neither promotes nor inhibits the development of EFP

+1 The Member State has (some) tax incentives on EFP, but their impact is not clear. This indicator alone might seem inadequate for rating since tax incentives could be ineffective and, therefore, have no impact on the practical implementation of EFP schemes. However, it does show the interest of the lawmaker in the issue and their willingness to adopt amendments, which could increase the effectiveness of tax incentives.

+2 The Member State has some tax incentives on EFP <u>and</u> the difference between the effective tax rate on a salary increase and that on an increase in income of the same value accruing through financial participation (e.g., employee shares or profit sharing) is **significant** due to these specific tax incentives (in some cases the advantage would accrue only if transferred shares are held by the employee for a period of time). The effective tax rates are calculated for all Member States in a separate table. A difference of over five per cent shall be deemed as substantial.

+3 The Member State has tax incentives on EFP applicable to most enterprises and the criteria for these tax incentives are clearly defined and not restrictive.

+4 The Member State has effective tax incentives (as under ++ and +++) and, additionally, other instruments of fiscal support for EFP schemes.

3.1.3. Political acceptance and social dialogue

The attitude of social partners, political parties and governments is a classic soft indicator. For the success rating, negative, neutral and positive attitudes were taken into account.

-1 The government and/or social partners are opposed to EFP in the Member State.

0 Neither government nor social partners are interested in EFP in the Member State.

+1 Only one social partner supports EFP in the Member State.

+2 Social partners support EFP, thus is a part of social dialogue in the Member State.

+3 EFP is a part of social dialogue and is substantially supported by the Government.

3.2. Methodology for effective tax rates

For the purpose of this study, taxes and social security contributions are calculated for 1 January 2010. However, the calculation tool developed in this context is a dynamic instrument providing comparative calculations for variable values.[78] Thus, the calcualtions can be performed for any other scenario as the one described here (see below 3.4.).

3.2.1. Identification of personal situations

In order to make the tax burdens comparable, the income of the employee, on which taxes and social security contributions are imposed, must be a median value for each country. In contrast to average (mean) income, a median value is a more precise statistical indicator, since it takes into account that more inhabitants of a country have lower incomes than higher incomes. The most recent data of Eurostat on household median income in EU-24 is from 2007. Since then, the household incomes in some countries might have risen; however, it is assumed that the relation between incomes in different Member States remained basically the same. Since not the absolute amount of taxes and social security contributions, but only the rates will be calculated, this relation is the only relevant value. Median incomes for the remaining three EU Member States were calculated by the economists of Staffordshire University on the basis of national statistics. All national median incomes are rounded by EUR 500.

Several standard personal situations are generally used for calculation of effective tax rates. Thereby, main criteria for differentiation are the marital status and the number of children. However, the aim of this study is to make taxation of different EFP schemes, also considering specific tax incentives for EFP, comparable. An additional differentiation according to family criteria would distort the results, since tax incentives for families and for EFP schemes have not the same volume in a given country. For that reason, only one personal situation (single person without children) will be considered.

[78] This dynamic tool, developed under the CETREPS project, is currently being tested by the authors. CETREPS (Calculating Effective Tax Rates for Employee Participation Schemes) was launched at Viadrina in 2010.

3.2.2. Identification of EFP schemes

For the sake of comparability, the amount of participation share granted (profit share in cash or the value of shares in share-based plans) is uniform for all countries and correspond to ten per cent of the annual median income.

The EFP schemes to be compared are cash-based profit-sharing, share ownership scheme, where shares are transferred to the employee directly, share ownership with an intermediary entity, which holds shares for the employee at least until the end of a mandatory holding period, as well as broad-based stock option schemes. Although such schemes in different Member States differ considerably, they have the same basic structure and are in so far comparable. In order to show the effect of tax incentives, taxation of a salary increase with the same tax value is included in the table for comparison.

3.2.3. Identification of taxation phases and taxes

Taxes and social security contributions are imposed in different phases. The most heavy tax and SSC burden is usually imposed at grant, because in most countries the participation share is considered to be a part of salary and therefore taxed by personal income tax, which might be progressive, and social security contributions. In this phase, tax incentives have a considerable effect. During the holding period taxes and—seldom—also SSC are imposed on the accumulated interest or dividends. At liquidation, participation share from a cash-based profit-sharing plan, which was deposited in a bank, is usually not taxed, whereas the proceeds of the sale of enterprise shares are generally taxed with capital gains tax. In each phase, the imposed taxes and SSC are calculated on the basis of special formulas. If deferred taxation is granted, the employee pays taxes on the value not at grant, but at liquidation, so that he can save the value accumulated during the holding period less the tax on interest.

However, stock options are usually—with the exemption of Belgium—taxed at exercise of the option. This means that in most Member States no tax and no SSC are imposed at grant and no interest on the option itself is accumulated during the holding period, but at exercise of the option—as a rule—PIT (and often also SSC) are payable. The tax base is generally the difference between the value of share at execution of the option and guaranteed price of share for the option holder. Additionally, CGT is imposed at sale of the share on the difference between the value of the share at sale and the value of the share at exercise.

3.2.4. Assumptions regarding the time period and interest rates

For determination of the holding period, the longest mandatory holding period for tax incentives in a Member State had to be considered. Therefore, the holding period of seven years according to § 7A of the Danish Tax Assessment Law was used as a calculation basis. Additionally, it is assumed that the employee is employed by his original employer during the holding period and liquidation.

The time aspect is taken into consideration by calculating the present value of taxes. Further, it is assumed that annual calculation interest is three per cent, annual interest on participation shares in cash three per cent and the annual increase in value of enterprise shares eight per cent. With respect of stock options, it is assumed that the granted options authorise the employee to obtain shares for a half of value of shares at grant of the options. The employee invests in the exercise period ten per cent of his annual salary. However, the options are not tradable even after the vesting period, which is the same as the blocking period of underlying shares as defined above. A further assumption is that the options are exercised immediately after the vesting period and the acquired shares are sold immediately.

3.3. Overview of the general taxation and compulsory social security contributions

Table 6: Overview of the general taxation and compulsory social security contributions

	Type of dividend treatment	CIT	Taxation of dividends at shareholder level	Taxation of share sale at share-holder level	PIT	Compulsory SSC
Belgium	Share-holder relief: reduced tax rate	3%	15%	Generally 0%	Progressive 25-50% central plus 0-9% sub-central; SSC deductible	Emp.: overall rate 13.07% EmpC: overall rate 35%
Bulgaria	Share-holder relief: reduced tax rate	10%	7%	Shares of public companies listed at Bulgarian stock exchange 0%	Flat 10%, vol-untary SSC deductible	Emp.: (cumulative) 12.10-25.74% EmpC: (cumulative) 29-29.7%
Czech Republic	Classical system	19%	15% with-holding tax at source	General PIT for sale of shares within 6 months	Flat 15%; SSC deductible	Emp.: (cumulative) 11% EmpC: (cumulative) 34%
Denmark	Classical system	25%	27% share income tax up to DKK 48,300, 42% above; not for professional traders	27-42%	Progressive 3.67-15% central plus 8% labour market tax plus aver-age 24.9% sub-central; ceiling 51.5%	Emp.: 8% health tax EmpC: 0%
Germany	Share-holder relief: reduced tax rate	34.5%	25% plus solidarity surcharge 5.5%; no SSC	25% plus solidari-ty surcharge 5.5%; no SSC	Progressive 14-45% plus soli-darity sur-charge 5.5%; limited by an absolute amount; pen-sion and health care contribu-tions partly deductible	Emp.: (average) 19.93-21.5% EmpC: (average) 19.03-19.43% both limited by an absolute amount
Estonia	Tax ex-emption for share-holder; exemp-tion of retained profits from corporate tax	21% on distri-buted profits	0%	General PIT	Flat 21%; mandatory SSC deductible	Emp: contribution to the unemploy-ment fund 2.8% EmpC: "social tax" 33% plus contribu-tion to the unem-ployment fund 1.4 %
Ireland	Classical system	12.5%	20%	25%	Progressive 20-41%; voluntary SSC deductible	Emp.: 5-8% EmpC: 10.75%
Greece	Share-holder relief: reduced tax rate	24%	10%	Generally 0%; 20% on sale of shares of LLC or partnerships	Progressive 18-45%; SSC deductible	Emp.: 16% EmpC: 28.06%; both limited by an absolute amount

Spain	Classical system	30.75%	General PIT	General PIT	19% up to EUR 6,000, 21% above	Emp.: 6.35% EmpC: 29.9%
France	Partial imputa-tion	33.33%	General PIT with tax credit of 40% (or optional 18% without de-ductions) plus social levies (CRDS, CSG) 12.1%	CGT 18% plus social levies (CRDS, CSG) 12.1%	Progressive 5.5-40%	Emp.: average 20% %; limited by an absolute amount EmpC: (aggregat-ed) 29.72-34.22%
Italy	Share-holder relief: reduced tax base and tax rate	31.4%	Qualified holdings—tax base reduced to 49.72%, tax rate gen-eral PIT; not qualified hold-ings—full tax base, tax rate 12.5%	12.5% for small shareholdings; general PIT on substantial; tax base reduced to 49.72% of gain	Progressive 23-43% plus sur-charge 0.9-1.4%; SSC deductible	Emp.: (cumulative) 9.2-10.2% EmpC: (cumulative) 23.05-32.08%
Cyprus	Share-holder relief: reduced tax rate	10%	15% special contribution to the defence fund	15% special con-tribution to the defence fund	Progressive 20-30%; SSC deductible	Emp.: overall rate 6.8% EmpC: overall rate 8.5% plus 2% to Social Cohesion Fund
Latvia	Share-holder relief: reduced tax rate	15%	10%	15%	Flat 26%	Emp.: overall rate 9% EmpC: overall rate 24.09%, both from after-tax income
Lithuania	Classical system	15%	20% plus 6% health care contribution	Generally 15%; 0% if held more than 1 year and no substantial share-holding for last 3 years	Flat 15%	Emp.: 9% EmpC: 30.98-31.7%
Luxem-bourg	Share-holder relief: tax base reduced	28.59%	15%	General PIT for short-term hold-ings; high allow-ance and ½ PIT rate for long-term holdings	Progressive 8-38%	Emp.: 12.14-14.45% EmpC: 12.14-19.07%
Hungary	Share-holder relief: reduced tax rate	10% up to HUF 500 m, 19% above	30%	20%	Progressive 17-32%; voluntary SSC deductible	Emp: 17% limited by an absolute amount EmpC: 29%
Malta	Full impu-tation	35%	General PIT and tax credit for CIT	Stamp duty 2-5%; shares quoted on Malta stock ex-change tax exempt	Progressive 15-35%	Emp.: overall rate EUR 13.24-65.82 weeklyEmpC: over-all rate EUR 13.24-65.82 weekly
Nether-lands	Share-holder relief: reduced tax rate	25.5%	15% for small, 25% for substantial holdings	0% for small, 25% for substantial shareholdings	Progressive 33.45-52%	Emp.: 5.2-31.15% EmpC: 19.43%

Austria	Share-holder relief: reduced tax rate	25%	25%; option-al: general PIT at a half rate; general-ly no SSC	0% for small long-term holdings, for substantial share-holdings 25%	Progressive 36.5-50%; statutory and voluntary pen-sion contribu-tions partly deductible	Emp.: (cumulative) 17.8-18.2% EmpC (cumulative): 21.7-21.9% deductible; both limited by an absolute amount
Poland	Share-holder relief: reduced tax rate	19%	19%	19%	Progressive 18-32%; SSC deductible	Emp.: average 13.71% EmpC: average 14.66-23.38%
Portugal	Partial imputa-tion	26.5%	20%; imputa-tion credit of 50%	Generally 10%; tax exemption if shares are held more than 12 months	Progressive 10.5-42%	Emp.: overall rate 11% EmpC: overall rate 23.75%
Romania	Classical system	16%	"Investment Tax" 16%	"Investment Tax" 16%; 1% for long-term investment	Flat 16%; vol-untary contri-butions to private pension funds deducti-ble	Emp.: (cumulative) 10.5-17% EmpC: average 20.8-29%
Slovenia	Share-holder relief: reduced tax rate	20%	20%	0-20% according to the holding term	Progressive 16-41% contribu-tions to private pension funds deductible	Emp.: 22.1% EmpC: 16.1%
Slovakia	Dividend tax ex-emption for share-holders	19%	0%	General PIT	Flat 19%; SSC deductible	Emp.: 13.4% EmpC: 35.2%
Finland	Full impu-tation	26%	"Investment Tax" 28%; generally no SSC; tax base reduced to 70%	28%	Progressive 6.50-30% central plus 18.49% (ave-rage) sub-central; SSC deductible	Emp.: average 7.3% EmpC: average 23%; both limited by an absolute amount
Sweden	Share-holder relief: reduced tax rate	26.3%	"Individual Capital In-come Tax" 30%	30%	Progressive 20-25% central plus 31.6% sub-central	Emp.: 7% EmpC: 31.42%
UK	Partial imputa-tion	28%	10% up to the basic rate limit; 32.5% above; 42.5% above GBP 150,000; imputation credit	CGT 18%; taper relief	Progressive 20-40%	Emp.: overall rate 11% EmpC: overall rate 12.8%

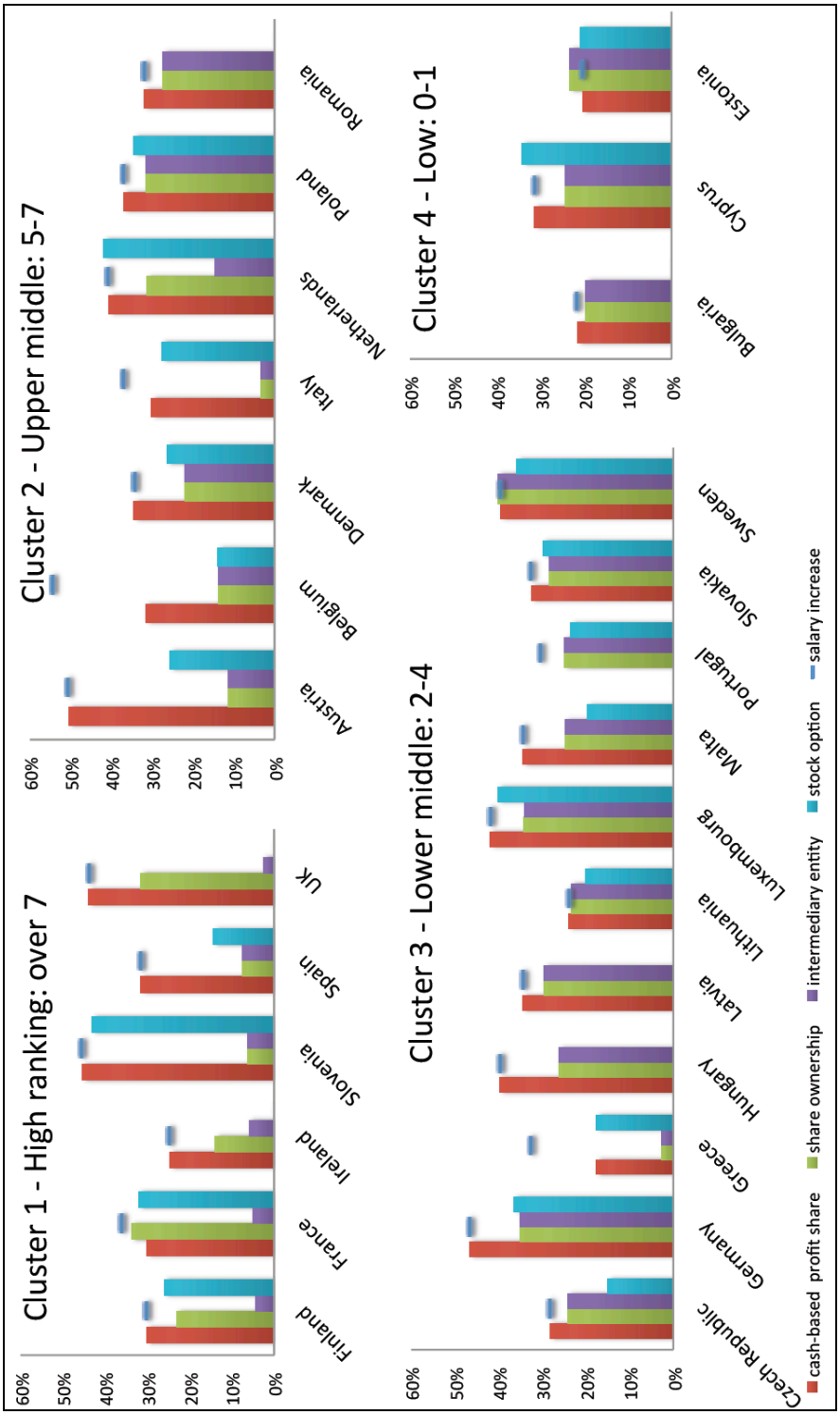
Source: Data on different types of taxes for 2010 are from the 2010 edition of the EU Report "Taxation trends in the European Union" or are downloaded from the EU's database (http://ec.europa.eu/taxation_customs/taxinv, log-in: 25 September 2010) and also http://www.dits.deloitte.com/DomesticRates/domesticRatesMatrix.aspx, Log-in: 25 September 2010. The generic term "corporate tax" includes in this context all central and sub-central statutory taxes and surcharges on corporation profits.

Abbreviations: CIT = Corporate Income Tax; Emp.: Employee; EmpC = Employer Company; PIT = Personal Income Tax; SSC = Social Security Contributions.

3.4. Overview of the effective tax rates in the EU-27

Figure 15: Overview of the effective tax burden (incl. social security contributions and other levies, etc.) on differernt EFP schemes in per cent of the final benefit in the EU-27.

"Final benefit" refers to the amount received by the employee at the time when the benefit is paid to the employee's account or when employee shares are sold, or invested profit share is cashed.



Value of financial participation from gross salary: 10%:	Calculations for a single with a median annual gross income in EUR									
Interest for calculation: 3%	Austria	22,500	Denmark	25,500	Finland	20,000	Luxemb.	30,000	Slovakia	6,000
Annual interest for profit share*: 3%	Belgium	22,000	Estonia	7,000	France	21,000	Malta	18,500	Slovenia	11,000
Annual increase in value for share ownership: 8%	Bulgaria	2,000	Hungary	6,000	Greece	14,000	Netherl.	22,000	Spain	16,000
Total period in years: 7	Czech Rep.	7,000	Ireland	22,500	Germany	21,500	Poland	5,500	Sweden	23,000
* = Average interest fixed long-term investment	Cyprus	34,000	Italy	19,000	Latvia	5,500	Portugal	10,000	UK	22,500
	Lithuania	5,500	Romania	3,500						

Source: Author's own calculations.

ANNEX 4: DESCRIPTION OF DATA SOURCES

Any benchmarking exercise, especially one involving a large number of countries, relies on the availability of comparable and consistent data. While there are a large number of studies on the impact of employee participation on company performance[79], there are very few sources of information on the availability and take-up of financial participation schemes across countries. Below we briefly present the main sources of information on financial participation (FP) schemes in European countries on which the discussion of this chapter and country reports are based. These sources are very different from each other and need careful interpretation.[80]

(i) CRANET Survey. This is a survey of companies with more than 200 employees[81] undertaken by the Cranfield School of Management (Cranfield University, UK) approximately every four or five years since 1992. It is largely a postal survey, sent to the Human Resources Departments of companies with the main aim of investigating the HR characteristics and practices of these companies. One section of the questionnaire is concerned with employees' remuneration and its components. In this section there are questions on whether the company offers any financial participation scheme (specifically, share ownership, profit-sharing or stock option schemes) to various occupational groups of employees (management, professional and technical, administrative, and manual workers). In 2005, the Survey covered 7,914 companies in 32 countries (among them the EU Member States and candidate countries not included were Ireland, Latvia, Lithuania, Luxembourg, Malta, Poland, Portugal, Romania and Croatia).[82] In 2010, the number of companies surveyed was 6,258 and only 20 Member States of the EU were included.[83] Because of the postal nature of the survey, the response rate is rather low (16 per cent in 2005 and around 10 per cent in 2010). The CRANET sample is selected randomly from the population of companies with more than 200 employees and is designed to represent the size and sectoral distribution of companies in the population.[84] The companies included in the sample are selected separately in each round of the Survey, thus the data is not in the form of a panel. It is essential to note that the CRANET Survey does not indicate the incidence of financial participation schemes in companies but only their availability. Furthermore, for the purpose of this research, we have been concerned with broad-based financial participation schemes (that is, schemes covering more than 50 per cent of employees) in private sector companies only, as profit-sharing or share ownership are largely not applicable to public sector organisations (which do not make "profit" as such and do not always have shares to distribute to employees).

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79 These studies are usually concerned with individual or a small number of countries and use different methodologies in pursuing their objectives.

80 In the period 2009-2012, three cross-country surveys, EWCS, ECS and CRANET survey, were conducted, including questions on employee financial participation. However, it should be noted that employee financial participation was only a minor issue in these surveys. The data from the three surveys on the incidence of employee financial participation differ considerably. This fact shows that—although the incidence must be an objective value—data from the surveys apparently do not reflect it with the necessary precision. The deviations can be connected with imprecise definitions, translation difficulties and/or the limited understanding of the respondents.

81 The 2010 Survey covered companies with 100 or more employees; in order to make this data set comparable with the previous two surveys it was recalculated for companies with more than 200 employees. The unit of investigation in CRANET is an "organisation" or a "business unit". While this may include a self-contained subsidiary of a larger company, in general it coincides with the boundaries of 'companies'. For the sake of simplicity, therefore, we refer to them as companies.

82 The number of companies in the countries of interest to this study was 5,214.

83 The number of companies in the countries of interest to this study was 3,811.

84 For more detailed information on the CRANET Survey, see CRANET (2011), CRANET (2005) and Pendleton et al. (2001).

(ii) European Working Conditions Survey (EWCS). This is a large-scale survey of working conditions across Europe undertaken by the European Foundation every four or five years to investigate a variety of factors influencing individuals' working and living conditions. One section of the questionnaire deals with remuneration and sources of income, asking the respondent whether they receive any income in the form of profit sharing or any income from the ownership of shares in the companies for which they work.[85] Given that individual subjects may be employed, unemployed, self-employed or retired, the present survey is only concerned with the individuals who are in employment. The 2005 Survey covered some 30,000 randomly selected individuals in 31 countries (including all EU Member States and candidate countries as well as some non-EU countries). The 2010 Survey covered 43,816 randomly selected individuals in 34 countries (including all EU Member States and candidate countries as well as some non-EU countries). These surveys are conducted by face-to-face interviews and, consequently, the response rate is higher (48 per cent in 2005 and 44 in 2010)[86]. As with the CRANET Survey, only a small part of this investigation is related to financial participation. The previous round of this survey took place in two waves—in 2000 for the EU-15 and a few other European countries and in 2001 for the accession and candidate countries. Unlike the CRANET survey, which only shows the availability of EFP schemes to employees, the EWCS represents the actual take-up of these schemes. However the data applies to all employees, irrespective of the size of their companies. Given that respondents may be from any category of employee (managers, professionals, clerical or manual), it is not possible to identify whether any financial participation scheme is broad or narrow. Unlike the 2000, 2005 and 2010 surveys, the 2001 round did not directly distinguish between employees of the public and private sector.[87]

(iii) European Federation of Employee Share Ownership (EFES) data. For many years, EFES has been collecting data on the scale of employee share ownership in large listed companies in 29 European countries, including all 27 EU Member States. The population of this database consists of all listed companies with a market capitalisation of at least EUR 200 million (in at least one of the years since 2007) and large non-listed employee owned companies (those employing more than 100 people with employees owning more than 50 per cent of shares). The former group consists of 2,196 (in 2010) companies and the latter of some 271 companies. For the purpose of this study, only the large listed companies have been used to indicate the trend of employee ownership between 2007 and 2010. The emphasis of this dataset is not on financial participation schemes in general but only on share ownership and only in large companies.[88]

(iv) Country Profiles. These are based on various sources, including the PEPPER I, II, and III and IV Reports, the EIRO Survey and our Project Expert Network in the field. These profiles of 29 countries (EU-27 and Croatia, Turkey) cover developments in three areas: Evolution of Financial Participation Schemes, Social Partners' Attitudes and Current Government Policy and Legal Framework.

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[85] There are however problems of definition. Especially the definition of profit sharing in the EWCS questionnaire is too broad and does not correspond to the formal definition of genuine profit-sharing plans. In some countries, the EWCS definition can include performance-related pay, bonuses, fringe benefits and even the 13th salary. Additionally, the distribution of these additional payments is often not linked to pre-defined criteria, so that it cannot be qualified as a plan. For that reason, the level of profit sharing according to EWCS is exceptionally high in almost all countries, but it does not reflect the actual situation.

[86] Of course, given that respondents either "did not know" or "refused to answer" some of the questions in the survey, the effective response rate was lower.

[87] However, given that the surveys identify the sector of activity of the respondents, the gap between the 2000 and 2001 surveys has been reduced by the elimination of those respondents working in "public services".

[88] For more detailed information on the EFES data, see Mathieu (2011).

(v) European Company Survey (ECS): The ECS 2009 was carried out in 30 countries: the 27 EU Member States, plus Croatia, Turkey and the Former Yugoslav Republic of Macedonia (FYROM). The following extracts from the European Foundation (2010) describe the sampling methodology of the European Company Survey (2009).

The unit of analysis in ECS is the establishment, the local unit in the case of multi-site enterprises. The sample is representative of establishments with ten or more employees from all sectors of activity, except for agriculture and fisheries (NACE A and B, Rev. 1.1), activities of households and extraterritorial organisations (NACE P and Q). The companies in the sample, selected for interviews, were chosen at random among those with ten or more employees in each country. Interviews were held in 27,160 establishments in 30 European countries, the number in each country ranging from almost 350 in Malta, the smallest EU economy, to about 1,500 interviews in the larger economies (for details of sampling method, see European Foundation, 2010, pp. 89-91).

The number of private establishments used for the analysis of profit sharing and share ownership was about 18,000. In this survey (questions MM460-464), a more precise definition of profit sharing and share ownership is included and a distinction is made between broad-based and executive plans. The respondents are managers and employee representatives, who have a good understanding of the issue discussed. Portugal is excluded from the information on share ownership due to incompatibility of the process with other countries.

ANNEX 5: LEGAL POLICY INSTRUMENTS FOR EFP AT THE EUROPEAN LEVEL

5.1. Harmonising Taxation and Company Law—The Directive Level

5.1.1. European framework directives

European Framework Directives aim to set minimum requirements that have to be implemented by Member States within a certain period of time.[89] By defining only basic aspects—e.g., general European guidelines—, they provide flexibility in choosing appropriate means to follow previously agreed standards. This could be a first move towards a common European fiscal treatment of EFP not previously available at Community level, enabling further political integration—a process, which could then be supported by succeeding regulations.[90] This approach is particularly apropos for the issue of taxation since they are subject to national sovereignty.

Competencies and scope of application

Therefore, a European Framework Directive regulating minimum standards for taxation—e.g., deferred taxation, a lowered level of capital gains tax, exemptions or lower compulsory social security contributions for benefits from EFP schemes—must not collide with national legislative sovereignty. Rather it would work as a binding letter of intent designed to inject basic principles into the system. To proceed beyond this basic harmonisation level, would require a different supranational legislative approach.

However, although a European Framework Directive would set only minimum standards for taxation, a Framework Directive could not be implemented according to Articles 289 and 294 Treaty on the Functioning of the EU (TFEU). The European Union respects Member States' sovereignty over tax matters – therefore, **tax** directives require the **unanimous consent of all 27 EU Member States**. In the area of indirect taxation, Art. 113 TFEU defines the EU's legislative competences to harmonise indirect taxes to ensure the effective functioning and consolidation of the internal market.[91] Any kind of harmonisation of taxation with regards to EFP falls within the category of direct taxes (Art. 115 TFEU). To fulfil their domestic policy objectives, Member States have broad freedom to design direct tax matters but in any event the fundamental **freedoms of the common market** must be respected. Only a few directives concerning company taxation, the general co-ordination of direct tax systems and taxation for individuals have been adopted, which is mainly due to the unanimity requirement for the adoption of such legislation.

Recommendation as the fallback solution

Accordingly, the legislative implementation of tax harmonisation as a second step after establishing an optional European concept of EFP based on the "28th regime" requires in any event unanimous consent within the Council. A recommendation although a legal instrument not having any binding force for the Member States would be easier to implement than a directive.

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[89] See http://www.europarl.europa.eu/brussels/website/media/Lexikon/Pdf/Rahmenrichtlinien.pdf.

[90] Examples relevant here are the European Water Framework Directive 2000/60/EC or the Directive 2000/78/EC establishing a general framework for equal treatment in employment and occupation (both adopted in 2000), see Whittle (2002.

[91] Examples relevant here are the Council Directive on the common system of value added tax (adopted in 2006) or the Council Directive concerning indirect taxes on the raising of capital (adopted in 2008).

It would, however, have a political weight advising member countries to take first measures to prepare favourable legislation towards tax harmonisation with regards to EFP in general.

5.1.2. Amending the European Company Statute (ECS) 512

In addition to the "28th regime on EFP", existing European legislation could be amended. Since employee share ownership fits into the framework of company law, rules to implement it could be proposed as an amendment of the "European Company" legislation. Like the European Company Statute[92] (ECS), which provides an option for forming a supranational company, there could be an amendment to the ECS permitting such companies to create "European Employee Shareholding" as an option.[93] This option could be easily extended to other companies, which do not fall under the ECS, provided that national legislation would then be adapted to the requirements of the supranational statute.

The EU Member States would have an incentive to implement legal rules pertaining to the "European Employee Shareholding Statute" as an amendment to the ECS, choosing from a variety of incentives, possibly including tax breaks as well as other preferential treatment:

- Unlike the supplementary rules to the ECS concerning participation in decision-making, those on "European Employee Shareholding" would be totally voluntary; they would apply only if the company decides to adopt one of the existing models of financial participation.
- As in the case of the supplementary rules to the ECS on participation in decision-making,[94] the scheme would be, at first hand, proposed by the employers to their employees; in other words, a negotiated proposition. If the proposed scheme does not correspond to a catalogue of minimum requirements, or the parties so decide, a statutory set of standard rules would apply as a "safe harbour".

The mechanism of the "default standard rules" concerning participation in decision-making, foreseen in the ECS for resolving potential conflict while at the same time not imposing a solution, would also be suitable in the field of financial participation:

- As for the "standard rules" for private and/or unlisted SMEs, an ESOP vehicle (trust or any other intermediary entity) would be feasible since it could provide a relatively non-controversial solution to the question of employee voting rights and may buffer potential risk more easily, while at the same time solving the problem of business succession (see above 3.2., 5.2.2. and 6.1.7.).
- As for the "standard rules" for quoted medium-sized and large enterprises, a restricted broad-based employee stock option or stock purchase scheme (as practised in the United Kingdom) would seem be feasible since there has already been substantial development in European harmonisation on the one hand, and a remarkable initiative put forward by the Enterprise Directorate-General (2003) on the other.

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[92] Council Regulation (EC) No. 2157/2001 of 8 October 2001 on the Statute for a European company (SE); OJ, L 294/1.

[93] As proposed in the report of the Committee on Employment and Social Affairs of 5 May 2003 (A5-0150/2003), p 11 and 14 and expressed in the European Parliament Resolution of 5 June 2003 (P5-TA (2003) 0253), 31. IV; like the Council Directive 2001/86/EC of 8 October 2001 "supplementing the Statute for a European company with regard to the involvement of employees" but with regard to financial participation.

[94] Here it is the result of negotiations between employer and employee representatives.

5.2. The "common ground"—Company Law originating in the acquis communautaire

Given the above-described difficulties in arriving at a supranational compromise either in the Commission or in the Council, in order to reach a regulation at the supranational level, the simplest solution is to build on existing national legislation originating in the acquis communautaire. A rare example of such legal "common ground" are some of the national rules on listed and unlisted joint-stock companies originating in the implementation of European Law, i.e., the Second Council Directive on Company Law 77/91/EEC, dating back to 13 December 1976. Articles 19 para. 3, 23 para. 2 and 41, para. 1 and 2 of the Directive allow Member States to deviate from the European legal framework of joint-stock companies in order to encourage EFP. Although primarily referring to share ownership schemes these—optional—regulations also leave room for combination with profit-sharing schemes.

5.2.1. Exemptions from the general prohibition against a company acquiring its own stock

Art. 19 para. 3 allows Member States to deviate from the restrictive rules governing exemptions from the general prohibition against a company acquiring its own stock. When the shares acquired by the company are earmarked for distribution to that company's employees or to the employees of an associate company, a general shareholders assembly decision is not obligatory although such shares must be distributed within 12 months of acquisition.[95] Member States may lift the limit of the nominal value of the acquired shares of ten per cent of the subscribed capital—including shares previously acquired by the company and held by it, and shares acquired by a person acting in his own name but on the company's behalf—though, according to Art. 41 para. 1.

5.2.2. Firms may provide financial assistance to facilitate ESO

As an exception to the general prohibition against a company leveraging the acquisition of its own shares, Art. 23 para. 2 allows Member States to permit companies to advance funds, make loans, and provide security (financial assistance), with the intention of selling these shares to company employees. Art. 41 para. 1 further allows for deviations from general rules and restrictions to encourage EFP during the process of raising additional capital. An example is the financing of the share issue from the companies' own funds or through a profit-sharing scheme. Finally, the opening clause of Art. 41 para. 2 of the Directive providing for the possibility of suspension of Articles 30, 31, 36, 37, 38 and 39 for companies under a special law issuing collectively held workers' shares, has not been used except in the case of France.[96]

As an analysis of national legislation (Lowitzsch et al., 2008, pp. 39 ff.) shows, a surprisingly large majority of Member States have adopted national legislation permitting a company to acquire its own shares to transfer them to its employees (implemented in 17, possible in 25) and to facilitate this acquisition by financial assistance (implemented in 23).

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[95] The general rules that (i) require that the acquisitions may not have the effect of reducing the net assets below the amount of the subscribed capital plus those reserves which may not be distributed under the law or the statutes and (ii) require that only fully paid-up shares may be included in the transaction still apply across the board.

[96] See Art. L.225-259 to L.225-270 of the French Commercial Code: Employee shares collectively owned by paid personnel in a workers' commercial co-operative.

Despite the fact that this legislation has rarely been used in some countries, the existence of corresponding regulations across the EU can serve as a foundation for a European concept.

5.3. OMC and mutual recognition

5.3.1. The Open Method of Co-ordination: A fallback solution

The Open Method of Co-ordination (OMC)[97], which is now also codified, for social policy in Art. 156 TFEU, can be employed to develop a standardised concept using a "building block approach" without necessitating a supranational arrangement based on European authorisation.[98] The OMC, which largely forgoes binding legal instruments, was developed for situations such as the current one where the political need arises to undertake measures in policy areas at a European level where no authority exists to adopt such legal acts. The Commission can collaborate with Member States to establish guidelines and promote the exchange of best practices by conducting analyses and consultations and providing statements on the results.

Here, for example the Commission could recommend that all EU Member States apply the employee participation models that use the "building block approach" and build upon existing national legal provisions and applications already being practiced. The Commission could implement the following measures, which are fundamental elements of OMC:

- The exchange of experiences and best practices among nation states (see the four PEPPER reports from 1991, 1997, 2006 and 2009);
- Establishment of EU guidelines by the Council on proposal from the Commission that take into consideration the national policies of Member States (see recommendation of 1992);
- Review whether the Members States will reach the objectives outlined in the guidelines (see Lowitzsch et al., 2009) using empirical data;

The Council can then upon proposal from the Commission provide detailed, recommendations for reaching these objectives. This would be supported by dialogue between social partners in the Member States and promoted by the governments' mutual recognition of existing best-practice models. OMC instruments therewith contribute directly to the standardisation of political practices in the Member States.

5.3.2. Mutual recognition procedure by Member States for EFP

One possible solution to the problem of national implementation would be a recognition procedure by Member States for financial participation similar to that proposed by the High Level Group of Independent Experts (2003, pp. 52 ff.). As a result of this procedure, single Member States would recognise single elements from the European Concept drawn up in the Recommendation as equivalent to a plan drawn up under its own laws and provide equivalent benefits. In this way they would provide companies operating under their legislation with a legal framework that delineates what is possible without invoking sanctions from regulatory, legal and taxation authorities.

Recognition is nonetheless a major step and would require considerable co-operation between the Member States and the Commission.

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[97] The method was first introduced in the European Commission "White paper—Growth, competitiveness and Employment" from 1993.

[98] The European Treaties make provisions for the principle of conferral. Legally binding acts may only be adopted when the treaties expressly authorise the EU Institutions to do so.

5.4. The 28th regime on EFP—What needs to be defined?

5.4.1. The Building Block Approach to EFP

A European solution should thus encompass a broad incentive system, which provides different and flexible solutions, compatible with those already established in the Member States. An adaptable scheme can provide for a solution suitable for use throughout the European Union, comprising best practises of national legislation and customs. Combining them in a single programme with alternative options leads to a "Building Block Approach", with the different elements being mutually complementary. These building blocks consist of the following three basic elements:

- Profit sharing (cash-based, deferred and share-based);
- Individual employee shareholding (stock options and employee shares);
- Employee Stock Ownership Plans (ESOPs) as collective schemes.

While profit-sharing schemes, stock options and employee shares are relatively widespread in the European Union, Employee Stock Ownership Plans (ESOPs) are predominantly to be found in countries with an Anglo-American tradition, e.g., the United Kingdom and Ireland.[99] Originated in the United States as a technique of corporate finance, the ESOP, using borrowed funds on a leveraged basis, has the capacity to create substantial employee ownership and can be used to finance ownership succession plans, an important feature, especially for European SMEs.[100]

Referring to the catalogue of minimum requirements—e.g., being transparent, broad-based, etc.—, the building block scheme reflects the existing postulates of European policy-makers[101] and neither relies on nor excludes tax incentives. All of the different elements are voluntary for both enterprises and employees. They can be put together in any combination with the different building blocks tailored to the specific needs of the given enterprise.

5.4.2. Contents of optional rules implemented through "28th regime on EFP"

Among the issues defined in the "28th regime" are above all:

i. **Range of application:** *What type of companies*: Ltd, JSC, etc. / *Eligibility:* 1-year waiting period; non-discriminatory, i.e., also part-time employees (e.g., minimum of 500 hours worked per year.

ii. **Mechanism**: *PS* – pre-defined formula; broad-based; deferred; *ESO* – blocking period; financial assistance; voting rights; *ESOP* – holding company; blocking period; voting rights.

iii. **Employer contribution**: *Discretionary*; but possible ceiling, e.g., 25 per cent of payroll; matching contribution possible, etc.

iv. **Vesting**: conditions of forfeiture; vesting period, etc.

v. **Distribution (form/timing)**: For each scheme *PS / ESO / ESOPs* – retirement, death, termination; payments in five annual installments; repurchase obligation;

vi. **Investments**: Catalogue of (authorised) instruments; diversified vs. non-diversified.

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[99] For Ireland, see Shanahan and Hennessy, 1998, p. 9.

[100] One of the key areas defined in European Commission Enterprise Directorate-General, 2003.

[101] Council Recommendation of 27 July 1992 concerning the promotion of participation by employed persons in profits and enterprise results (including equity participation), 92/443/EEC, Official Journal L 245, 26/08/1992 pp. 53-55.

ANNEX 6: CASE STUDIES

6.1. Sociedades Laborales, Spain

6.1.1. Introduction

Employee financial participation in Spain largely takes the form of co-operatives and *Sociedades Laborales* (Worker-owned Companies). It is probably the only EFP scheme existing across the EU applying to small and smallest companies, which makes them of particular interest for this study. Worker-owned companies have proven to be successful business models both for society and the economy; at the same time, they are an innovative instrument of labour market policy.

A *sociedad laboral* (SL) is a specific form of corporation with no exact parallel in other EU countries. It is an inexpensive form of incorporation, majority-owned by its permanent employees, but unlike co-operatives, it is based on stock ownership and is permitted to utilise non-employee capital. SLs provide stable employment for their worker-owners, who control the company's directive bodies (Morales, Martín and Lejarriaga, 2008). Their democratic decision-making processes and equitable distribution of profits distinguish them. Companies may be founded as SLs or conventional companies may convert to this form.

Spain categorises worker-owned companies as part of their "Social Economy" because they have the following principles in common: the precedence of human interests over the economic, solidarity within the organisation as well as with society, the sharing of profits, and democratic organisation. Nevertheless, assigning SLs to the same category as Associations for the Handicapped has put them in the same context as subsidised assistance organisations. Nothing could be more misleading; SLs are productive economic enterprises. Notably, despite their more equitable distribution of profits, they are accorded the same treatment as conventional corporations (where profits are mainly shared only by a few). SLs are based on such concepts as flexibility, worker motivation, continuous learning, information transparency, and open communication.

Sociedades Laborales were created in response to the needs of the times. In 1973, the Oil Crisis forced workers in Spain to take over the companies for which they worked, securing their jobs and the means of production. Thereafter, Law 15/1986 was passed to create *Sociedades Anónimas Laborales* or SALs (Public Worker-Owned Companies). After a period of economic turmoil, worker-owned companies became recognised as a new form of organisation equivalent to the conventional corporation. The real breakthrough came a decade later with the passage of the current legislation (Law 4/1997, dated 24 March 1997). It created the Sociedad Limitada Laboral or SLL (Limited Liability Worker-Owned Company), which required considerably less starting capital (EUR 3,005.60 instead of EUR 60,101.21). Its low incorporation costs further provided the flexibility necessary to SMEs. SLLs have since become the most predominant form of worker-owned company.

Population of SL today[102]

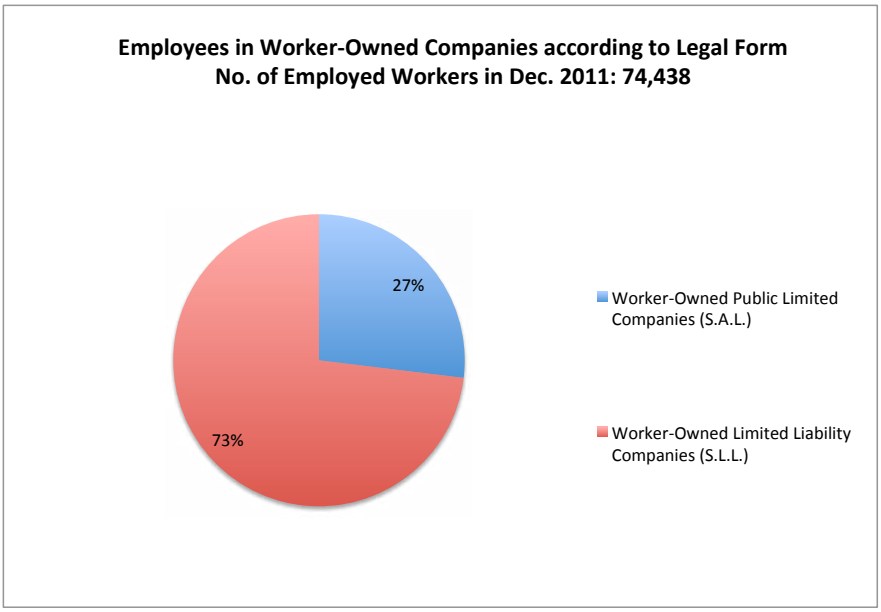
By the end of 2011, there were a total of 13,465 worker-owned companies, providing 74,438 jobs and representing 3.8 per cent of Spain's private sector companies with more

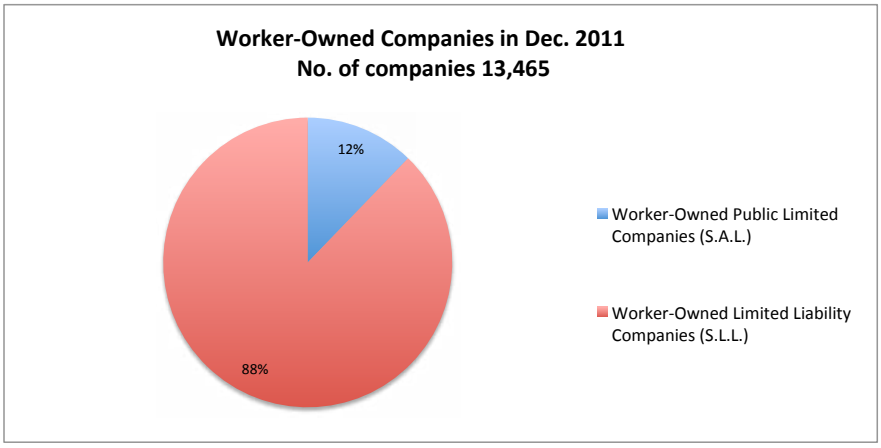
[102] The data used in this case study stems from MEYSS (Ministerio de Empleo y Seguridad Social, i.e., Ministry for Employment and Social Security), relating to the Social Security Administration; additional data was obtained from the INE (Instituto Nacional de Estadística, i.e., National Statistics Institute).

than two workers.[103] Clearly, the preferred legal form is the SLL, with SALs a mere 12 per cent of total Sociedades Laborales. Nonetheless, SALs provide more employment because of their larger size; they employ an average of 12.2 workers, while SLLs employ an average of 4.6 workers. As a result, SALs employ 27 per cent of workers in Sociedades Laborales.

Sociedades Laborales are basically SMEs (99.9 per cent of SLs have 250 or less employees). Most of them (75 per cent) are micro-entities with fewer than five workers; followed by micro-entities with six to ten workers (15 per cent). They were initially large industrial companies, but today most of them (59 per cent) are small service firms; 25 per cent are in the industrial sector, followed by 14 per cent in the construction sector, and two per cent in the agricultural sector.

Figure 16a and b: Sociedades Laborales Dec. 2011 number of employed workers (left) and number of companies (right)[104]



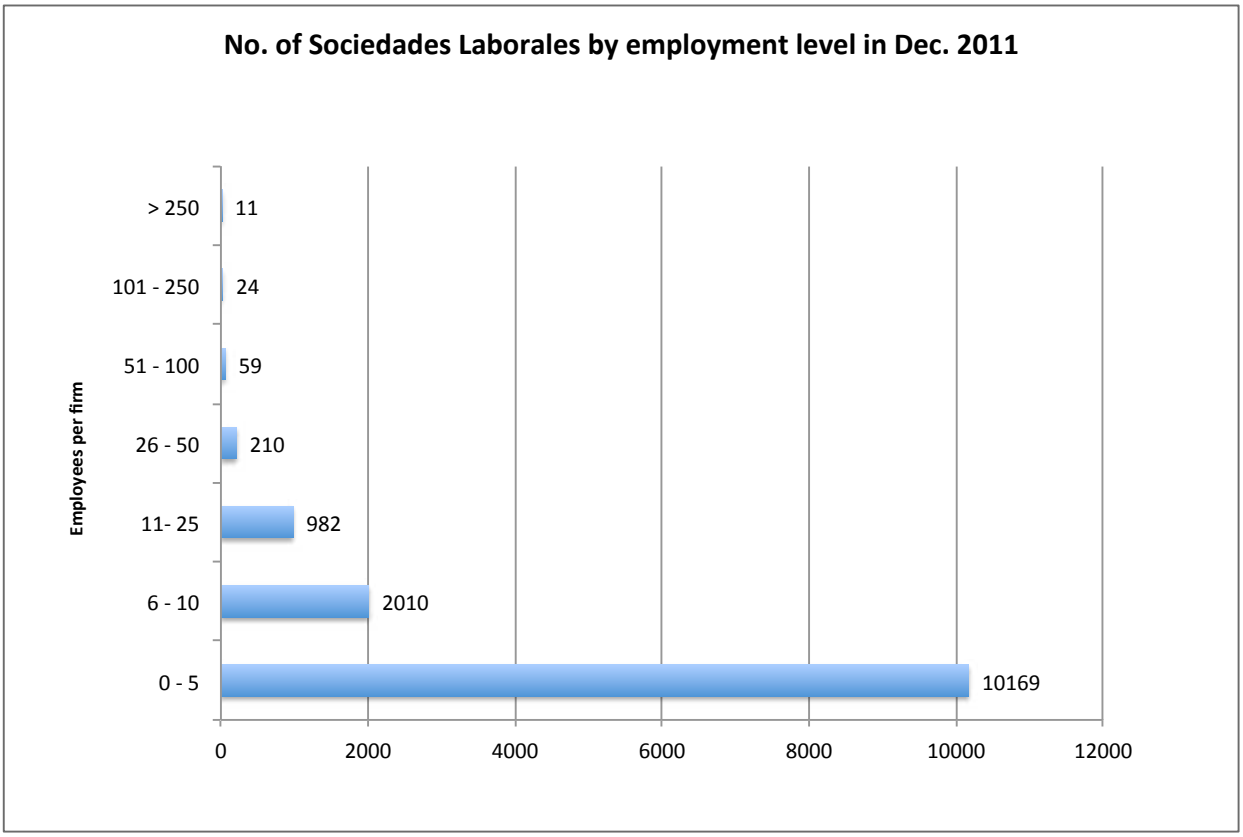


Source: Own elaboration with data obtained from MEYSS.

[103] For comparison purposes, only conventional firms with more than two workers were taken into account (SLs are legally required to have at least two workers).

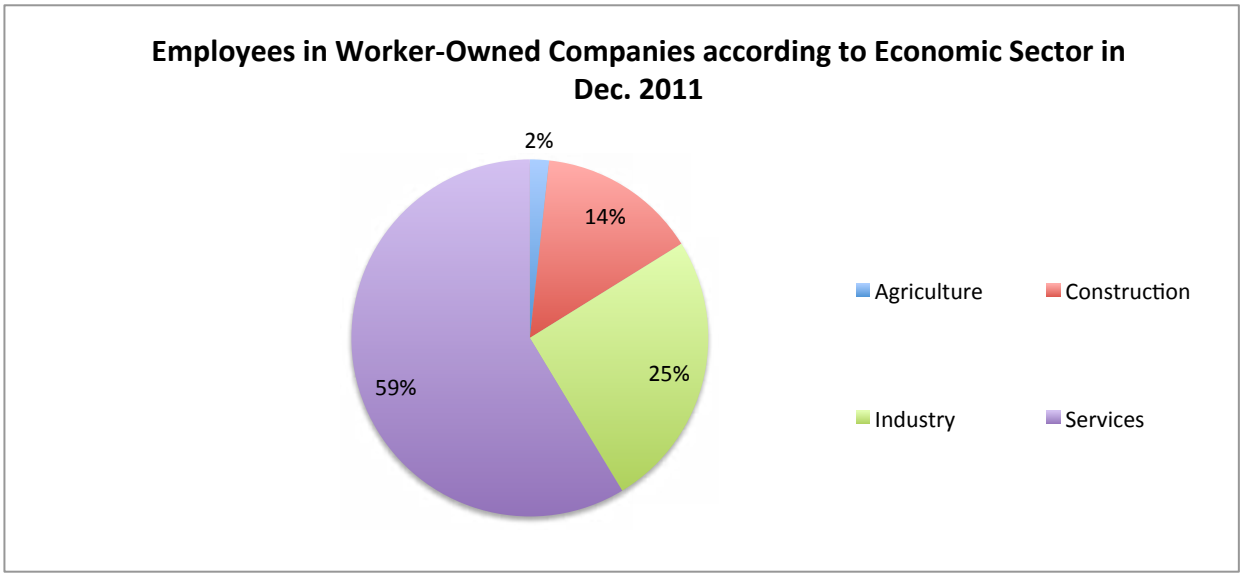
[104] The number of workers in Sociedades Laborales reflects only workers registered with the Social Security Administration under the General Regime. Statistics are not kept on SL workers registered under the Special Regime for Self-Employed Workers. Thus, according to a poll conducted by CIRIEC (Monzón et al., 2010), real employment levels are around 32.09 per cent higher than the ones presented by MEYSS.

Figure 17: Number of Sociedades Laborales by employment level in Dec. 2011



Source: Own elaboration with data obtained from MEYSS.

Figure 18: Workers in Sociedades Laborales by economic sector in Dec. 2011

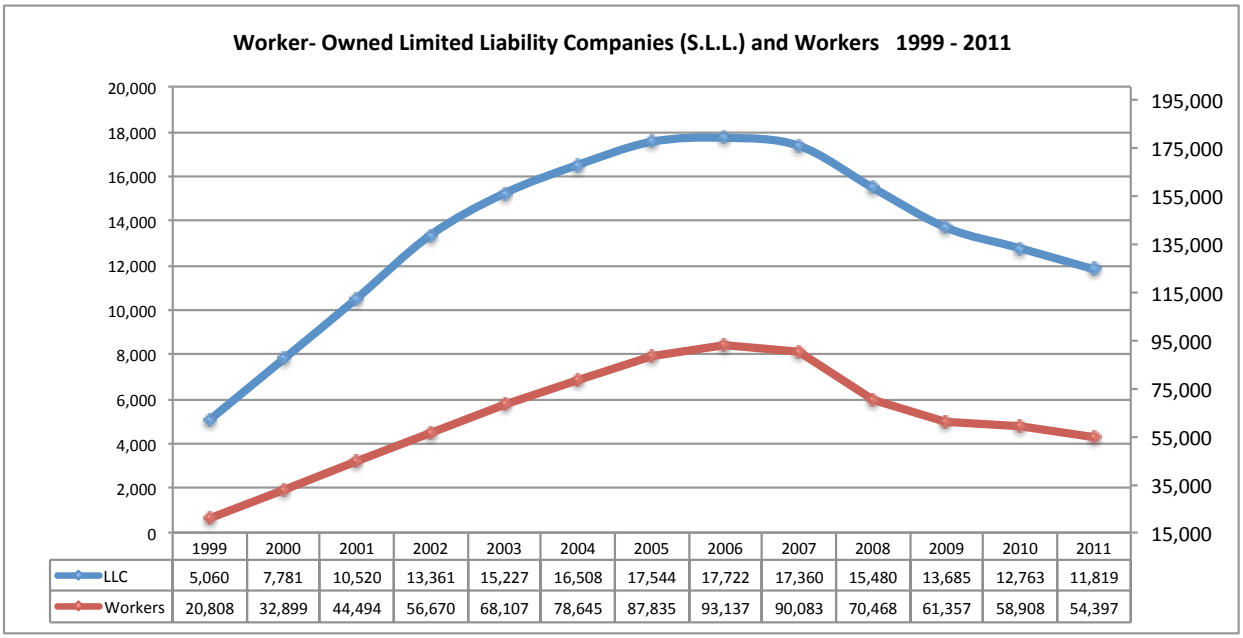


Source: Own elaboration with data obtained from MEYSS.

Development during the past decade

The development of SALs and SLLs during the past 12 years (1999-2011) has clearly diverged: the number of workers in SALs decreased by 63 per cent during this period, while the number of workers in SLLs increased by 161 per cent. It must be noted that the strong growth shown by SLLs was not matched by their conventional counterparts (LLCs). The number of workers in LLCs grew by only 52 per cent (compared to 161 per cent in SLLs) during the same period. In contrast, the number of workers in conventional public limited companies decreased by a modest six per cent, compared to the 63 per cent decrease seen in SALs, their worker-owned equivalent.

Figure 19: Number of worker-owned limited liability companies and workers, 1999-2011

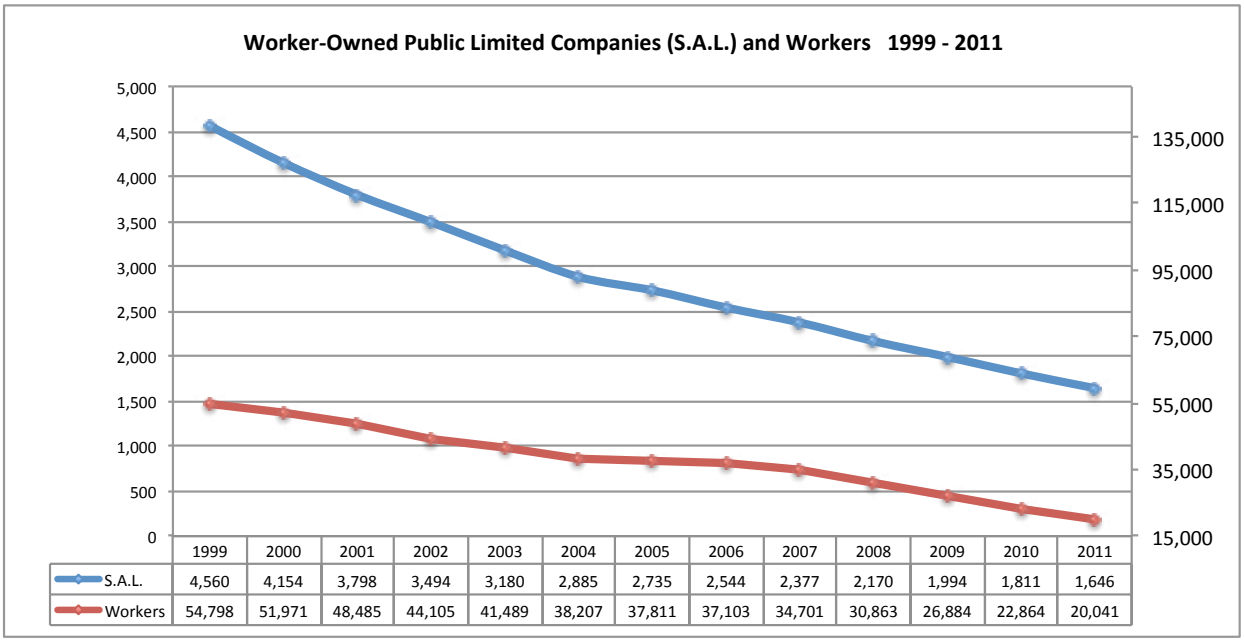


	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
LLC	5,060	7,781	10,520	13,361	15,227	16,508	17,544	17,722	17,360	15,480	13,685	12,763	11,819
Workers	20,808	32,899	44,494	56,670	68,107	78,645	87,835	93,137	90,083	70,468	61,357	58,908	54,397

Source: Own elaboration with data obtained from MEYSS.

The general trend followed by SLs mimics that of mercantile companies since they are basically economic equals. They face the same problems as other SMEs, mainly to become sufficiently competitive. Compared to conventional companies, SLs have grown in greater numbers, yet the net increase is negative. Unlike co-operatives, dissolving a SL is a mere administrative act. As a result of this model's volatility, a company can easily switch from an SL to a conventional company. Thus, the steep decrease in the number of SLs does not mean that these companies have ceased to exist. In most cases, they have converted to conventional companies (either by choice or by disqualification). The financial crisis has played a large role in their decline (in a pattern similar to that of conventional companies).

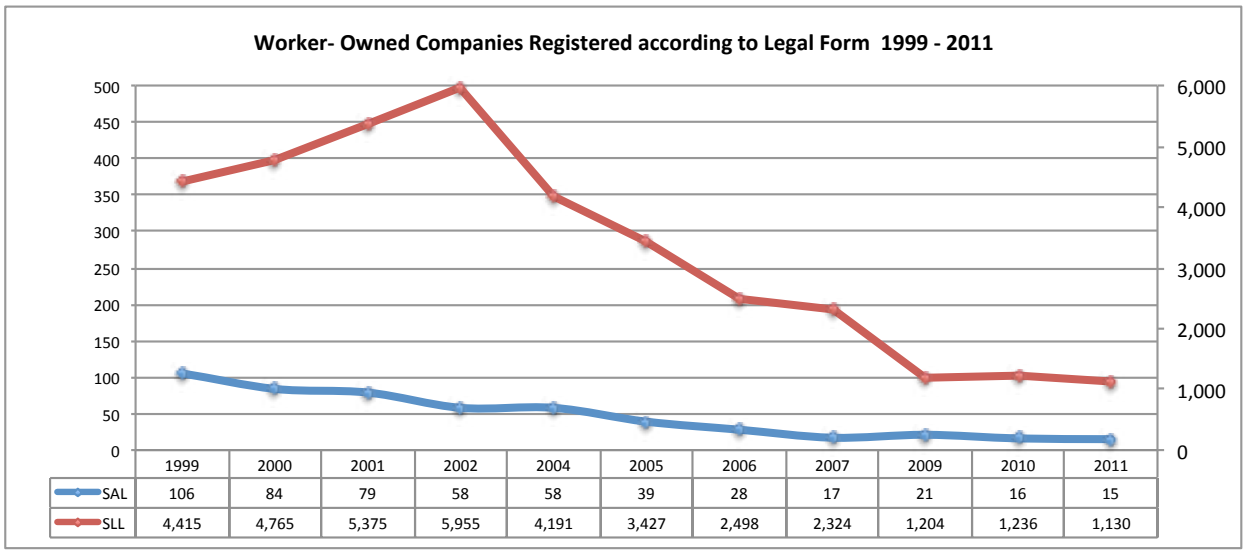
Figure 20: Worker-owned public limited companies and workers, 1999-2011



	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
S.A.L.	4,560	4,154	3,798	3,494	3,180	2,885	2,735	2,544	2,377	2,170	1,994	1,811	1,646
Workers	54,798	51,971	48,485	44,105	41,489	38,207	37,811	37,103	34,701	30,863	26,884	22,864	20,041

Source: Own elaboration with data obtained from MEYSS

Figure 21: Worker-owned companies registered by legal form, 1999-2011



	1999	2000	2001	2002	2004	2005	2006	2007	2009	2010	2011
SAL	106	84	79	58	58	39	28	17	21	16	15
SLL	4,415	4,765	5,375	5,955	4,191	3,427	2,498	2,324	1,204	1,236	1,130

Source: Own elaboration with data obtained from MEYSS

With regards to employee ownership, it is the dearth of employee-owned start-ups that stands out. Conventional share schemes like Employee Stock Ownership Plans (ESOPs) are too expensive for new businesses, especially SMEs. In this respect, SLs are a great tool for creating new employee-owned enterprises or for buying troubled companies; they are simple, flexible and economical.

The decreasing number of worker-owned company start-ups can be explained by a change in policy regarding the capitalisation of unemployment benefits. When this aid was offered exclusively to SLs and co-operatives, worker-owned companies grew at a steady rate (see Figure 23). In 2002, when policy changed and capitalisation became possible for self-employed workers, the attractiveness of incorporating as a SL declined. The annual variation in the Registry of Sociedades Laborales has been negative almost every year since 2002, hitting an all-time low of -48 per cent in 2009 (due to the financial crisis).

Evidently, judging by the steep descent in the number of SLs registered during the past nine years, this measure was detrimental to worker-owned companies.

Table 7: Sociedades Laborales registered, 1999–2011

Year	Total new SLs	Total part-ners	Working partners	Investing partners	Per cent Investors	Average # of working partners
1991	586	5,132	4,473	659	13%	7.63
1992	820	5,772	4,928	844	15%	6.01
1993	1,077	7,493	6,336	1,157	15%	5.88
1994	1,318	8,439	6,805	1,634	19%	5.16
1995	888	5,939	4,930	1,009	17%	5.55
1996	706	4,260	3,422	838	20%	4.85
1997	1,315	6,071	4,779	1,292	21%	3.63
1998	3,979	15,313	11,307	4,006	26%	2.84
1999	4,522	16,589	11,814	4,775	29%	2.61
2000	4,851	17,405	12,306	5,099	29%	2.54
2001	5,454	19,387	13,654	5,733	30%	2.50
2002	6,013	21,209	14,983	6,226	29%	2.49
2003	5,353	19,088	13,770	5,318	28%	2.57
2004	4,249	15,558	11,281	4,277	27%	2.65
2005	3,466	12,491	8,982	3,509	28%	2.59
2006	2,526	8,967	6,488	2,479	28%	2.57
2007	2,341	8,290	5,987	2,303	28%	2.56
2008	1,514	5,655	4,164	1,491	26%	2.75
2009	1,225	4,793	3,526	1,267	26%	2.88
2010	1,252	4,590	3,382	1,208	26%	2.70
2011	1,145	4,336	3,293	1,043	24%	2.88

Source: Own elaboration with data obtained from MEYSS.

The future of SLs shows a clear preference for the SLL as the incorporation form of choice; 98.7 per cent of worker-owned companies registered in 2010 had adopted this form. Company size is also significantly smaller: 1,252 SLs were registered with 4,590 partners, out of which only 3,382 were working partners. This means the average size of new SLs is only 2.7 workers. By law, the minimum number of working partners is two, but no partner may own more than 33 per cent of the company. Therefore, many companies are founded by two workers who recruit a third investing partner.

The main characteristics of these entrepreneurs are:

- They plan their investment strategies on a long-term basis.
- They tend to prefer long-term growth than the distribution of dividends or profits.

Survival prospects

Worker-owned companies have a mission that sets them apart from other mercantile companies; their main function is to create stable employment for their worker-owners. This peculiarity creates a stronger bond between the worker and the company, which translates into increased productivity. For this reason, SLs have demonstrated their ability to generate stable employment and endure over time. The survival rates of SLLs mirror those of conventional companies—49 per cent of SLLs compared to 49 per cent of conventional companies survive the first five years—, however, SALs outperform conventional companies with a survival rate of 55 per cent.

Table 8: Survival rates of Sociedades Laborales according to age (in per cent)

	1	2	3	4	5	6	7	8	9	10
SAL	89.74	78.27	71.24	62.61	54.72	48.78	42.84	41.33	37.95	33.51
SLL	88.17	76.01	64.22	55.38	48.51	42.37	37.57	34.30	31.24	28.45

Source: Own elaboration with data obtained from MEYSS.

The higher survival rates of worker-owned companies can be explained by the difference in their main purpose. Since their main goal is to secure stable, high-quality jobs, unlike conventional companies they do not pursue financial gain as an end in itself (Millana, 2002). Organisations such as ASLE (Agrupación Empresarial de Sociedades Laborales de Euskadi, i.e., Business Association of Worker-Owned Companies of the Basque Country) and CONFESAL (Confederación Empresarial de Sociedades Laborales de España, i.e., Spanish Business Confederation of Worker-Owned Companies) have also played a key role in the support and promotion of worker-owned companies in Spain.

Despite their small size, with an average of 12 workers, three out of four SALs in the Basque Country made a profit in 2011[105]. Since 2007, employment in SALs in the Basque Region has decreased by 20 per cent, while in Spain as a whole it has decreased by an astounding 40 per cent. The superior performance of worker-owned companies compared to conventional companies is due to the flexibility provided by employee participation (García-Gutiérrez and Lejarriaga, 2009). Flexibility, in this context, means companies are able to adapt to adverse economic conditions. Workers are highly motivated and willing to sacrifice (in the form of pay-cuts and overtime) in order to keep their company in business.

6.1.2. Legal and fiscal framework

Worker-owned companies are subject to two-fold legislation; their own individual regulation and conventional legislation in any matter not covered in the 1997 Law on Sociedades Laborales. The essential features of Sociedades Laborales are the following:

- Permanent workers must own more than 50 per cent of company shares.
- No single owner may own more than one third (33 per cent) of the company's stock (except for public organisations, which may own up to 49 per cent).
- Non-owners may not work more than 25 per cent of the hours worked by worker-owners in companies with fewer than 25 employee shareholders.
- Non-owners may not work more than 15 per cent of the hours worked by worker-owners in companies with more than 25 employee shareholders.

[105] Nuñez (2012). Siete de cada diez sociedades laborales Vascas aguantan la crisis sin pérdidas. Retrieved from http://www.confesal.com/home/index.php/component/content/article/…guantan-la-crisis-sinperdidas.html?tmpl=component&print=1&page=.

- There is an order of preference in the acquisition of shares; they are not treaded in public markets.
- When an employee leaves the company, the company is required to offer the employee's shares for sale. Should no one wish to exercise his or her purchase rights, the former worker shall become a general shareholder.
- Two types of shares exist: *worker shares* (*acciones de clase laboral*) and *general shares* (*acciones de clase general)*. Worker shares are reserved for permanent employees and they **always have voting rights** (unlike public limited companies, who may issue shares without voting rights).
- Companies must set up a *Special Reserve Fund* into which ten per cent of their annual net profits are allocated.
- If tax benefits are being applied for, companies must allocate 25 per cent of their annual net profits to the Special Reserve Fund.

Precedence in the acquisition of shares gives certain groups priority in the following order:

i. permanent workers who are not already owners;
ii. existing worker-owners;
iii. temporary workers and existing shareholders outside the company;
iv. the company itself;
v. third parties.

Each group is given a time frame to act upon their preferred rights, therefore it might take up to six months before third parties are allowed to purchase shares. The reason for preferential purchase rights is to maintain broad employee ownership. This policy, however, has its drawbacks; the time slots allotted to each preferred group to buy shares may delay the transfer of ownership to a point that makes the sale pointless (Lejarriaga, 2004).

Plans for legal reform

The law of 1997 has greatly stimulated employment growth by accelerating the creation of SLs; still, it was passed 15 years ago and it needs to be updated in order to adjust to today's legal and economic environment (Valiñani, 2008). To illustrate the pitfalls of this regulation, SLs that do not continue to meet the above conditions, loose their legal status as worker-owned companies. They may, however, continue to operate as conventional public or limited companies. This legal flaw, which unnecessarily disqualifies SLs, has been detrimental to countless worker-owned companies. In most cases, companies sunk below the 51 per cent threshold required for qualification as an SL—due to the retirement of partners or because new workers chose not to become partners or delayed the transition to ownership—, yet the companies themselves still maintained broad worker-ownership. Furthermore, this regulation has skewed the available statistics on SLs. It is hard to grasp the full economic extent of SLs when innumerable companies are being disqualified on such superficial grounds.

Since 2008, a proposal improving the laws on SLLs has been under discussion. Its main objectives are the following:

- To make Sociedades Laborales a more attractive legal form for entrepreneurs;
- To adapt labour-market policy proven successful for self-employed workers, so as to make worker-owned companies more attractive as a potential incorporation form;
- To make SLs a valid corporate alternative in times of recession as well as in times of economic growth.

To achieve these goals, the reform proposal plans to:

- Establish effective mechanisms to facilitate the access of permanent workers to ownership.
- Encourage interest in increasing and maintaining the number of worker-owners by offering positive incentives instead of imposing ineffective restrictions on the permissible number of non-owner workers.
- Create fiscal incentives that stimulate the re-investment of profits and a higher degree of social commitment.

Examples of the measures proposed include:

- Tax allowance for unemployment benefits when companies are in process of being capitalised to join or create co-operatives or worker-owned companies.
- Compensation of employees made in the form of stock options or company shares to be exempted from income tax (shares must be kept for a minimum of five years).
- A tax deduction for an increase in capital investment.
- Creation of a company savings account to facilitate workers' access to ownership to be granted a tax deduction of up to EUR 12,000 per year.
- An income tax of 20 per cent for Sociedades Laborales that dedicate a minimum of 25 per cent of the Special Reserve Fund to facilitate workers' access to ownership (e.g., by the establishment of a share acquisition plan).

It is clear that the Law of Sociedades Laborales needs to be reformed in order to revitalise the growth of SLs and to prevent their conversion into conventional firms (Martín, 2010).

Tax incentives

Sociedades Laborales receive the following tax benefits:

- First, they are exempted from incorporation taxes, as are conventional companies converting to SLs.
- Second, 99 per cent of transfer taxes are refunded when the property being acquired was owned by the company for which most of the partners in the SL worked.
- Third, 99 per cent of loan notary fees are refunded on loans invested in fixed assets (necessary for normal operations).
- Fourth, they are allowed free amortisation for their first five years of existence.

Worker-owned companies fulfil social and economic needs that should justify a more benevolent tax treatment (Alguacil, 2010). First, they create and maintain high-quality jobs; second, they promote EFP. Their small size, as well as the handicaps arising from their special structure and organisation, should be taken into account. The current tax treatment does not seem adequate considering these criteria.

Government aids and subsidies

Since the 1980s, policy makers in Spain have taken measures to encourage the growth of co-operatives and Sociedades Laborales. This set of measures was called the "Programme for the Development of the Social Economy". It constitutes one of the active labour-market policies, encompassing only five per cent of total labour market policy spending. It has never really been a priority in comparison to other employment goals, e.g., self-employed workers or handicapped persons (Chaves, 2007). The programme follows two main lines:

(i) Aids and subsidies that encourage employment in co-operatives and Sociedades Laborales

The following measures are eligible for subsidies:

- incorporation of unemployed persons as worker-owners;
- technical assistance (mainly for feasibility studies, auditing, and consulting services);
- training, promotion, and communication of the *Social Economy* to stimulate employment.

(ii) Investment aids for co-operatives and worker-owned companies

The following measures are eligible for subsidies:

- investment in fixed assets (necessary for normal operations);
- reimbursement of loan interests.

Subsidies in category (i) above include grants from the European Social Fund (ESF), while subsidies for category (ii) receive support from the European Regional Development Fund (ERDF). The amount spent on these measures is quite insignificant, namely EUR 12.6 million in 2010.

Table 9: Subsidies for co-operatives and worker-owned companies (in EUR)

Year	Total subsidies paid	Loan interests reimbursed to companies	Technical assistance subsidies	Direct subsidies for investment in fixed assets	Subsidies for incorporating unemployed persons as partners	Communication, promotion, and training subsidies
2001	**16,584,937**	2,185,756	163,739	2,776,509	8,405,867	3,053,065
2002	**18,168,531**	1,427,555	120,591	2,995,860	10,518,986	3,105,538
2003	**18,117,457**	904,063	141,398	5,571,632	7,730,365	3,769,999
2004	**19,401,225**	346,044	198,300	3,066,259	12,081,125	3,709,496
2005	**21,508,131**	103,983	165,668	6,015,671	8,491,172	6,731,637
2006	**20,310,003**	69,810	3,248,714	3,987,804	7,779,142	5,224,532
2007	**19,456,671**	232,770	418,951	3,665,053	10,540,611	4,599,286
2008	**18,317,341**	264,546	922,530	4,162,405	7,702,433	5,265,427
2009	**11,656,712**	24,115	710,498	1,935,710	6,888,002	1,462,672
2010	**12,589,672**		371,501	1,682,825	8,405,911	2,129,436

Source: Own elaboration with data obtained from MEYSS.

The capitalisation of unemployment benefits

Despite the lack of sound fiscal incentives for worker-owned companies, these companies have flourished over the past 15 years. The reason for their success is that since 1985, unemployed persons wanting to join a co-operative or worker-owned company may receive their unemployment benefits as a lump sum rather than monthly payments in order to buy into the company (Barrachina, 2004). This capitalisation of unemployment benefits can also be done to start a new co-operative or worker-owned company, or to recapitalise an existing one. In addition, the funds can be used to pay for employees' social security contributions. If one decides to create a new co-operative or worker-owned company by capitalising

unemployment compensation, a viable business plan must be presented. The plan is then screened by a SL development programme and scrutinised by the unemployment compensation system. The new business continues to be monitored for three years after its founding.

The capitalisation of unemployment benefits is regulated by Law 45/2002, dated 12 December 2002. So far, this measure has been very successful (Mercader and Diaz, 2010). It is almost solely responsible for the 134 per cent increase in the number of limited liability SLs (SLLs) between 1999 and 2011. In comparison, conventional limited liability companies (LLCs) increased by 35 per cent during the same period. For all its success, government funds spent on the capitalisation of unemployment benefits are negligible compared to the employment and economic activity generated (Millana, 2003).

Table 10: Capitalisation of unemployment benefits (in EUR)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
New SLs	6,013	5,353	4,249	3,466	2,526	2,341	1,514	1,225	1,252	1,145
Working partners in new SLs	14,983	13,770	11,281	8,982	6,488	5,987	4,164	3,526	3,382	3,293
Average number of working partners per SL	2.49	2.57	2.65	2.59	2.57	2.56	2.75	2.88	2.70	2.88
Working partners, who capitalised unemployment benefits	7,688	7,423	8,134	8,339	7,788	7,302	6,426	5,335	4,940	4,422
Potential SLs created from capitalising unemployment benefits	3,085	2,886	3,064	3,218	2,526	2,341	1,514	1,225	1,252	1,145
Estimated percentage of SLs created from capitalising unemployment benefits	51%	54%	72%	93%	100%	100%	100%	100%	100%	100%
Estimated number of partners, who capitalise unemployment benefits to join an existing SL					1,300	1,315	2,262	1,809	1,558	1,129
Average number of days capitalised	413	184	146	127	140	136	130	150	156	156
Average sum capitalised	9,859	4,544	3,482	3,075	4,166	3,888	3,693	4,201	4,510	4,624

Source: Own elaboration with data obtained from MEYSS.

Since 2002, self-employed workers are also allowed to capitalise their unemployment compensation. The average sum capitalised (see Table 10: Capitalisation of unemployment benefits (in EUR)) was calculated using the total amount of beneficiaries (including self-employed workers as well as co-operative and SL workers).

Self-employed workers generally capitalise a much smaller amount than workers in SLs; therefore, as the number of self-employed workers utilising this option grew, the average sum capitalised decreased (from EUR 9,859 in 2002 to EUR 4,624 in 2011) (Martín et al., 2005). Disaggregated data on the amounts capitalised by each group were not available. Nevertheless, most people founding SLs or joining existing ones capitalise between one and two years of unemployment compensation (EUR 12,000 to EUR 30,000).

To better comprehend the impact of this policy on the creation of worker-owned companies and the number of SLs this incentive potentially created, it is useful to look at the dynamic

over time (see Table 10: Capitalisation of unemployment benefits (in EUR)). In 2002, 51 per cent of SLs were established by means of this financial resource. By 2006 the figure was 100 per cent. Finally, an estimate was made of the number of workers capitalising unemployment benefits to join an existing worker-owned company. The positive growth in employment has made SLs an important mechanism in labour market policy (Melgarejo et al., 2007).

6.1.3. Organisations representing Sociedades Laborales

The Confederación Empresarial de Sociedades Laborales de España or CONFESAL (Spanish Business Confederation of Worker-Owned Companies) is a non-profit organisation representing worker-owned companies in Spain. It is composed of 17 members, one for each autonomous region. It promotes the creation of new SLs and acts as liaison between government, social-economic agents, and public and private entities. CONFESAL is a founding member of the Confederación Empresarial Española de la Economía Social or CEPES (Spanish Enterprise Confederation of the Social Economy). CEPES represents the interests of organisations within the social economy.

In addition to the national associations, the regional system of worker-owned start-ups is truly remarkable. There are a series of organisations that provide high-level services, particularly in business development centres. ASLE, CONFESAL's partner in the Basque Country, helps create approximately 20 new Sociedades Laborales every year. ASLE's fee-services include accounting, human resources management, legal services, marketing, IT consulting, quality assurance, training services, assistance with government programs, and occupational health and safety. For new companies, they assist in the preparation of feasibility studies and assure eligibility for the lump-sum distribution from the unemployment compensation programme (in order to capitalise the new company). They even do the legal work required to incorporate and set up the business.

The result of these measures has been the establishment of a growing sector of employee-owned businesses. Most importantly, this system enables employees who have worked together but lost their jobs to form new companies that preserve the social capital created over years (Logue, 2008).

6.1.4. Conclusions

Sociedades Laborales have established themselves as effective mechanisms for job creation and social cohesion providing high-quality, stable employment for their work force.

- Modern Sociedades Laborales are SMEs, mostly based in the service sector, with an average of 4.6 workers in limited worker-owned companies and 12.2 in public worker-owned companies. Most workers in SLs come from unemployment.
- The success of Sociedades Laborales is evident by the number of companies created and their survival rates, which are up to 6 per cent higher than those of conventional companies. This is mainly due to the long-term thinking of workers, who forego immediate financial gain in order to secure their workplace. Furthermore, worker motivation in SLs is very high, making companies more flexible and able to adapt to adverse economic conditions. SLs owe their success to a series of factors: the capitalisation of unemployment benefits; support for the incorporation of new partners via subsidies; adequate legal regulation (which should nonetheless be improved); and a smaller tax burden (still of limited significance). In addition, the organisations dedicated to assisting SLs in their start-up phase and during their development, have played a key role in their growth and survival.

- The capitalisation of unemployment benefits has been a very successful measure, almost solely responsible for the 134 per cent increase in the number of worker-owned LLCs between 1999 and 2011. In comparison, conventional LLCs increased by 35 per cent during the same period. For all its success, government funds spent on the capitalisation of unemployment benefits are negligible compared to the employment and economic activity generated.
- The largest increase in worker-owned company start-ups occurred when the capitalisation of unemployment benefits was allowed for persons wanting to create or join a Sociedad Laboral. The number of start-ups subsequently declined when this benefit was extended to self-employed workers. A reform of the Law on Sociedades Laborales would help to reactivate their growth and prevent their conversion into other legal forms. Most importantly, worker-owned companies need significant fiscal incentives, as well as mechanisms for the acquisition of shares by company workers.
- Sociedades Laborales face the same problems as other SME; they mainly strive to become sufficiently competitive.

6.1.5. The example of Izar Cutting Tools S.A.L.

The story of Izar Cutting Tools spans more than 100 years, the company having been founded in Zumarraga at the beginning of the 20th century as "Muelles y Aceros Eguzkia" (Docks and Steels Eguzkia). It was a pioneer firm in the metallurgic industry in the Basque Country, originally producing steel crossbows for carriages. In 1927, Francisco Belausteguigoitia bought the company, which he then went on to head for the next 50 years. He reinvented the firm under the name of Izar ("Star" in the Basque language), producing innovative steel cutting tools, which made the company a market leader. The quality of its products allowed its 1,100 workers to carry on despite the crisis of the 1970s. In 1988, an indifferent owner bought the company and let it crumble for the next two years. Out of despair, the workers took over the company and began their odyssey as owners.

In October 1993, a bankrupt Izar Tool Machines was converted into a SAL in order to utilise the financial incentives that would enable it to consolidate operations. It became Izarbarri S.A.L., reducing its workforce from 317 to 178 employees, but considerably increasing its sales. Financing came from a variety of sources, first, by capitalising the employees' unemployment benefits. Although this subjected workers to a high risk, it was their only option to preserve their jobs. Second, came a 20 per cent pay cut and an increase in working hours. Third, was an advance instalment from the National Severance Fund (which pays severance to employees when a company goes bankrupt). As a measure of last resort, four workers mortgaged their homes in order to buy material to continue production. Salaries were paid on a fractional basis, when possible.

Still, Izarbarri S.A.L. was not able to become financially stable. In 1996, recapitalisation was necessary. The workers took out personal loans in order to invest 750,000 pesetas each; they also reduced their salaries by 13 per cent. They elected a new Administration Council, which restructured the company's management team. In April 1997, workers voted on and started implementing a new feasibility plan; it included downsizing and the founding of a new Sociedad Laboral. The new SAL's partners had to invest up to two million pesetas, in addition to the sum they would get from the capitalisation of their unemployment compensation. The company's resources were truly modest; most machines were obsolete and real estate assets were mostly mortgaged. Nonetheless, by the end of that year the company had recovered its zest for success, earning a profit of ESP 226 million. The new SAL, renamed Herramientas de Amorabieta S.A.L. had 124 partners. It invested in cutting-edge technology and quality improvements. Gradually, workers' salaries increased;

in 1999, dividends were paid out to the worker-owners for the first time. A bankrupt company had become a world-class producer of cutting tools.

From 1999 to 2004, EUR 2 million a year were invested in quality improvements and new products. Then in 2008, the company moved into its new factory, one of the most modern in the region. Finally, the workers decided to rename the company "Izar Cutting Tools S.A.L." in order to revive the Izar brand's old prestige. Today, the firm employs close to 200 people—most of them partners. It relies heavily on exports—to 80 different countries—; these have been the key to its continued growth. Izar is the largest manufacturer of cutting tools in Spain, and one of the largest in Europe. It is an innovative company managed according to the total quality model EFQM. It is also highly committed to corporate and social responsibility, placing special emphasis on enhancing social cohesion within the company. Being a worker-based company, the main goal is to develop long-term high-quality jobs. It is firmly committed to balancing human development with business development—in fact, its real mission.

Table 11: Main data 2010 of Izar Cutting Tools S.A.L.

Net turnover	EUR 17,634,454
Number of shares	368,295
Price per share	EUR 8.29
Company's share of stock	9.3%
EBITDA	EUR 1,614,281
Equity	EUR 16,797,970
Share capital	EUR 3,053,166
Number of employees	184
Number of worker-owners	128

Table 12: Izar Cutting Tools S.A.L. in 2010 compared to sector companies

Financial ratios	IZAR	Sector average
EBITDA margin	9.15%	5.89%
Indebtedness	69%	53%
Financial profitability	1.60%	1.35%
Productivity	1.34	1.20

Source: Own elaboration with data obtained from Izar Cutting Tools S.A.L.'s annual accounts and the annual accounts of sector companies submitted to the Trade Register.

Corporate Governance

Administration Council: The highest governing organ in the company, it supervises and approves the work of company directives. It serves a similar function as a Board of Directors in a public limited company. Its seven members are chosen by the Shareholders General Assembly (from all worker-owners). They represent different company areas: production, sales, purchasing, quality control, etc. Members serve five-year terms and work without remuneration.

The Council and the General Manager meet at least once a month to discuss the company's most relevant affairs. Additionally, a paid outside lawyer functions as Council Secretary. He is not a member, but the presence of a lawyer is legally required.

Shareholders General Assembly: Resembling conventional public limited companies, the Shareholders General Assembly meets at least once a year to review the company's accounts, approve the work of the Administration Council and elect its members. It also serves as a participation vehicle for the company's worker-owners.

Company Committee: This is the workers' formal organ of participation in management. Its members are chosen from the whole body of employees for a four-year term. It holds monthly meetings with the General Manager to discuss work issues and negotiate the terms of the *company contract,* which affects 100 per cent of employees.

Management: The firm's directors are in charge of company strategy design and management. The General Manager heads the group. The company is unionised and the General Manager meets with the union every month.

General Assembly: The General Assembly meets at least once a year and serves to communicate the company's current situation and its future prospects. It also serves to answer any questions about the company.

The advantage of being worker-owned

Izar is profoundly committed to the well-being of its workers. The firm has weathered the current crisis better than most companies in its sector largely because it is worker-owned. During 2009, employees demonstrated their commitment to the firm by reducing their salaries up to 10 per cent and decreasing working hours to adjust to real market demand.[106] Being "worker-owned" gave Izar the flexibility needed to swiftly adapt to adverse economic circumstances. All measures taken to keep the company afloat were approved and supported by the workers and the Company Committee.

Despite the disastrous results of 2009, with its 33 per cent decline in client orders, Izar went on to create new employment in 2010 adding ten employees to its workforce.[107] It increased sales by 20 per cent over the previous year. In addition, salaries were restored to previous levels. Furthermore, Izar showed its commitment to workers by continuing to allow partial retirement of senior workers at age 60 and hiring only permanent workers to replace them. In an economic environment plagued by temporary workers, Izar made an extra effort to behave in a socially responsible way. Only 15 per cent of Izar's workers have temporary contracts, compared to 25 per cent of private sector workers.

Company structure

Table 13: Ownership structure of Izar Cutting Tools S.A.L.

Year	Buy-ins	Buyouts	Number of partners
2010	3	2	128
2009	5	0	129
2008	9	4	124
2007	14	3	119

Source: Izar Cutting Tools S.A.L.

Unlike the company's original partners in the 1990s—who were forced to become owners—, current partners are owners by choice. As one of the workers said: "I was excited to become a partner because I like my job, and above all because I see my future at Izar. As worker-owners, we are highly engaged; we cannot forget that we are putting our money and our jobs on the line." Izar is owned by 128 of its 184 employees (70 per cent). There are no outside shareholders and all permanent employees are owners. The main idea at Izar is that every permanent worker should become a partner. Toward this end, the firm created a *company contract*, which went into effect in 2003, after being approved by the majority of worker-owners. Its main purpose is to ensure that social interests prevail over those of individual stockholders. The company contract regulates the following:

- acquisition of shares by new partners;

[106] The number of production-work hours plunged from 118,520 in 2008 to 74,670 in 2009.
[107] Total workforce was 204 employees in 2008, 174 in 2009, and 184 in 2010.

- sale of shares by workers leaving the company;
- share prices and the order of priority in acquiring shares;
- distribution of dividends.

The company contract provides a regulatory framework that continually allows new partners into the company. By establishing share prices, it eases the transfer of shares between old and new partners, thus guaranteeing the firm's continued existence as a worker-owned company. New employees wanting to become partners may buy in through a wage deduction over a period of a maximum of ten years. All of Izar's shares have the same rights and do not trade in public markets. By contractual agreement, which is not legally mandatory, the company buys back the shares of retiring workers every year, thus ensuring that all permanent workers have the opportunity to become partners.

Furthermore, the company contract generally favours the distribution of dividends, but only after considering the firm's future stability. Historically, it has paid an average of 30 per cent of profits to worker-owners as dividends. The firm re-invests approximately 70 per cent of its profits back into the company, far beyond the mandatory 10 per cent required for the Special Reserve Fund. As a worker-owned company, Izar aims to empower its workers. It makes a great effort to communicate the social dimension of the firm, holding frequent information meetings to instil new workers with a sense of pride and belonging.

6.1.6. The example of Komunikazio Biziagoa S.A.L.

In 1998, Komunikazio Biziagoa S.A.L. was founded as a worker-owned company, although its origins go back to 1919, the year the Capuchin Order[108] created *Zeruko Argia* (The Light of Heaven), a religious magazine in the Basque language. Then in 1921, the weekly news journal *Argia* was born. Komunikazio Biziagoa S.A.L. is the heir of these two publications. During the 1960s, the years of resistance against dictator Francisco Franco, *Zeruko Argia* promoted the Basque people's work and progress. In 1997, it became the first communication medium in the Basque language to go on the Internet.

Table 14: Main data 2010 of Komunikazio Biziagoa S.A.L.

Net turnover	EUR 807,629
Number of shares	16,664
Price per share	EUR 6.01
Company's share of stock	0%
EBITDA	EUR 33,194
Equity	EUR 611,722
Share capital	EUR 100,153
Number of employees	23
Number of worker-owners	19

Table 15: Komunikazio Biziagoa S.A.L. in 2010 compared to sector companies

Financial ratios	Kom. Biz.	Sector average
EBITDA margin	4.11%	0.27%
Indebtedness	24%	188%
Financial profitability	0.96%	-7.44%
Productivity	1.06	1.01

Source: Own elaboration with data obtained from Komunikazio Biziagoa S.A.L.'s annual accounts and the annual accounts of sector companies submitted to the Trade Register.

In 1998, after considering the various legal forms available for adjusting the business model to the times, Komunikazio Biziagoa S.A.L. was founded. Today, it is the publisher of

[108] The Capuchin Order of the Catholic Church was founded in 1525 aiming to restore the ideals of St Francis.

ARGIA (The Light), a weekly magazine in the Basque Country. Its main challenge is to keep readers well informed about Basque issues on a weekly basis.

Corporate Governance

Workers at *Argia* are the business owners in every sense of the word. They participate in all decision-making. As a worker-owned company, the business revolves around its workers. Even though becoming a partner in Komunikazio Biziagoa is optional, more than 86 per cent of workers are partners. Being in the communication industry, credibility is of utmost importance. Maintaining worker-ownership is the key to independence. To make it all work, the company has established trust, communication, and equality as its fundamental values. According to general manager Berdaitz Goia: "every worker has his or her own responsibility, but we are all equal; it is a completely flat organisation". Workers are free to choose their subjects as well as the stance they will take.

The advantage of being worker-owned

The company considers itself as having no employees, only truly motivated partners. Workers are reported to be firmly committed to their work; a level of co-operation attributed to being co-owners. Although the focus is on employee participation in all decision-making processes, task delegation is essential. Komunikazio Biziagoa workers' dual status as owners and employees allows them to establish sustainable growth policies, practice financial restraint, and re-invest profits in the company's future.

Company ownership structure

The company's capital stock consists of 18,964 shares valued at EUR 6.01 each. The minimum holding is 500 shares (EUR 3,005.06). Total stock is EUR 113,975.93. There are two types of shares:

- Type A shares are reserved for employees, without exceptions. These shares have voting rights.
- Type B shares are reserved for companies belonging to the corporate group, or employees of these companies who were formerly partners of Komunikazio Biziagoa. They do not have voting rights.

Table 16: Ownership structure of Komunikazio Biziagoa S.A.L.

Year	Buy-ins	Buyouts	Number of partners
2011	4	0	23
2010	3	0	19
2009	3	1	16
2008	2	1	14
2007	1	0	13

Source: Komunikazio Biziagoa S.A.L.

The company has a total of 23 partners: 20 worker-owners (who own type A shares) and three companies belonging to the corporate group. The percentage of type A shares owned by each worker ranges from 2.64 to 7.91 per cent.

Workers own 75 per cent of the company, while the companies belonging to the corporate group own the remaining 25 per cent. To ensure that the business continues to be employee-owned, workers leaving the company must sell back their shares.

6.2. Child Base, UK

6.2.1. Introduction

Childbase Partnership Limited is a company with the headquarters in Newport Pagnell, UK, which operates a chain of nurseries throughout the United Kingdom, but mainly in the South of England. Originally, Sir Peter Thompson and his son Mike Thompson founded it as a small family company with four staff members and 20 children in 1989. Mike Thompson is still CEO and co-owner. As the company expanded, the owners introduced the "Childbase All Employee Share Plan" in 2001 to enable the employees to obtain company shares in order to increase employee motivation, to secure the succession, to provide additional capital resources for future expansion and, consequently, to achieve a sustainable progress of the company.

Childbase provides care for currently 4,500 pre-school children at the age from one to five years. According to the turnover in 2011, it is the largest private childcare provider in the UK.[109] It has 1,304 employees (Bibby, 2009b) and operates 42 nurseries. The employees currently hold approximately 64 per cent of the equity capital individually or through the Employee Benefit Trust (EBT). Childbase is expanding by two to four new nurseries annually, either by opening new entities or by acquisitions (Bibby, 2009a). This expansion is at present being financed from Childbase's own cash reserve, since the cost of credit on the financial markets has risen due to the European financial downturn (Bibby, 2009a).

In the ranking of best companies to work for in the Sunday Times, Childbase took the 23rd place in the category of mid-sized companies in 2011[110], and rose to the 13th place in 2012.[111]

6.2.2. The case of Childbase

As the company expanded, the Thompson family as core owners decided to enable the employees to participate in the capital of the company. The underlying idea was, in the first place, to act in line with the corporate culture "we all contribute, we all benefit" and to motivate the employees with the concept of fair participation. This idea, on which also the company image is based, makes the company also more attractive and reliable for its clients. A positive and fair working climate is of special importance in the childcare business. Additionally, the transfer of ownership to employees can solve the problem of succession, which might become relevant in a family company, and protect the company from hostile takeovers (Bibby, 2009a).

Origin of the Childbase Nurseries Employee Participation Scheme

Sir Peter Thompson, the father of the current CEO and co-owner Mike Thompson, already had experience with the ownership transfer to employees, since he was responsible for the privatisation of the state-owned National Freight Corporation through an employee buyout.

The first step in the employee financial participation programme of Childbase was to establish the Childbase All Employee Share Plan as an approved scheme, under which the employees could obtain one matching share for each share they buy from the Employee Benefit Trust (EBT). Later the number of matching shares was, for a certain period, increased to

[109] According to the data of the Employee Ownership Association, the turnover of Child Base was GBP 25 million, i.e., EUR 29.8 million in 2011.
[110] http://www.bestcompanies.co.uk/survey_list.aspx.
[111] Ibid.

two in order to further motivate employees to buy shares. The core owners are committed to the goal of hundred per cent employee ownership.

In order to provide EBT with its own funds, Childbase diluted its own shares and transferred them to the EBT as free shares under an approved scheme. From the established funds, the EBT first paid out the core owner Sir Peter Thompson. Afterwards, Childbase transferred matching shares to the EBT in relation two to one and occasionally also transferred free shares under the respective approved scheme.

With concerns to trust establishment there was a problem of legal nature. It was preferable to establish the trust under the Scottish law, since the Scottish law, unlike the English law, allows establishing trusts for more than eighty years, as these trusts have no "shelf life". Childbase founded three new trusts simultaneously under Scottish law, which was a complex legal process.

Schemes

The main scheme is the Childbase All Employees Share Plan, under which all permanent employees can buy shares and obtain the matching shares from the EBT. The employees can let the interest be paid out in cash or invest it in shares. Within the Childbase All Employees Share Plan, employees also can obtain benefits not directly related to employee ownership. Additionally, Childbase implements an approved save as you earn (SAYE) scheme.

The employees currently already hold the majority of the equity capital, so that they can influence the election of the management. The former core owner and current CEO and co-owner Mike Thompson now needs the approval of the employees to be re-elected. Such control corresponds to his idea of an employee-owned enterprise.

The employees have no direct representatives in the management of the company. However, their representatives, called councillors, are involved in decision-making, e.g. as far as remuneration and working hours are concerned. (McDonald, 2011) One councillor is elected in each of 42 nurseries to the Childbase Partnership Council. The tasks of the councillors are to promote employee ownership at company and nursery level through regular meetings with the staff, to decide on staff bonuses, reduction of hours strategy, to propose new policies, to represent staff views and to improve co-operation between the management and the staff. Additionally, the communication between the staff and the top management takes place at the regular "listening lunches", specially organised in order to enable employees to directly address the top management.

The Employee Benefit Trust and its role

The core mechanism of the Childbase All Employees Share Plan is the EBT. On the one hand, the trust sells shares to employees and provides them with matching shares under the approved scheme. On the other hand, both employees and external investors are allowed to sell their shares only to the EBT, so that the EBT also serves as the only market place for Childbase shares. Employees are obliged to sell their shares to the EBT after leaving the company. Due to this mechanism, a pool of shares for the future one hundred per cent employee ownership is created within the EBT.

Shares can be bought or sold back on two annual dealing days held in May and November each year under the Childbase All Employees Share Plan.

The company accountant is setting the share value before the trade takes place. The Child Base shares were traded at GBP 0.40 in 2000 and at GBP 1.14 in April 2011 (Employee Ownership Association, 2009). Each individual shareholder is limited to 2.5 per cent (Bibby, 2009a) to prevent individuals from gaining substantial control over the company.

The sale of the company is only possible with the approval of the Independent Board holding the so-called Golden Share that grants the right to veto any decision concerning the company existence. The decision must be unanimous.

Implications

The share ownership plan has led to an increase of the employee share in the equity capital from zero to 64 per cent in 12 years. If the plan is implemented on the same lines in the future, the goal of one hundred per cent employee ownership could be achieved in the next ten years. Consequently, the succession in the company and the protection against hostile takeovers are secured. Profit-sharing schemes, social programs and participation in decision-making flank the plan. The acceptance of the employee share ownership plan by the staff and the management is high and has already led to a substantial change of attitude.

According to the survey "Best Companies", 80 per cent of Childbase employees like to work for the company, 85 per cent are proud of it and 71 per cent believe that they are treated fairly and that the management respects their needs. As a result, Childbase, unlike many mid-sized companies, has low personnel fluctuation and has the advantage of recruiting personnel for higher management positions from the own company.

The management also supports employee ownership and feels more responsibility towards the employees than in most companies. The CEO Mike Thompson conducted an experiment within the Partnership Council offering the managers high financial profits for the case the company is sold to a Bahamas trust. Even provided that the sale should be under the condition of employment protection, nobody voted for the sale.

According to CEO Mike Thompson, the results of the introduction of the employee ownership plan are:

- A Times 100 company—still the only one in the sector to achieve that status;
- Office for Standards in Education, Children's Service Skills (OFSTED) results unparalleled for the sector—50 per cent for Childbase at a sector average of 12 per cent;
- Profits up by over 200 per cent in six years;
- Share take up amongst employees growing;
- Dividend yields growing;
- Annual bonuses for staff worth of GBP 650,000, i.e., EUR 775,000 per year.

6.2.3. Best practice and transferability

Success of the concept

Childbase qualifies as a best practice example by its structured approach towards employee participation, at the same time maintaining high performance, and by its thoughtful business approach that makes Childbase one of the leading companies in its industry. Further, Childbase managers are highly efficient in motivating the employees.

In the Sunday Times ranking of best companies to work for, Childbase moved to the 13th place in 2012. Commenting the 23rd place in 2011, Helen Bass, Child Base HR Director, said: "We take great pride in the fact that Childbase directors and employees are partners; it is the foundation on which we have built a successful, sustainable and ethical business" (Childbase, 2011).

Childbase is also active in spreading best practice throughout the UK. It is a member of Employee Ownership Association. Recently, Childbase sponsored the report "All of Our

Business: Why Britain needs more private sector employee ownership" by the Academic Director of the Centre of Mutual and Employee Owned Business at the Oxford University William Davies. (Davies, 2012) The report was launched at the House of Commons in April 2012 and enjoyed cross-party support. The Government also supported the report and promised to let political measures follow.

Transferability

The transferability of the specific scheme implemented by Childbase is limited, at least to the UK and Ireland, since the legal form of trust is possible only under common law. The specific tax incentives for the SIP scheme enabling Childbase to provide the trust with own funds and facilitating participation for employees are also limited to the UK.

6.2.4. Conclusions

The case of Childbase qualifies as best practice, while the legal structure is specific for the UK and in this particular way can be adopted only in common law countries.

The case is of special interest for mid-sized family enterprises throughout the EU, since it shows that succession problem can be solved and, at the same time, the productivity increased by introducing an employee ownership plan. This experience is of special importance to family enterprises in other EU Member States where employee ownership is considered to be a barrier for economic growth of the enterprise.

Childbase being an enterprise, where employees are majority owners, also shows that employee ownership can have a significant positive effect on performance and growth, also in the financial crisis. Among others, the case of Childbase has convinced the House of Commons and the UK Government to provide more political and legal support to employee ownership plans in order to strengthen the national economy and to overcome the financial crisis.

6.3. The French employee-buyout mutual fund ("FCPE de reprise")

6.3.1. Background: Employee share ownership in the French system of EFP

In France, employee share ownership is mostly[112] acquired by means of profit-sharing plans as part of the overall system of EFP composed of the following major plans: "intéressement" profit sharing, "participation" profit sharing and short-term savings plans (Plan d'epargne d'enterprise or PEE).[113]

Within this system, invested employee earnings and matching amounts of the employer company must be—and employee profit shares can be—transferred to mutual funds (Fonds commun de placement d'entreprise or FCPE)[114], usually managed by assets management firms, i.e., branches of banks or insurance companies, which invest the assets on the capital markets in shares or bonds of the employer company or of several different companies. In PEE it is furthermore possible to offer employees an option to subscribe to a capital increase at a subscription price with up to 20 per cent discount of the fair market value using their savings and company matching contributions.

If the employer company is not listed, the traditional non-diversified FCPE is obliged to invest one third of assets in marketable shares or bonds. There are however two exceptions: (i) "FCPE simplifié"—a mechanism guarantying the liquidity (e.g., by the enterprise) is installed, or the company buys back ten per cent of its own shares—or (ii) since 2006 the "FCPE de reprise"—all assets belong to employees planning to participate in a leveraged buyout.

All plans must be broad-based (i.e., apply to all employees, with the exception of those with less than three months of service). A blocking period of five years (profit sharing, PEE) is compulsory and linked to substantial tax incentives, which generally include exemption from personal income tax and social security contributions and imposition of special social contributions of eight per cent for both employees and the employer company and on returns of 13.5 per cent (instead of 32.5 per cent without incentives).

The blocking period expires under certain personal circumstances of employees (death, disability, cessation of employment, insolvency, marriage, birth of a third child, divorce while keeping custody of at least one child, purchase of a principal residence, founding or acquisition of an enterprise by the employee).

6.3.2. The system of the "FCPE de reprise" (employee-buyout mutual fund)

In 2006, the so-called "FCPE de reprise" (employee buyout mutual fund) was introduced into the French system of EFP in order to allow employees to take over their employer company under preferential conditions.[115] This new business succession vehicle is a specific form of FCPE to facilitate business succession in non-quoted SMEs.

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[112] However, it is possible to transfer free shares to employees; since 2006 such transfers are without a holding period and with a vesting period of four years. In privatisation, ten per cent of shares are reserved for employees and can be offered at a discount of up to 20 per cent of fair market value.

[113] Since 1986 "participation" profit sharing is compulsory for all companies with more than 50 employees (initially 100 employees in 1967) and since 2006, companies operating such a plan must introduce a PEE.

[114] FCPE are a specific type of Undertakings for Collective Investments in Transferable Securities (UCITS) at enterprise level reserved to its employees; at the EU level UCITS are regulated by Directive 2001/107/EC and 2001/108/EC.

[115] Art. 37 Law No 2006-1770 of 30 December 2006 for the development of financial participation and employee shareholding, codified Art. L.3332-16 Labour Code defining the new vehicle while Art. 9 Decree No 2008-244 of 7 March 2008 introduced Art. R.3332-29 Labour Code further specifying it. Other amendments concern Art.

Differences between the "FCPE de reprise" and the "classic FCPE"

The "FCPE de reprise" is invested in unlisted securities, Art. L.3332-16 Labour Code defines this new type of savings fund designed to acquire unlisted shares of the employer company) or of a company of the same group in the sense of Art. L.444-3 Labour Code (or of a holding company set up in view of its acquisition reserved to the employees. The "FCPE de reprise" can be invested up to 95 per cent in shares of the purchased company vs. 67 per cent in the case of the regular non-diversified FCPE[116]; thus, the liquidity reserve is limited to five per cent. The blocking period of sums allocated to the fund continues until the completion of the takeover of the company but no less than five years (as opposed to five years for the classic FCPE).

Pursuant to Art. R.3332-29 Labour Code, there are three cases of early release, i.e. disability, death and retirement while the conventional FCPE allows for nine cases. The limitations to unblock funds ensure longevity and stability superior to that of the classical FCPE in order to strengthen the "FCPE de reprise" as a business succession device and to reassure partners of this undertaking.

A holding company is created to carry the debt needed to buy out the company; this is usually a S.A.S.[117], i.e., a "simplified joint-stock company" non-quoted and common in LBO transactions (similar to the British limited company and the U.S. limited liability company). Prerequisite is the existence of a negotiated company savings plan (as opposed to a PEE unilaterally implemented by the employer) anticipating the "FCPE de reprise". At least 15 employees (or one third of employees in firms with less than 50 employees) must hold shares in the acquisition vehicle (holding) created. These employees may own unequal shares of the capital, and it is not required that the operation be offered to all employees. However, an agreement with the employees must stipulate the identity of those employees participating in the buyout and the final structure of ownership control, as well as the time horizon of the operation. The members of the supervisory board of the "FCPE de reprise" must be elected by all employee shareholders and not appointed by the representatives of trade unions.

Practice example—The EsoPacte® solution proposed by Equalis Capital

Equalis Capital, a French independent asset management firm, proposes the following system of employee buyout based on the use of the "FCPE de reprise":

Step 1. Creation of a buyout holding company whose shares will be subscribed to directly by at least 15 employees in the context of an enterprise savings plan (PEE).

Step 2. Professional investors or the owner, who is selling the company, contribute to the financing of the buyout by subscribing to convertible bonds, which carry an interest coupon and a premium for non-conversion, which may be variable (i.e., the bonds are not intended to be converted).

220-ninth of the General Tax Code as well as Art. 31-5 of the AMF Instruction of 21 December 2011 as well as Q&A of 26 November 2007.

[116] FCPEs are usually at enterprise level whereas special rules apply to SMEs; they may be either diversified or non-diversified and while the company must offer the former the latter is optional.

[117] Art. L227-1 to L227-19 of the French Commercial Code, which was rendered more flexible by Law of 15 May 2001 and most recently was reformed in 2009.

Step 3. The holding company borrows from a bank to complete the financing of the acquisition of the securities and to benefit from leverage.

Step 4. In a second phase, annually all managers and employees are offered the option to invest in the buyout holding company through a dedicated fund, the "FCPE de reprise", which will become part of the conventional enterprise savings plan (PEE). Managers and employees will have the opportunity to finance their investment in the "FCPE de reprise" from the following sources: (i) sums from profit-sharing schemes ("intéressement" and/or "participation"); (ii) company's matching contributions; (iii) company contributions to increase the capital of the holding company via issuance of new shares; (iv) funds previously held accumulated within the PEE; (v) voluntary payments.

Step 5. Such, the acquisition loan will be repayed in two ways: (i) through dividends of the target company paid out to the buyout holding company; (ii) via issuance of shares of the buyout holding company financed with funds from the profit and gain-sharing schemes ("Intéressement" and/or "participation") and complementary company matching contributions. Contributions to the buyout holding company financing the issuance of new shares will be tax deductible to the target company.

6.3.3. Implementation difficulties: "Simplified" FCPE as work-around—A practice example

As of May 2012, no "FCPE de reprise" has yet been approved by the AMF (Autorité des marchés financiers), the French securities regulator. The fact that this model first conceived in 2006 has not been implemented yet, despite the enormous need for corporate business succession[118], is probably due to the ignorance of market operators. Among asset management companies, accountants, brokers in mergers and acquisitions, and other consultancies, few professionals are familiar with the "FCPE de reprise". Consequently, this device is not being proposed to clients. Nevertheless, once introduced to professionals, these professionals usually find the system interesting. However, the organisational threshold of 15 participating employees as well as the condition of an agreement identifying these individuals, the final ownership structure, and the time horizon, together with the necessity to involve investors and financiers in the operation, also seem to be obstacles to the adoption of this model.

Confronted with a new device, market operators are naturally sceptical and often prefer to use a proven instrument.

In fact, for similar reasons, Equalis Capital reports that it is easier to structure the financing of employee buyouts, especially those that are management-led, by using the "FCPE simplifier". In comparison to the "FCPE de reprise", this modification of the non-diversified classic FCPE has no limit on holding unquoted employer securities, provided that a mechanism guarantying the liquidity is in place, or the company buys back ten per cent of its own shares. The only additional requirements are that the FCPE obtain a liquidation valuation at least once a year and that the FCPE give employees a two-month notice before publication in order to make subscription or sale orders. As the following example illustrates investors and financiers still may find management buyouts where employees have an insignificant role more attractive.

[118] For France the transfer volume of enterprises is estimated around 600,000 for the next decade (Vilain, 2004), for Germany around 354,000 over the next five years (Institut für Mittelstandsforschung, 2005); the final report of the BEST project on the transfer of small and medium-sized enterprises, 2002, estimated that the annual transfer potential for the EU-15 was 610,000 businesses.

Company overview

This company is a spin-off of a large group of the CAC 40 index, which considered it to be non-strategic and, therefore, wished to sell it. The subsidiary operates in the retail sector of hygiene products and is based near Paris. In 2010, when the parent company informed the management of its subsidiary that it intended to sell the subsidiary, it was management, who refused to come under the control of an investment fund, threatening to leave the company if necessary. As the value of the enterprise was strongly linked to the presence of management, the parent company found itself forced to find an alternative and to accept a takeover offer by management. However, the three-four managers interested in the takeover could not provide the sum necessary (EUR 25 million).

To address this issue, Equalis Capital proposed a recovery operation through the "FCPE de reprise" within the company's savings plan (PEE). In January 2011, Equalis Capital convinced the parent to accept the takeover, to be financed partly (30 per cent of funding) as mezzanine debt through convertible bonds, partly (50 per cent of funding) through a bank loan, and the rest by contributions from executives and employees. In this configuration, the divested business issued bonds that were redeemed by the assignor in exchange for shares. The parent received a 15 per cent coupon and kept a stake in the divested company. Consequently, the parent immediately received proceeds corresponding to the bank loan and the contribution of employees.

For repaying the debt, the operating company will make dividend payments to the buyout holding company as in a classic LBO transaction. Moreover, in order to repay the debt more quickly, employees are encouraged to invest in the capital of the acquiring holding company through a system of matching contributions: 20 per cent for monies from profit-sharing schemes ("participation" and "intéressement") invested in shares, and 50 per cent for voluntary payments, up to the legal maximum of 14.4 per cent of the annual ceiling for the calculation of social contributions, representing EUR 5,161 in 2011. However, the offer did not include a discount on the share price, as the shares are not quoted. Finally, a yearly capital increase reserved to employees is planned.

It is important to stress that the target company benefiting from this system should be financially sound, profitable, and with positive business prospects, as the debt reimbursement system is largely based on the availability of dividends, as well as the availability of funds to ensure profit-sharing bonuses and matching contributions.

The subscription offer to employees

The offer took place in the second half of 2011. All employees who wished so could subscribe shares between 1 and 15 June 2011. A holding company was created for the managers' participation, and a mutual fund, the "FCPE de Reprise", for employees. The offer was communicated to employees in informational meetings in groups of 20-25, as well as by a brochure describing the practical modalities of the subscription.

As a result, 70 per cent of the 1000 employees participated in the offer for a total of 3.5 per cent of the capital, against 96.5 per cent for the ten managers.

For the management, the "FCPE de reprise" was essentially seen as a way to involve all employees in this radical change of ownership of the company, and to provide them with a vested interest in the future expansion of the company. The company's general manager, 40 years old with a financial background, is a very charismatic person who was able to win the support of the other managers and employees in taking over the company.

With more than 96 per cent of capital held by ten managers, the role of the employee "FCPE de reprise" in the governance of the operating company is marginal. The fund's su-

pervisory board is composed of three representatives of the company and three representatives elected by employee shareholders on the basis of one share, one vote.

6.3.4. Conclusions

The "FCPE de reprise"—the French cousin of the Employee Stock Ownership Plan (ESOP)

A full or partial employee buyout provides an ideal vehicle to facilitate transitions in ownership and management of closely held companies. This field of action has been highlighted as one of the main objectives of the Council Recommendation of 7 December 1994[119] and recently by the European Commission, explicitly stressing the importance of ownership transfers to employees as a specific measure for facilitating business succession in SMEs.[120] In essence, the "FCPE de reprise" as the new French vehicle—both with regards to legal structure as well as financing mechanism—is very similar to its Anglo-American cousin the Employee Stock Ownership Plan (ESOP).

Both are share ownership schemes, where the acquisition of shares via a trusteed fund (as an intermediary entity) is financed by a profit share paid in addition to wages. Both may use borrowed funds on a leveraged basis, have the capacity to create substantial employee ownership, and can be used to finance ownership succession plans.

While, e.g., share-based profit-sharing schemes have only one source of funds (i.e., direct contributions from the employer company), the "FCPE de reprise" (as the ESOP) can obtain financing from such different sources as:

- a loan from the employer company, from a selling shareholder or from a financial institution such as a bank;
- contributions from the employer company within a profit-sharing scheme (intéressement/participation) including employer matching contributions;
- capital increase financed by the company itself;
- dividend earnings;
- reinvestment of a part of the purchase price obtained by the departing owner in the form of quasi capital or mezzanine debt at attractive conditions.

While share ownership generally involves additional risk for employees, both the "FCPE de reprise" and the ESOP avoid this consequence.

Although employees—as in other share ownership schemes—are encouraged to allot part of their wealth into the shares of their own companies rather than those of other companies, resulting in concentrated rather than diversified risk, there is this fundamental difference: the debt is funded by appropriately timed contributions from the company to the buyout vehicle. Thus, the scheme provides an additional benefit to basic wages. The employee's salary remains unaffected. There is an additional advantage to the company: shares are not sold to outsiders; thus, there is no risk of loss of control, and the company remains

[119] On the transfer of small and medium-sized enterprises, 94/1069/EEC, with explanatory note, Official Journal No C 400, 31. 12. 1994, p. 1; reiterated in the Communication from the Commission on the transfer of small and medium-sized enterprises, OJ C 93, 28 March 1998.

[120] One of the key areas defined in the Final Report of the MAP 2002 Project (European Commission Enterprise Directorate-General, 2003).

local. Finally, ESOPs tend to make employees more motivated and productive, while at the same time making enterprises more competitive.[121]

Perspectives for the "FCPE de reprise"

Just as the ESOP, which is primarily popular as a business succession vehicle for SMEs[122], the French "FCPE de reprise" creates a market for retiring shareholders' shares, which is of major importance to unlisted SMEs that have no other ready source of liquidity. There are three types of companies likely to be interested in using a "FCPE de reprise" in the future:

- subsidiaries of large groups, which are subject to plans to be sold;
- SMEs whose retiring founder has no children wishing to take care of the business (which is the core target for this type of device);
- companies owned by investment funds that do not perform exceptionally well and thus are difficult to resell to another fund.

The market in France is potentially enormous, with an estimated number of companies to be sold of around 50,000. In order to spread the use of the "FCPE de reprise", Equalis Capital among of a small group of pioneers is targeting prescribers (accountants, intermediaries in mergers and acquisitions, investment funds, asset management companies, etc.) rather than enterprises directly.[123] Large asset management companies, on the other hand, are more interested in private equity transactions and the management of diversified employee savings plans, which is undoubtedly one of the reasons why this device has not been often implemented yet. The "FCPE de Reprise", although very similar to the classical FCPE, much better ensures the stability and continuity of an employee buyout operation and thus provides more security to potentially interested external investors and stakeholders.

The scarce incidence of "FCPE de reprise" (only one according to Equalis Capital) is therefore surprising. However, this essentially appears to be a problem of the limited knowledge of its existence among professionals in the concerned financial sector. As the experience with similar concepts in other countries shows (especially more than 50 years of U.S. ESOPs), increased incidence of "FCPE de reprise" is most likely just a matter of time and successful pilot projects.

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[121] For a recent, comprehensive overview of the positive economic evidence (esp. for ESOPs) see Blasi, Kruse and Bernstein, 2003; they find an average increase of productivity level by about four per cent, of total shareholder returns by about two per cent and of profit levels by about 14 per cent compared to firms without EFP.

[122] In the United States, over half of all the Fortune 500 companies and over 40 per cent of Inc. magazine's 100 fastest growing private companies now sponsor ESOPs. As of 2011, there were approximately 11,500 ESOPs in the U.S., covering approximately ten million employees (ten per cent of the private sector workforce). About 330 ESOPs—3 per cent—are in publicly traded firms, while the vast majority are sponsored by privately held firms. An estimated 7,000 of the 11,500 companies have ESOPs that are large enough to be a major factor in the corporation's strategy and culture, about 4,500 are majority and about 3,000 100 per cent owned by the ESOP.

[123] Such, only a month after the initial contact with several investment funds operating in the area of mergers and acquisitions of medium-sized companies, Equalis Capital liaised already with a dozen of companies interested in setting up the EsoPacte® device.

Table 17: Comparison of non-diversified FCPE with a view to business succession in SMEs

Non-diversified FCPE (type) Characteristics	**"Classic" FCPE** Art. L.214-40 Monetary & Financial Code (MFC)	**"Simplified" FCPE** Art. L.214-40 MFC and Art. L3332-17 Labour Code	**FCPE "de reprise"** Art. L.3332-16 Labour Code
Governance, i.e., supervisory board	(i) Election by employee shareholders; or (ii) Appointment by enterprise representatives and (on behalf of employee shareholders) social partners		Election by all employee shareholders
Vesting period	Five years		Until completion of buyout; minimum of five years
Specific fiscal incentives for a buyout	Exemption from PIT and SSC / instead reduced 8% social tax and 13.5% on returns for: • employee contributions up to 25% of annual payroll; • monies from profit sharing (participation / intéressement); • matching contribution of up to EUR 5.000 per year; • contribution of free shares. Company contributions in turn are tax-deductible: • matching contributions; • free shares; • discounts in capital increases. Invested employee earnings and matching employer contributions must be transferred to mutual funds (FCPE).		As for the other FCPEs (contributions to buyout holding company financing the issuance of new shares are tax-deductible expenses for the company) additionally: • Art. 220 ninth General Tax Code, tax credit in the amount of the interest paid to finance acquisition; • L3332-15: FCPE not compulsory to manage investment.
Exceptions for early exit	Nine: death, disability, retirement, cessation of employment, insolvency, marriage, birth of a third child or divorce while keeping custody of at least one child, purchase of a principal residence, founding or acquisition of an enterprise by the employee		Three: death, disability, retirement
Minimum requirements for liquidity	33.3% in high liquidity stock	None, provided: (i) a mechanism guaranteeing the liquidity (e.g., by the company); or (ii) the company buys back 10% of its own shares.	5% in high liquidity stock
Thresholds for non-quoted employer stock	33.3% to 66.6%	33.3% to 100%	33.3% to 95%
Enterprise savings plan (PEE) carrying the FCPE	Set-up: (i) as a result of negotiations, or (ii) unilaterally on initiative of the employer		Set-up as a result of negotiations (exclusion of compulsory plans)

Source: Own research with the support of FONDACT and partners.

6.4. German recognition of the French FCPE granting deferred taxation to similar national schemes

6.4.1. Background

Despite a long standing tradition and the general acknowledgement of the positive effects on both productivity and job creation, EFP is not widespread in Germany. Traditionally, German schemes focus on defined contribution savings plans with a total capital allocated much higher than that of all employee share plans; with regards to financial participation, the combination of share ownership plans with these savings plans may be considered typical. Germany's lower standing in comparison to other countries and a recent decrease in employee share ownership may be attributed to insufficient government support and a somewhat sceptical social partners' attitude.

Since 2007, a number of government officials as well as representatives of major political parties declared that EFP should be better promoted in the future. Nevertheless,—resulting from the substantial differences that had divided the two member parties of the Grand Coalition—the new Law on Capital Participation of Employees[124], which came into force in April 2009, merely increased existing insignificant fiscal incentives. Under the new Law and the 3rd Law on Asset Formation including previous provisions[125], these are only offered for employee share ownership, while profit sharing is not supported by any tax incentives.

6.4.2. The Special Fund for Employee Participation introduced in 2009

Introduced by the 2009 Law primarily for SMEs, these funds are governed by the Investment Law. They pool voluntary employee savings including savings bonuses as well as capital participation shares offered by participating companies to their employees and re-invest them in these companies and in the capital markets. The funds may be set up at branch level in co-operation with employers association and/or trade unions and have to invest 60 per cent of their assets in the employer companies. While a company may apply for re-investment, it has no claim to actually receive financing from the fund.

This new fund category, which allows for indirect investment first and foremost for employees of SMEs, has in fact not been implemented in practice so far. Though this fund solution is sensible for the further development of EFP in Germany, there were doubts from the beginning whether the intended objective of combining employee participation with the benefits of fund investment and, at the same time, opening up a new source of financing for SME were compatible with each other. On the one hand, the purpose of the fund (promoting capital participation in the employer company; providing new sources of financing for SMEs) stands in contradiction to the principle of independent investment policies for the sole purpose of increasing returns. On the other hand, the structure of the fund's resources being in the SME's illiquid assets runs contrary to the principle of maintaining the fund assets' liquidity.

[124] Act on Tax Incentives in Employee Participation (Employee Participation Act) from 23 January 2009; BGBl. 2009 I p. 451.

[125] The provisions of the 5th Law on Asset Accumulation and § 19a of the Income Tax Law.

Table 18: Composition of the Special Fund for Employee Participation

(Limitations for types of assets or issuers in per cent of total value of the Special Fund)

As a minimum, 60% qualified assets of enterprises that grant their employees contributions in order to acquire shares in the Special Fund *As a maximum, 20%* of a single enterprise or group		*As a maximum, 40%* qualified assets of other enterprises or other investments
Up to 100% • listed securities • selected financial instruments • non-bonded loan-claims	*Up to 25%* • non-bonded holdings • non-listed securities	*Up to 5%* of each issuer or investment fund: • listed securities • blocked current account • money market: cash equivalents • investment shares • derivatives

Source: Author's compilation.

To unlock the potential of the new **Special Fund for Employee Participation,** the proposal[126] was made to expand diversified fund investment offered by the new Law to include a non-diversified investment option following the American and French models (e.g., non-diversified FCPEs or ESOPs[127]). Neither the French nor the American system can be directly copied due to structural differences in the economy and the legal systems. The basic idea, however, of giving companies and employees the choice between two distinct kinds of investment (diversified, non-diversified) appears to be the most suitable way to eliminate the systemic contradictions of the new German model. This is one way to ensure that the conflicting objectives engendered by the "diversified" and "non-diversified" investment strategies are not at loggerheads, but reach their full potential in each respective investment type.

With modifications to the investment limit following the French standard FCPE model, the new German fund model appears to be a feasible concept for diversified investments, while the ESOP funds or the "FCPE de reprise" (see above case study France) seem appropriate as a model for non-diversified investments. Both concepts are particularly suited for SMEs due to their high level of flexibility. In particular the ESOP has proven to be a useful vehicle for business successions in the SME sector.[128]

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126 Cf. the analysis of the situation in Germany, Lowitzsch et al. (2008) "Expert Opinion on the Employee Participation Act" prepared for the economic department of the Hans Böckler Foundation.

127 ESOP is the acronym for Employee Stock Ownership Plan. An ESOP—a indirect employee participation scheme financed by credit and combined with employee profit sharing, which finds widespread use in the United States— has far simpler structures and is more cost-efficient.

128 A full or partial ESOP buyout provides an ideal vehicle to facilitate transitions in ownership and management of closely held companies. In this way, the ESOP creates a market for retiring shareholders' shares at a price acceptable to the owner, a market, which in unlisted SMEs—having no other ready source of liquidity—would not exist. For details see Lowitzsch et al., 2008, pp. 46, 54 ff.; see above 3.2.

6.4.3. Major obstacle to implementation: No deferred taxation in employee share schemes

However, it is not the described deficiencies of the new Law or the question of insufficient tax incentives (to date with a ceiling of EUR 360 tax exemption per year, which is very modest) as such that impede broad participation of employees in share schemes. A major obstacle was and still is the absence of deferred taxation of the benefits employees received as employee shares. Under German tax legislation, employees acquiring shares free, discounted or at market price need to have sufficient liquidity to pay income tax at the moment of transferral of the share, which especially in the lower income stratum hinders them to participate in share schemes. Given the typical blocking periods of these schemes, employees usually cannot sell the shares at once to pay the taxes but have to use their already scarce income while still running the risk of a depreciation of the value of the shares acquired during the holding period. This well-known problem has been discussed in Germany for the past 30 years with changing governments arguing against an introduction of deferred taxation above all with prohibitive cost (for a description of the effect of deferred taxation see above 4.1.2.).

It was not until the German tax authority's recognition of the taxation of the French FCPE outlined in the **circular released 8 December 2009 by the German Federal Ministry of Finance**[129] that this problem was alleviated. The circular grants deferred taxation of employee participation to the "Fonds Commun de Placement d'Entreprise" (FCPE) pursuant to French law, which is similar to the Special Fund for Employee Participation introduced in Germany by the 2009 Law. Furthermore, the French FCPE model is de facto recognised in Germany by defining equal treatment of similar German models. In this way, "taxation of payment in kind occurs in employee participation schemes by means of the Fonds Commun de Placement d'Entreprise (FCPE) and **in similar cases** when the scheme is liquidated and a money amount is transferred to the employee or other financial contributions are granted that are derived from benefits (e.g., exchange of shares). The employee shall not receive any capital income (dividends, interest, etc.) until the scheme is liquidated."[130]

6.4.4. Mutual recognition triggers a new German ESOP scheme for SMEs

The removal of the obstacle of missing deferred taxation as a result of the recognition of the French FCPE triggered the development of a model similar to the French based on the common ESOP logic. As this new German EFP model targets above all the problem of business succession in SMEs, it mimics the ESOP successfully implemented in Ireland, the UK and above all the U.S. (2011 about 11,500 ESOPs[131], with more than ten million employee shareholders).

Interestingly, this logic is the same for the new French "FCPE de Reprise" (see case study France above) and consequently also the structure of all three models: the acquisition of shares via a trusteed fund is financed by a profit share paid in addition to wages. All three indirect share ownership schemes employ a separate intermediary entity, which manages the shares held in trust for employees (a trust in the case of the ESOP, a limited liability holding company in the case of the French "FCPE de Reprise" and the new German model).

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[129] On the treatment of capital participation under personal income tax starting in 2009 (§ 3 Nr. 39, § 19a EstG); Reference number IV C 5 - S 2347/09/10002; Doc 2009/0810442. In reference to permanent ruling of the Federal Finance Court (cf. FFC from 23 June 2005 - VI R 124/99 -, BStBl II p. 766, on convertible bonds).

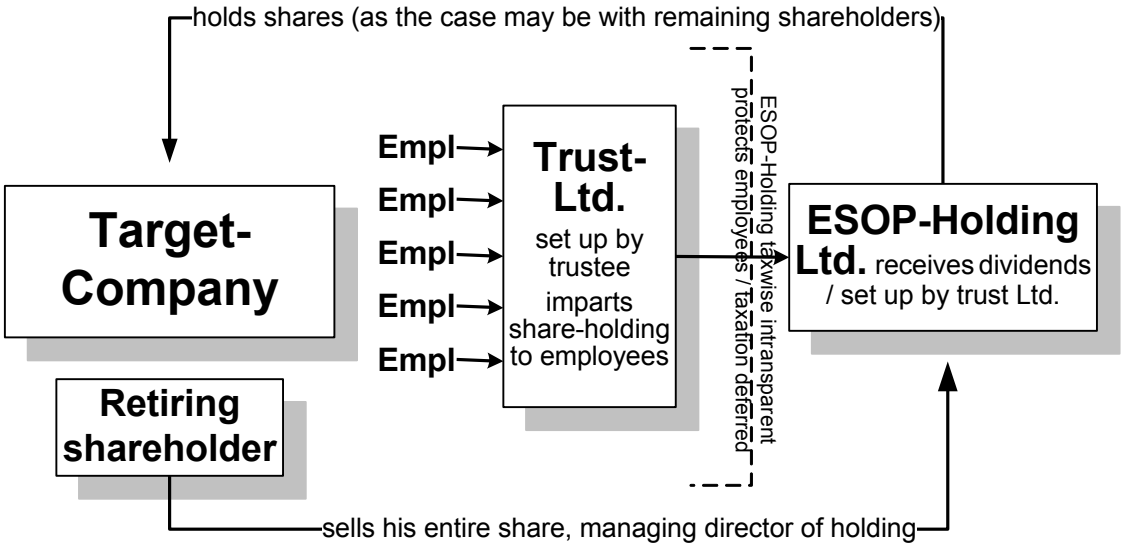
[130] Point 7 of the circular under item 4; author's emphasis.

[131] About 330 ESOPs—3 per cent—are in publicly traded firms while the vast majority are sponsored by privately held firms. An estimated 7,000 of the 11,500 companies have ESOPs that are large enough to be a major factor in the corporation's strategy and culture, about 4,500 are majority and about 3,000 100 per cent owned by the ESOP.

In France, at the enterprise level, the combination of a savings plan and a mutual investment fund is used, which is a similar idea as that of German savings plans (Vermögensbildung). As a consequence of this parallel structure, the new German model enjoys deferred taxation just as French FCPEs operating in Germany do.

In the new German model, the target business is a typical family enterprise (as a rule a Ltd; but this could also be a limited partnership). Under the assumption that one or more shareholders want to cash out, maximum profit is not necessarily the sole aim, but also: (i) the continuance of the enterprise, (ii) a rearrangement of the ownership structure, (iii) the protection of jobs, (iv) a gradual transfer of management, and (v) a tax efficient exit for the retiring owner. Provided that the scheme takes into account these aims sufficiently, the retiring owner(s) might be interested in selling to an ESOP as intermediary entity.

Figure 22: Structure of the German ESOP



Source: Author's illustration.

Against this background, the structure shown in Figure 22 is a result of the following steps:

i. A trustee sets up the "Trust Ltd" with the retiring owner sitting on its supervisory or advisory council. The employees enter into an escrow agreement and contribute, e.g., EUR 250 per employee to the Trust Ltd (in Germany a maximum of annual EUR 360 participation in employer equity is tax-exempt).

ii. The "Trust Ltd" sets up an "ESOP-holding Ltd", which the retiring owner chairs as managing director. The holding acquires the retiring owner's complete shares and holding the employees' shares controls the target company (depending on the size of its share, together with the remaining owners).

iii. The purchase of the shares is financed by a bank loan collateralised by the value of the target company. Interest and principal are repaid: (i) from dividends of employees' shares (indirect profit sharing), (ii) voluntary employee's contribution (up to 10 per cent of salary), and (iii) contributions of the company to the ESOP holding.

iv. The retiring owner leaves the management of the "ESOP-holding Ltd" after the loan is repaid; from then on the trustee determines the management according to the employees' vote.

A unique feature of this new German ESOP model is above all that it offers an alternative to the sale to third parties, thus facilitating a transfer of enterprise without immediate loss of

control. Furthermore, ESOP profits are tax-free with potential losses being carried forward and a single taxation at level of target enterprise. The direct participation of employees in the equity of the target company via the ESOP holding strengthens the link to the employer firm. After the end of a minimum seven-year holding period, a gradual diversification of the investment five years prior to the employee's retirement reduces the risk of the volatility of the value of the stock. The specific legal structure that combines the "Trust Ltd" with the "ESOP-holding Ltd" provides full transferability of shares while it ensures that a new employee can easily take over the share of a retiring employee at no additional cost.[132] This is particularly important in SMEs when shares are not to be sold to outsiders.

The deferred taxation of employee financial participation is guaranteed by the parallel structure to non-diversified French FCPE as well as by the "Holding Ltd" that—being tax-wise intransparent—shelters employees. Finally, no "double risk" to employees is involved, as the benefit is a profit share "on top" of their regular salary and voluntary employee contributions can be hedged or insured against insolvency risk. The time horizon of the buyout transaction is projected with employee contributions to seven years and without them to 10-12 years.

6.4.5. Conclusion

In Germany, considering the shortcomings of the 2009 German Law on Capital Participation of Employees, the process of mutual recognition was an important step to facilitate the creation of a new EFP scheme for SMEs.

It was the removal of the obstacle of missing deferred taxation as a result of the recognition of the French FCPE that triggered the development of a new German model similar to the French one based on the common ESOP logic. In this way, a well-known obstacle, which was ignored by the new 2009 Law, was quietly removed through the recognition procedure at ministerial level. Therefore, this can serve as an example of the mutual recognition of models described above.

[132] Being a direct shareholder in a German Ltd the transfer of shares from one employee to another requires registration with a notary public and thus may lead to prohibitive cost.

6.5. Voestalpine, Austria

6.5.1. Introduction

Voestalpine AG—headquartered in Linz (Austria)—is mainly active in the production and treatment of steel. As a successful international corporate group with some 300 production and sales companies in more than 60 countries, it has nearly 40,000 employees (fewer than half of them in Austria). In conjunction with discussions about the full privatisation of the corporate group undertaken at the beginning of 2000, the group's Board of Management together with the employee representatives developed and later implemented an employee participation scheme, which at that time was unprecedented in Austria. Through this, a large portion of the group's workforce as well as a small group of ex-employees currently hold a 13.3 per cent stake (around 22 million shares) administrated by a private foundation (Voestalpine Mitarbeiterbeteiligung Privatstiftung).

6.5.2. The case of the Voestalpine AG

In 2000, the Austrian Government—under Chancellor Wolfgang Schüssler—enacted the so-called ÖIAG Act[133] with the intention of accelerating the privatisation process among (partial) state-owned industrial companies. One of these companies administrated by the Austrian Industry-Holding Company Stock Corporation ÖIAG (*Österreichische Industrieholding AG*) was the Voestalpine AG. In 2000, ÖIAG administrated a state-owned stake of 38.8 per cent, which subsequently was slightly reduced in two steps to 34.7 per cent. In 2003, the Austrian Council of Ministers mandated ÖIAG to fully privatise the Voestalpine AG. Against all concerns, in the context of the so-called secret project "Minerva", a hostile takeover by Magna was prevented, and since August 2005 the Voestalpine AG has been fully privatised (Auer, 2008, pp. 245-249).

Origin of the Voestalpine employee participation scheme

In response to the privatisation ambitions of the Austrian Government, in 2000, the Voestalpine management in co-operation with the group's employee representatives immediately started intensive discussions about the group's future ownership structure. In the course of these talks it became generally accepted by both parties that a substantial equity stake owned by the group's workforce could contribute to a more stable ownership structure (strategic ownership). From the very beginning, an ambitious plan was conceived to acquire in the short and medium term an employees' stake of not less than 10 per cent of the total number of voting rights (Voestalpine Mitarbeiterbeteiligung Privatstiftung, 2010, p. 20).

Schemes

Through the first of the six employee participation schemes implemented so far, the Voestalpine workforce in Austria acquired an immediate 4.9 per cent equity stake (around 1.6 million shares). Once again, based on opening clauses in relevant wage agreements, an additional wage agreement (*Zusatzkollektivvertrag*) was fixed between social partners (Labour Union and Economic Chamber) on 1 November 2000, which allowed the group's management to retain parts of concluded pay increases for the purpose of attaining the employee share ownership target.

[133] The ÖIAG Act was publicly announced in the Federal Law Gazette 1 no. 24/2000.

Thus, one per cent of monthly employees' gross wages in combination with company's savings in non-wage labour costs arising from stock transfers[134] and a yearly value adjustment of employees' own contributions[135] were the basis to calculate within the complex *Barwertmodell (Cash Value Model)* the total advance of money used for the acquisition of the above mentioned 1.6 million shares at the stock exchange (Voestalpine Arbeitnehmer-Privatstiftung, 2006, p. 12).

An irreplaceable element of the first and all later schemes—the still extant private foundation—has been utilised and developed. The *Voestalpine Mitarbeiterbeteiligung Privatstiftung* is not only responsible for the administration of the acquired stock, but also concentrates all individual employees' voting rights due to a transfer of the ownership's civil claim, fixed within integrated trust agreements (*Treuhandverträge*). Thus, it is ensured that the workforce has an important vote within the General Meeting of Shareholders. On the other side, the individual right to receive a dividend remains in employees' hands. To fully utilise tax incentives according to § 3 I Z. 15 lit. b of the Austrian Income Tax Act and savings in social security contributions according to § 49 III Z. 18 lit. c of the Social Security Act, acquired shares were just allocated to employees to a maximum limit of EUR 1,460 per year. Employees' shares remain within the foundation for the entire period of employment. All relevant regulations—e.g., relating to the retention of employees' pay increases or the allocation of shares to individual employees—were concluded within the internal company agreement mentioned under 2.1 (Voestalpine Mitarbeiterbeteiligung Privatstiftung, 2010, p. 33).

- For all employees hired after 1 November 2000, a *Schichtmodell (Shift Model)* was developed, which calculated the employee's own monthly contribution in accordance with the *Barwertmodell* (one per cent of the employee's monthly gross wage, the company's savings in non-wage labour costs and a yearly value adjustment (3.5 per cent) of this contribution) (Voestalpine Arbeitnehmer-Privatstiftung, 2006, p. 12).

Strategic employees' share ownership has been further promoted through five additional schemes (II-VI). All of these have been based on additional wage agreements to retain a percentage of employees' pay increases . Furthermore, the financing of the monthly employees' own contribution in all schemes is accordant with the *Schichtmodell* (model I). Unlike the initial scheme, the pre-financing of shares in the following schemes II, III and V was leveraged (credit-financed).

- In 2002, scheme II increased the existing employees' stock[136] by 2.5 per cent (around one million shares), and in 2003 the so called "squeeze-out-boundary" of ten per cent was overstepped for the first time by the purchase of around 1.5 million shares (3.7 per cent). Since then, the *Voestalpine Mitarbeiterbeteiligung Privatstiftung* on behalf of the workforce has been empowered to nominate a representative to the Supervisory Board. This achievement was only once put at risk when in 2005 the Voestalpine AG issued convertible bonds and increased the group's share capital.
- Thus, at the end of 2005, a fourth scheme was concluded, through which the Voestalpine AG between 2007 and 2009 credit financed the purchase of about 3.2 million shares[137] (two per cent) on the stock exchange and transferred them to the

[134] According to the Social Security Act, employers in Austria are not required to pay non-wage labour costs in case of stock transfers. In the example of the Voestalpine AG it was decided to pass these savings on to employees, thereby increasing their own contribution about 25 per cent.
[135] The calculation included a yearly 3.5 per cent increase in employees' contributions.
[136] At this time, the stake already had been decreased to around four per cent in consequence of an increase in capital.
[137] As a result of a share split in July 2006, each share had been split into four.

Voestalpine Mitarbeiterbeteiligung Stiftung (Voestalpine Mitarbeiterbeteiligung Privatstiftung, 2010, pp. 38-44).

- Based on an additional wage agreement—reached in the course of collective bargaining in the metal industry—, a fifth scheme was started in November 2007, mainly in order to integrate a large number of new Voestalpine staff—particularly from the BÖHLER-UDDEHOLM-Group—into the employee participation scheme. It was agreed to allot 0.5 per cent of their monthly gross wages for this purpose. On the other side, the monthly contribution of already participating employees was raised by 0.3 per cent of their monthly gross wages. Deviating from the procedure in previous models, shares still available within the foundation were utilised for this new allocation.
- Scheme VI—implemented as a result of a conditional capital increase—enlarged the employees' stock within the foundation by two per cent, i.e., 3.3 million shares (Ibid., pp. 46-48).

Today, Austrian employees spend up to 3.25 per cent[138] of their monthly gross wages for the allocation of shares (Ibid., p. 48).

The Voestalpine Mitarbeiterbeteiligung Stiftung and its role

As earlier mentioned, the *Voestalpine Mitarbeiterbeteiligung Stiftung* is the centerpiece of the Voestalpine employee participation scheme. In Austria, the utilisation of a private foundation for the purpose of employees' (financial) participation legally underlies § 4 XI Z. 1 lit. c of the country's Income Tax Act (Otto, 2011, p. 136). The work of the *Voestalpine Mitarbeiterbeteiligung Stiftung* mainly consists of the following three tasks (Stelzer, 2010, p. 6):

- administration of the different schemes (assisted by the Actuaria Benefits Consulting GmbH, see Voestalpine Mitarbeiterbeteiligung Privatstiftung, 2010, pp. 96 f.);
- further development of the employee participation scheme;
- execution of voting rights at the General Meeting of Stakeholders.

The two main bodies of the foundation are the Management Board and the Advisory Board. The group's Board of Management and Works Councils nominate its members equally.[139] Both bodies are chaired by an employees' representative, who—in case of a tie—casts the deciding vote (*Dirimierungsrecht*). The Advisory Board makes all decisions concerning employee participation schemes—e.g., their further development—and is responsible for appointing the Management Board. The chairman of the Management Board represents the voting rights of all participating employees at the General Meeting of Stakeholders. His vote at the meeting is restricted by the decisions of the Advisory Board, which are always taken on the basis of a suggestion by the Management Board and a wide opinion-building process among the group's Works Councils.

The Management Board is further responsible for administering the participation scheme and also foundation assets[140].

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[138] All implemented schemes increased the amount taken from the monthly gross wage: scheme I (one per cent), scheme II (0.5 per cent), scheme III (0.5 per cent), scheme IV (0.5 per cent), scheme V (0.5 per cent in case of new integrated employees and 0.3 per cent in case of already participating employees) and scheme VI (0.45 per cent). Thus, an employee involved in the employee participation scheme since the beginning spends at the moment 3.25 per cent of its monthly gross wage for the allocation of shares.

[139] The Management Board consist of three members (the third member is collaboratively nominated) and the Advisory Board of 12 members.

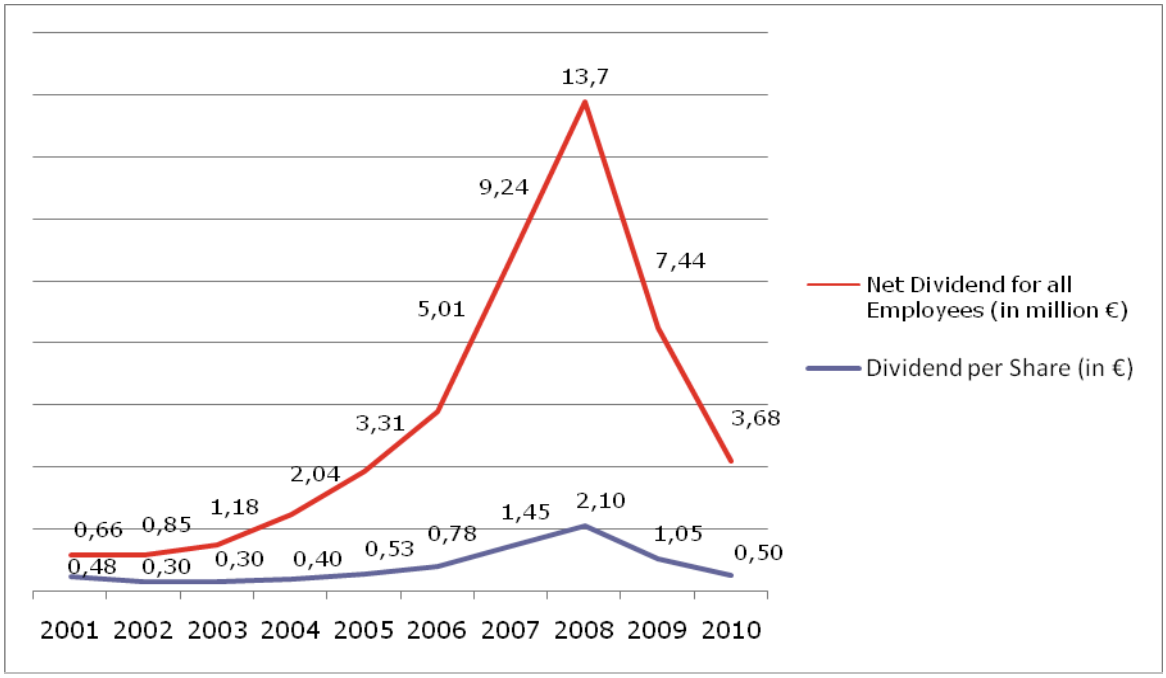
[140] Voestalpine Mitarbeiterbeteiligung Privatstiftung, 2010, pp.92-94

Implications

As presented within the introductory remarks of this chapter, the strategic dimension has been the driving power in 2000 to apply such an ambitious employee participation scheme. The *Voestalpine Mitarbeiterbeteiligung Privatstiftung* on behalf of the workforce has been the most stable core shareholder for years. Today, it is the second largest shareholder (13.3 per cent[141]) after the Raiffeisenlandesbank Oberösterreich Invest GmbH & Co. (more than 15 per cent). The chairman of the foundation's governing body represents 12.4 per cent of the voting rights within the General Meeting of Shareholders (Voestalpine Mitarbeiterbeteiligung Privatstiftung, 2010, pp. 62 f.). In addition, since 2003 the foundation has had the power to nominate a representative for the Supervisory Board.

From a financial perspective, the workforce's capital investment has absolutely proved its value. As Figure 23 shows, each year since 2000 the Voestalpine AG has declared a dividend. In total, between 2000 and 2010 it has distributed EUR 47.3 million in dividends to participating employees.

Figure 23: Dividend payout, 2000-2010



Source: Voestalpine Mitarbeiterbeteiligung Privatstiftung (2010), p. 32.

As proof of the employees' confidence in their capital investment, 17 per cent of them (3,576 individuals) have decided to re-invest their dividend. Furthermore, at present, 3,277 individuals—either still active within the Voestalpine AG or already separated from it—exercise their option to keep their "private shares" (around 1.6 million shares) within the *Voestalpine Mitarbeiterbeteiligung Stiftung*. Among them are almost two thirds of all employees, who left the group within the last three years (Voestalpine Mitarbeiterbeteiligung Privatstiftung, 2010, pp. 62 f.).

[141] The 13.3 per cent stake mainly includes the share ownership of Austrian employees, but also in a small part of German and British employees as well as of ex-employees.

6.5.3. Best practice and transferability

The results of the previous chapters should help to answer whether the employee participation scheme of the Voestalpine AG, whose general structure resembles an ESOP, deserves to be designated as "best practice" and if it is transferable or has already been transferred to other companies.

Success of the concept

Comparing potential implications or benefits collected in chapter 2 with those from the Voestalpine example, it is evident that both the Voestalpine employees and the Voestalpine AG itself have demonstrably benefited from such an ambitious employee participation scheme. Even though not solely intended as an employee financial participation scheme, it has created an additional source of income for all participating employees. Furthermore, the objective to establish strategic ownership has been fully achieved and the workforce has been put in a position to contribute as a key stakeholder to the group's future. Thus, to a certain extent, it seems possible for them to support their own concerns, in particular job security. From the employer perspective as well, the Voestalpine AG has strategically benefited from its courageous decision to implement strategic employee share ownership. It not only reacted flexible to the privatisation process, but also established a stable anchor shareholder under its ownership structure, present and future, i.e., its employees.

As for negative results or implications, none could be identified. It must be mentioned, however, that for several of these criteria no data is available in the Voestalpine case (e.g., if production has increased after the introduction of the employee participation scheme). Nevertheless, positive implications reported for Voestalpine employees as well as for the Voestalpine AG itself are important indicators that the Voestalpine case can undoubtedly be labeled as an example of best practice.

Transferability

Acknowledging that the Voestalpine employee participation scheme deserves the appellation of best practice, it is interesting to speculate whether it could easily be transferred to companies in or even outside of Austria. With respect to its export potential, the efforts of the Voestalpine AG to adapt certain features of the Austrian models to Voestalpine companies in other EU Member States have clearly shown the difficulties. In particular, widely differing national labour and tax regulations have made this implementation impossible. Therefore, both of the international models[142] so far implemented are based on conditions different from those of the Austrian models, although oriented around general characteristics (such as concentration of the voting rights within a private foundation[143]) (Voestalpine Mitarbeiterbeteiligung Privatstiftung, 2010, pp. 50-53).

At first glance, it seems possible to duplicate the Voestalpine employee participation scheme within Austria. Nevertheless, certain aspects still narrow its transferability. First, the scheme is not appropriate for small and medium-sized companies inasmuch as the integration of a private foundation as well as a large administrative workload is too expensive for them.

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[142] In 2004, the first international-oriented model was implemented for Voestalpine staff from the Netherlands. Based on these experiences early in 2007, it was started to develop a common international model. So far, this was implemented in Great Britain and Germany. In Belgium and Sweden, legal boundaries and the impacts of the economic crisis have prevented an implementation.

[143] While the Dutch model concentrates all voting rights in an own private foundation, voting rights from the international model are held in the Austrian Voestalpine Mitarbeiterbeteiligung Privatstiftung.

Furthermore, the employee participation scheme has been designed to fit certain circumstances, conditions and objectives. Thus, the question of whether it would work under (partly) different conditions is an open one.

Though according to the PEPPER IV Report, since 2001 employee financial plans have increased in Austria (Lowitzsch et al., 2008, p. 155), the best practice example of the Voestalpine AG has yet to be imitated. Although Voestalpine representatives have held several meetings with interested companies about its employee participation scheme, none of them has yet adopted the Voestalpine model for itself. Moreover, no other companies within Austria are using the opportunity of an additional wage agreement.[144]

6.5.4. Conclusions

In conclusion, this case has shown how the Voestalpine model—with its strong positive effects on the workforce as well as on the entire corporate group—deserves to be designated as best practice. Nevertheless, its transferability abroad is limited, above all because of the particular legal structure. Within Austria, though it is possible to duplicate the model. In practice, transfer to small and medium-sized companies will hardly be an option because of implementation and administrative costs arising from the private foundation.

[144] Information provided by Max Stelzer, Management Board Executive Voestalpine Mitarbeiterbeteiligung Privatstiftung, to the author.

6.6. Spółki Pracownicze (Employee Companies), Poland

6.6.1. Introduction

The most significant form of employee financial participation in Poland today is employee ownership. Poland's privatisation programme was characterised by significant incentives for employee participation, especially in firms privatised by leasing and transformed into so-called Employee Companies (*Spółki Pracownicze*). Contrary to expectations, ownership structures in these companies have—on the whole—been relatively stable, with non-managerial employees retaining—on average—a significant portion of enterprise shares. Research conducted in the late 1990s from a sample of 110 employee-leased companies privatised between 1990 and 1996 showed that on average the share of non-managerial employees in ownership decreased from 58.7 per cent immediately after privatisation to 31.5 per cent in 1999. Approximately 32 per cent of leasing-privatised firms were still majority-owned by non-managerial employees by mid-1999. Over time, more and more shares were also found in the hands of outsiders (probably due largely to retention of shares by people whose employment relationship with the firm ceased for whatever reason), while the presence of strategic outside investors (including foreign investors) had begun to be felt in a minority of firms by the end of the last decade (see Lowitzsch, 2006, p. 237, Table 3). Less significant forms of minority employee share ownership emerged from privatisation methods other than leasing. Insiders possessed only 12.7 per cent of shares at the beginning of 1998, and this fell to 11.4 per cent two years later. Although, all current forms of financial participation may also be used in employee compensation schemes outside of privatisation, there are no tax incentives to encourage this.

With regard to EFP schemes and other forms of workers' participation, the positions of trade unions like Solidarność were and still are inconsistent and often ambiguous.

Institutions created to support employee-owned firms in Poland include the Union for Employee Ownership (*Unia Własności Pracowniczej*) and the Gdańsk Employee Ownership Bank (*Bank Własności Pracowniczej SA w Gdańsku*). However, their role in employee-led privatisation in Poland was very limited. As of now, the Union for Employee Ownership—founded in the autumn of 1990—has 300 member firms.

Clearly, since the mid-1990s, the main, openly declared objective of privatisation policy has been to maximise revenues; therefore, all but the smallest state enterprises are to be privatised by commercial methods, despite the fact that employee-owned firms were often the most successful. Moreover, policy makers have encouraged enterprises being commercially privatised to seek outside investors; for this purpose, a clause was included in the 1996 Privatisation Law requiring at least 20 per cent of the shares of a leasing firm to be purchased by persons not employed by the firm. 100 per cent management-employee buyouts were thus made difficult. Policy makers provided no incentives for the extension of employee financial participation other than through privatisation schemes.

6.6.2. Legal and fiscal framework for "Employee Companies" (1990, 1996)

"Employee companies" emerged from leveraged-lease buyout privatisation. This is one form of so-called liquidation privatisation introduced in 1990, which—according to Art. 39 of the Law on Commercialisation and Privatisation (PrivL[145])—since 1997 requires: relatively

[145] Of 30 August 1996, Dz. U. No. 118, Pos. 561, republished in Dz. U. 2002 No. 171, Pos. 1397, No. 240, Pos. 2055, with subsequent amendments.

good financial and market conditions; no requirement for substantial investment to modernise, replace, develop equipment, etc; a yearly turnover of a maximum of EUR 6 million; a maximum of EUR 2 million of equity consisting of two enterprise funds; willingness of management and employees to assume the financial risk involved in undertaking a common investment (including third parties). A newly established private company concludes an agreement with the State Treasury to lease the assets of the state enterprise for a maximum period of 15 years.[146] The interest payment was initially set at 30 per cent (75 per cent of 40 per cent) if the central bank refinance rate exceeded 40 per cent, which in 1993 was lowered to 50 per cent of the refinance rate.[147] With the implementation of the acquis communautaire in 2004, the minimum for the market rate was set at the EU reference rate for Poland, while preferential rates from then on were treated as public subsidies governed by separate rules.[148]

Moreover, a leased company can apply to its founding organ for a reduction of interest payments owed as a result of postponements during the first two years of the leasing period, if its investment expenditures out of profits amount to at least 50 per cent of its net profit. Finally, the corporate income tax law allows firms to include the interest portion of their lease payments as costs, thus reducing their tax liability. The new Privatisation Law in 1996 additionally leveraged the financial lease contracts in order to enhance the creditworthiness of employee-leased firms applying for bank loans. Art. 52 PrivL makes it possible for full ownership to be acquired before the end of the contract if one third of total leasing rates have been paid, provided that the balance sheet for the second business year of the company has been approved.

If more than half of the total leasing rates have been paid, the blocking period is cut in half. Because of conditions on the Polish credit-market, this regulation has become very important in practice.[149]

6.6.3. Development of SP over time

By 2002, the most common way to manage a privatised enterprise was to lease it to an employee company. From 1990 until 2010, 62.4 per cent of enterprises undergoing "direct privatisation" were transferred into private hand through a leveraged-lease buyout, 24.1 per cent were sold, and in 10.9 per cent assets were transferred to a company. In recent years, under the forms of direct privatisation, the share of leasing in relation to the initial period of the process of the privatisation is significantly decreased, whereas the share of sales increased. From 1990 to 2010 a total of 7,534 state-owned enterprises underwent privatisation, of which 1,750 were transferred into private ownership through commercialisation, while 2,115 were directly privatised.[150]

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[146] Until 2002 Art. 52 para. 1 PrivL foresaw a maximum of ten years; the legal regulations for leveraged-lease buyouts are to be found in Art. 39 para. 1 No. 3 and 50 to 54 PrivL; it is reserved exclusively for Polish nationals and as an exception also legal persons (Art. 51, para. 1 No. 2 PrivL).

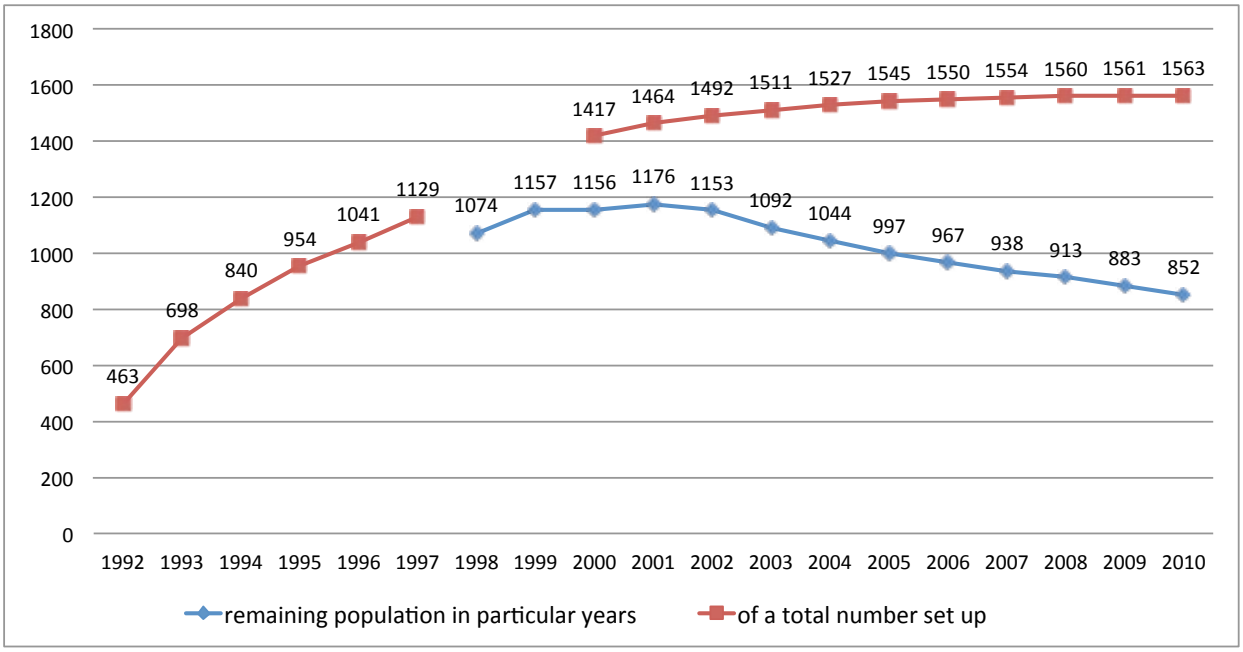
[147] Ordinance of the Minister of Finance of 13 May 1993, M. P. 1993 No. 26, Pos. 274, altering that of 7 May 1991, M. P. 1991 No. 18, Pos. 123 replaced by Ordinance of the Council of Ministers of 16 October 1997, Dz. U. No 130 Pos. 855.

[148] Ordinance of the Council of Ministers of 14 December 2004 Dz. U. No 269, Pos. 2667.

[149] Furthermore, Art. 54 PrivL foresees the possibility to regulate the specific conditions of such leverage by Ordinance of the Council of Ministers including the possibility to reduce the threshold of paying 20 per cent of the net value of the object of the lease stated in Art. 51 para. 1 No. 3 PrivL to 15 per cent. In this context, Art. 64 PrivL granted existing Employees Companies the right to renegotiate their contracts within three months after the Ordinance came into effect.

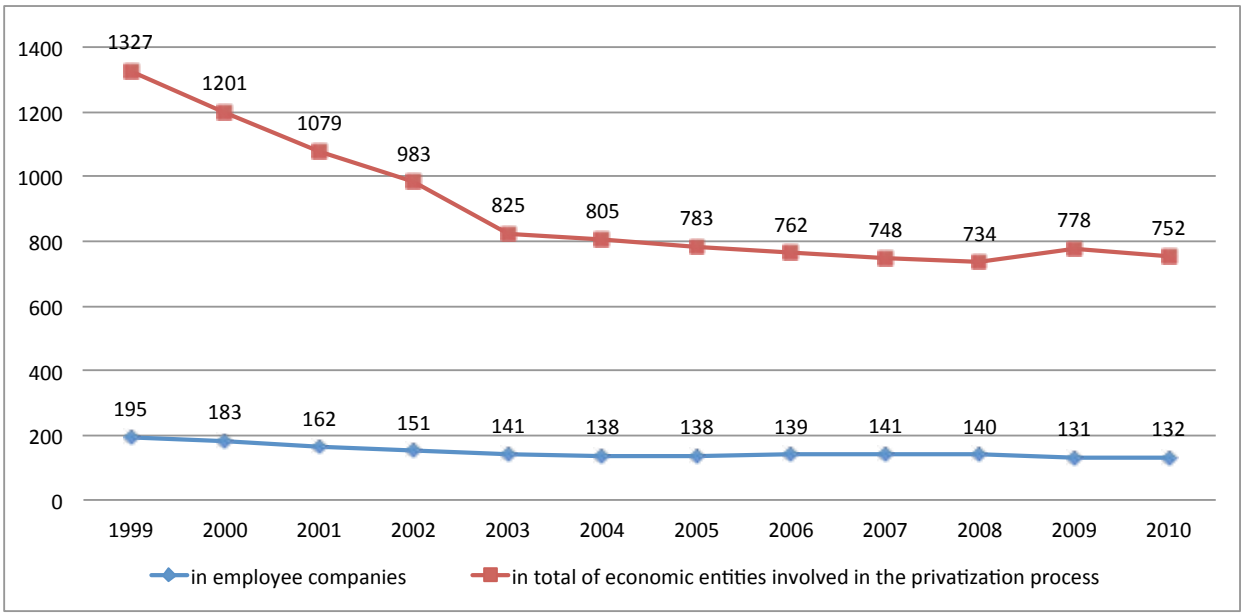
[150] Of the remaining SOEs roughly 505 were indirectly privatised, 1,110 were liquidated, while 1,654 were incorporated into the Agricultural Property Stock of the State Treasury.

Figure 24: Number of Employee Companies in Poland



Source: Author's calculation using data obtained from CSO.
Note: Data was only partly available before 2000.

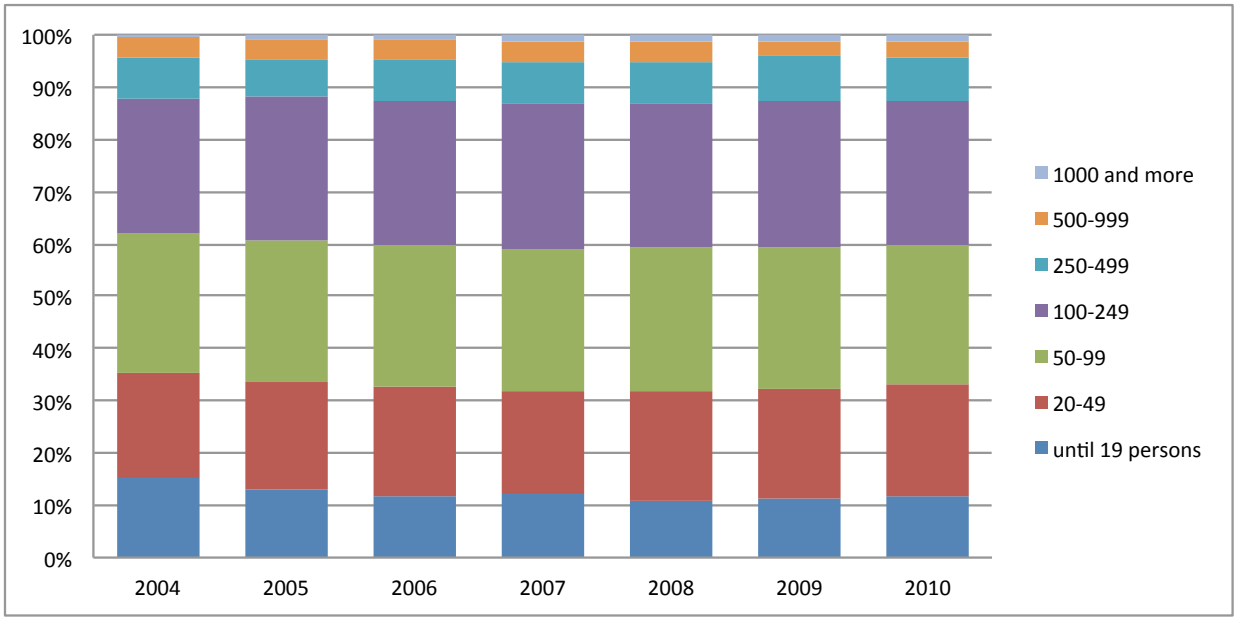
Figure 25: Persons employed in Employee Companies (in thousand)



Source: Author's calculation using data obtained from CSO.

Between 1991 and 2010, a total of 1,563 Employee Companies emerged from former state enterprises. Until the end of 2010 their population decreased to 852 (see Figure 24) employing a total of 131.5 thousand workers with an average size of 150 employees. This decline gave reason to the current Government programme to support Employee Companies entitled "Supporting Privatisation through Granting Sureties and Guarantees to Employee Companies and Civic Activity Companies" (see below 4.) As Figure 25 shows, the number of employees in employee companies decreased by only 28.2 per cent over the last ten year compared with companies privatised by other methods, where the number of employees decreased by 37.4 per cent. Among the companies, the majority (54.3 per cent) were the entities employing 50 to 249 workers (see Figure 26).

Figure 26: Employee Companies' structure by number of persons employed



Source: Author's calculation using data data obtained from CSO.

It is difficult to obtain information on the reasons for the decline of employee share ownership, as Employee Companies are not a specific legal form of enterprise but registered together with all other Ltd or joint-stock companies. It was certainly not economic distress, as Table 19 and Figure 27 illustrate. In 2010, employee companies have achieved a positive gross profit of PLN 2,322 million and the net amount of PLN 1,879.5 million (as compared to PLN 2,106.7 million and PLN 1,666 million in 2009). Basic economic relations developed for these entities as follows: cost level indicator was 95.6 per cent (against 95.8 per cent in 2009), gross turnover profitability rate of 4.4 per cent (4.2 per cent in 2009), and net 3.5 per cent (3.3 per cent in 2009). Gross profit and net profit reached respectively 75.9 per cent and 74.9 per cent of companies.[151]

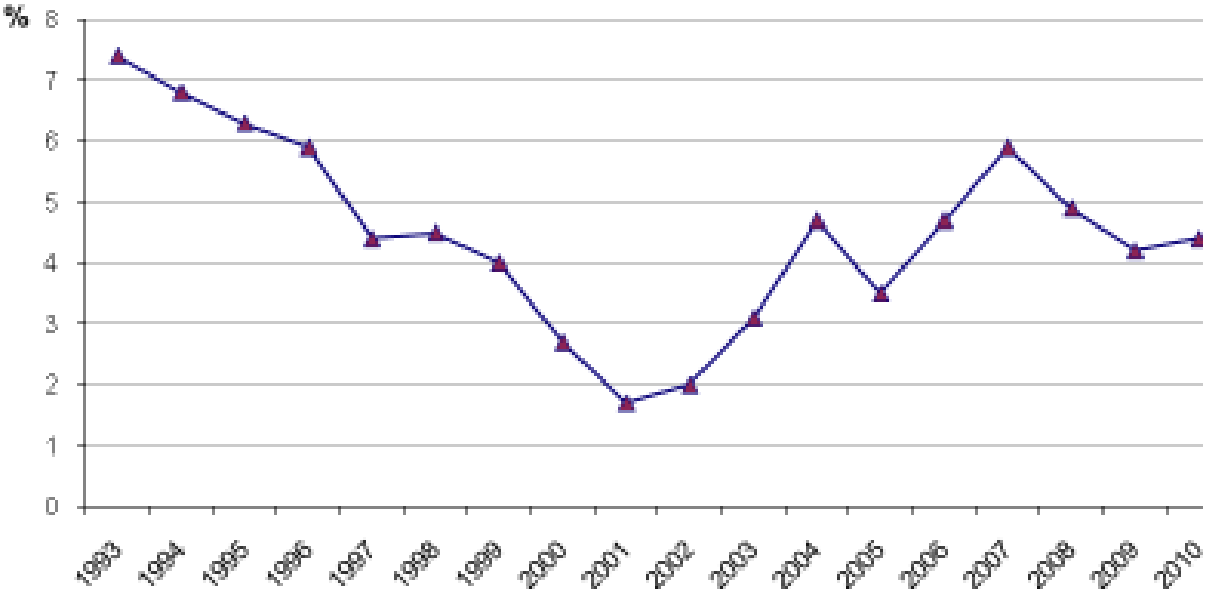
Table 19: Financial results and encumbrances of Employee Companies in million PLN

Spółki pracownicze / Employee companies	Employee companies' financial result			Income tax
	Gross	Less encumbrances	Results in Net	
2004	1,648.9	416.8	1,232.1	410.6
2005	1,298.7	332.4	966.3	330.6
2006	1,992.8	415.8	1,577.0	415.1
2007	2,873.2	542.5	2,330.7	536.5
2008	2,459.9	459.5	2,000.3	458.0
2009	2,106.7	440.7	1,666.0	433.1
2010	2,322.0	442.5	1,879.5	442.5

Source: Author's calculation using data obtained from CSO.

[151] Cf. Central Statistical Office (2011b), pp. 41 f.

Figure 27: Profit margin (i.e., profit divided by sales revenue) for Employee Companies, 1993-2010



Source: CSO (2011), p. 42.

6.6.4. The current Government programme and reforms under way

The current Government programme to support Employee Companies entitled "Supporting Privatisation through Granting Sureties and Guarantees to Employee Companies and Civic Activity Companies" was enacted 20 October 2009.[152] Among the reasons underlying the programme there is—above all—the broadening of the employee ownership stated. The legal basis of the Ministry Programme is Art. 34a para. 1 of the Law on Guarantees and Pledges granted by the Treasury and some legal persons.[153] The programme defines the Company of Civic Activity (CCA)[154] and a system of guarantees for Employee Companies and CCA and foresees amendments to three Laws on: the Commercialisation and Privatisation, the Guarantees and Pledges Granted by the Treasury and Some Legal Persons, and the Law on Bankruptcy and Reorganisation. It is supervised by the Minister of Economy in co-operation with the Minister of the Treasury and Minister for Finance and implemented by the Bank Gospodarstwa Krajowego (BGK), Poland's only state-owned bank, and addressed to employee companies and CCA. Programme objectives[155] are among others:

- supporting the initiative of workers in privatisation processes;
- increasing economic involvement of local communities;
- widespread of citizenship's ownership and active participation of citizens in the economic life in Poland.

The so called Civic Activity Company (spółka aktywności obywatelskiej) is a joint-stock company or limited liability company, where 33 per cent shares belong to at least 30 per cent of the active employees of a privatised enterprise; the remaining shares may only belong to the farmers or fishermen, local government units and business partners—individuals

[152] Wsparcie prywatyzacji poprzez udzielanie poręczeń i gwarancji spółkom z udziałem pracowników i jednostek samorządu terytorialnego (spółkom aktywności obywatelskiej), pp. 10-11.
[153] Ustawa o poręczeniach i gwarancjach udzielanych przez Skarb Państwa oraz niektóre osoby prawne.
[154] Definition in Ministerstwo Gospodarki (2009), p. 10.
[155] Cf. Ministerstwo Gospodarki (2009), p. 9 f.

who over the past two years rendered for its services. It is planned to **codify this new company** form by way of amending the Commercialisation and Privatisation Act; this bill also specifies the disclosure requirements of the Minister of the Treasury, who must inform employees, employers and local government units about initiating the process of privatisation of the company and its progress. The project envisages a ban on sale of shares in the CCA within two years after the conclusion of the privatisation agreement and penalties for violating this injunction.[156]

The system of sureties and guarantees was introduced by the Act of 9 May 1997 on Sureties and Guarantees Granted by the Treasury and Certain Legal Persons[157]. Under this act, it is possible to obtain sureties and guarantees granted in the name and on behalf of the Treasury by the Council of Ministers, the Minister responsible for public finances or the Bank of National Economy[158] in its own name and for its own account in the implementation of government programs for socio-economic and local self-government programs and regional development. The planned changes of the Law on Guarantees and Pledges include **extending the catalogue of measures eligible to receive guarantees** on the basis of the provisions of this Act by adding a settlement about "encouraging the participation of companies of civic activity and employee companies in privatisation and bankruptcy processes."

The Insolvency and Reorganisation Law (IRL) of 2003—a completely new version of Polish insolvency law[159]—provides a contingent possibility for setting up "employee companies" in the context of a liquidation procedure. If the sale of the debtor's business as one or several functioning units is impossible, then each asset is to be publicly auctioned by the administrator, under supervision of the judge-commissioner. If assets are not sold at a public auction or the judge-commissioner does not accept the offer, he can order a second auction, or can determine the minimum price and conditions of sale and allow the administrator to find a purchaser or to sell assets free of procedural restrictions (to be approved by the creditors' committee). In this case, a commercial company founded by at least half of the debtor enterprise's employees and with the participation of the Treasury has a pre-emptive right of purchase of the enterprise or functioning enterprise units (Art. 324 IRL). It is planned to extend the possibility of EFP via the described **pre-emptive right of purchase** under bankruptcy proceedings, extending the right of priority to the CCA.[160]

6.6.5. Conclusions

The most significant form of employee financial participation in Poland today is employee ownership above all in the so-called Employee Companies. These majority employee-owned firms resulted from a leverage lease employee buyout scheme in the framework of Poland's privatisation programme, which provided the scheme with significant fiscal incentives. Employing a total of 131,500 workers in 852 enterprises with an average size of 150 employees today, this model is one of the few schemes for employee share ownership in SMEs across the European Union. Contrary to expectations, ownership structures in these companies have—on the whole—been relatively stable, with non-managerial employees retaining—on average—a significant portion of enterprise shares.

However, the current population of 852 Employee Companies has to be seen against a background of a total of 1,563 of these firms that emerged from former state enterprises since 1991. The slow but steady decline had different motives, with the most successful

[156] Cf. Ministerstwo Gospodarki (2009), p. 11.
[157] Dz. U. 2003 No. 174, Pos. 1689, as amended.
[158] Bank Gospodarstwa Krajowego.
[159] Dz. U. 2003 No. 60, Pos. 535. For a detailed analysis of the new Law see Zedler (2003).
[160] Cf. Ministerstwo Gospodarki (2009), p. 21.

companies going public and the least successful going bankrupt or being liquidated. While it is difficult to obtain statistical information on the reasons for this decline—as Employee Companies are not a specific legal form of enterprise but registered together with all other Ltd or joint-stock companies—, it was certainly not economic distress: In 2010, Employee Companies have achieved a positive gross profit of PLN 2,322 million (as compared to PLN 2,106.7 million in 2009) with an average gross turnover profitability rate close to five per cent.

While already the scheme itself can be classified best practice, what is really worth noting is the way that the Polish Government reacted to the decline of Employee Companies. In the end of 2009, the Ministry of Economics launched the current programme to support these companies entitled "Supporting Privatisation through Granting Sureties and Guarantees to Employee Companies and Civic Activity Companies". Beyond a system of guarantees for "Employee Companies", the programme defines the "Company of Civic Activity", a joint-stock company or limited liability company, where 33 per cent shares belong to at least 30 per cent of the active employees of a privatised enterprise.

This policy reply to the decline in employee ownership is quite different from other post-socialist countries that joined the EU in 2004/07. For example, Lithuania and Hungary—experiencing a much more dramatic decline in employee share ownership—did not formulate counteracting measures (see the relevant case studies). Poland—in contrast—reacted not only by providing Employee Companies with a credit facility in order to help their sustainable development, but added a new scheme that is detached from privatisation, which obviously is less and less of importance. In this way, the Company of Civic Activity is a continuation of the successful privatisation scheme ensuring continuity for the creation of employee (co-)owned companies and for employee ownership schemes in Poland as such.

6.7. Hungarian ESOPs resulting from privatisation

6.7.1. Introduction

Hungary can be considered as one of the countries with the highest and fastest rates of privatisation in Central and Eastern Europe. In 1990, there were 1,857 SOEs in the portfolio of the State Privatisation Company (ÁPV Rt.)[161] with a total net value of HUF 1,670 billion (approximately USD 26.5 billion).[162] At this time, these companies represented approximately 85 per cent of the total number of companies (Hiller and Bormann, 2002, pp. 383 f.). By 2001, one fifth remained in state property, i.e., 375 SOEs, while the managed value of the ÁPV Rt. dropped to one tenth, to a total net value of HUF 708 billion (approximately USD 2.5 billion) (Mihályi, 2011, 10.2). The role of the state declined significantly in the first ten years of privatisation; this process may be regarded as finished in 1998. However, some major and valuable services of general interest were put on the market in the following years, yet others are not going to be issued for privatisation for decades (Ibid., 10.1).

As the main objective of the ÁPV Rt. was the rapid sale of state-owned property and revenue maximisation, instruments to accelerate the transformation providing domestic investors—i.e., workers, managers and entrepreneurs—with privileged condition in the privatisation process were introduced. The first stage of decentralised privatisation—also called spontaneous privatisation—was unfavourable for both, the wide population as well as for the ÁPV Rt. The main profiteers were managers, who succeeded in transforming their power in companies into high revenues and ownership to their own interests.[163] Such, the state "lost" some small, but well performing enterprises, which he could have sold under better conditions. It is therefore understandable that the public support for privatisation suffered under these unregulated conditions and asked for more just way of privatisation.[164] The state reacted to this phenomenon and introduced policy measures to regulate the privatisation environment. One strategy was to include the workers in the privatisation process. A legal framework was set up to foster employee ownership but also to push the sale of state ownership. Besides, in many cases this was the only way to find buyers while avoiding foreign investors (Boda, Neumann and Víg, 2006, p. 8). Starting from 1992, employee share ownership schemes began to play a prominent role.

The right-wing interim Government of the early transition period under Prime-Minister József Antall favoured the centralisation of privatisation and introduced the Hungarian Privatisation and Holding Company.[165] The coalition Government[166] introduced legal regulations[167] concerning instruments and incentives for acquiring employee ownership. At this stage, the framework for collective financial participation schemes—the Hungarian ESOP—was introduced as a privatisation vehicle. The political parties—from both the left and the

[161] At this stage, the company in charge of the management of state privatisation was the ÁPV Rt. The ÁPV Rt. had many successors—such as ÁVÜ, ÁV Rt., ÁV Zrt., MNV Zrt.—, of which some functioned concomitantly.

[162] Numbers are based on data from the State Privatisation Companies in Mihályi (2001), 10.2.

[163] The Law on Business Associations equipped management with extensive decision-making power. Management had the advantage of negotiating relations between the headquarters and its plants in the privatisation process. No firm could be sold against their will. In this period, many managers became majority-owners of firms and shaped the entrepreneurial landscape even after privatisation (Boda, Neumann and Víg, 2006, pp. 6 f.).

[164] The introduction of special instruments to promote employee ownership might be seen as a social gesture based on the will of creating social justice. This approach—seeming almost too naïve—represents only one side of the coin. In many cases, especially in that of SMEs, enterprises simply lacked the interest of foreign investors, and employee ownership played an increasing role (Mihályi, 2011, 5.4).

[165] Állami Privatizációsés Vagyonkezelő Részvénytársaság (ÁPV Rt.).

[166] The coalition was composed of Magyar Demokrata Fórum (MDF—Hungarian Democratic Forum), Független Kisgazda, Földmunkás- és Polgári Párt (FKGP—Independent Smallholders, Agrarian Workers and Civic Party) and Keresztény Demokrata Néppárt (KDNP—Christian Democratic People´s Party).

[167] The most important legal regulations were the Government Decree 28 of 1991 on "Egszisztencia" Credit and Deferred Payments Benefits; Law XLIV of 1992 on Employee Share Ownership Plans.

right political wing—were apparently supportive in their attitude towards employee ownership, which has been an issue bridging political ideologies in Hungary. However, the support for ESOPs and employee ownership was limited to the early stage of privatisation. Although the first democratically elected Government after 1989 constructed the laws on employee ownership in a way that resulted in capital concentration and not in a broadening ownership, the second Government did not respond to these developments in an ESOP-supportive way but introduced further limitations in 1995[168].

In 2003 though, there was a shift in the rather unfriendly attitude towards long-term employee ownership. The amendment of the ESOP Act introduced core elements to protect and to foster the continuation of established ESOPs enjoying a cross-party support with only four dissentient votes and one abstention (Mihályi, 2011, 5.4.2).

In the same year, a left-wing coalition[169] introduced a new share-ownership scheme aiming at listed companies. The Approved Employee Securities Programme[170] allows companies to set up tax-qualified[171] employee stock option plans upon approval by the Ministry of Finance. However, this scheme cannot be called a successful scheme, since less than six companies have introduced it until now.[172]

The latest attempt for a wide share ownership programme dates back to 2008, which was initiated by the MSZP.[173] Prime-Minister Ferenc Gyurcsány made a surprising suggestion to involve Hungary's residents in a programme for acquiring ownership under preferential rights in the context of the privatisation of the last major state-owned public utilities.[174] He introduced the "Új Tulajdonosi Program"[175] (ÚTP). The consequences of the global financial crises, though, made Gyurcsány to recall the ÚTP after only eight months (Mihályi, 2011, 3.6.7).

6.7.2. Legal and fiscal framework

Legal measures for systematically involving employees in the privatisation were introduced when the restructuring process started to stumble and the dissatisfaction of the population about the general developments in privatisation rose. As a result, different rules for the acquisition of state-property have been introduced, of which share ownership schemes were the prevalent form of privatisation to employees. As ESOPs received the opportunity to bundle employees' acquisition power, they often acquired the majority shares in companies during the early 1990s.

The legal framework for the Hungarian ESOPs[176] was laid down in Law XLIV of 1992 on the Employee Share Ownership Programme[177]. Deriving from the U.S. ESOP model, the Hungarian ESOP structure simulates the Anglo-American trust. It served a dual purpose: it transformed employees into owners of state-owned companies while accelerating the pri-

[168] In this year, Law XXXIX on Realisation of Enterpreneurial Property in State Ownership has been introduced.
[169] The coalition between Magyar Szocialista Párt (MSZP—Hungarian Socialist Party) and Szabad Demokraták Szövetsége (SZDSZ—Alliance of Free Democrats) under Prime Minister Péter Medgyessy.
[170] Decree No. 5 of the Ministry of Finance of 2003 on the Procedure of Registration of Approved Employee Securities Programme and on the Rate of Administration Service Fee for the Initiation of the Procedure.
[171] The first HUF 500,000 (approximately EUR 1,700) are not subject to taxation (Boda, Neumann and Víg, 2006, p. 23).
[172] See the Hungary profile on the website of the European Trade Union Institute, http://www.worker-participation.eu.
[173] Magyar Szocialista Párt (Hungarian Socialist Party).
[174] Magyar Villamos Művek (Hungarian Electrical Works), Magyar Posta (Hungarian Post), Szerencsejáték Rt. (Hungarian Gambling Ltd), Állami Autópálya Kezelő (State Motorway Management Company Ltd).
[175] New Ownership Programme.
[176] Magyar Résztulajdonosi Program (MRP).
[177] The Hungarian term is Munkavállalói Résztulajdonosi Program (MRP).

vatisation process.[178] Today, the legal framework of the ESOP largely retains its original form, even though it has been amended several times, most recently in 2003[179]. The ESOP Act regulates the establishment and the termination of an ESOP. The most important conditions and prerequisites for setting up ESOP organisations are[180]:

- The company, in which the ESOP organisation will be set up, must be a registered limited liability or joint-stock company in Hungary (the Law does not apply to financial or insurance institutions).
- A written declaration initiated by at least one quarter of the employees and the participation of at least 40 per cent of the company's employees. They form the general assembly for the election of the administrative board.
- The participating employees must be employed for at least six months (this precondition can be raised in the ESOP statute to a maximum of five years) and work at least half of the official time.
- Election of a three-member committee.
- Preparation of a feasibility study of the company's financial situation countersigned by the company's representative body.
- Preparation of the credit application and purchase offer for the credit institution.
- Registration of the ESOP organisation at the county court.

Once these prerequisites are met, the ESOP organisation becomes a non-profit legal entity under the supervision of the public prosecutor (Boda, Neumann and Víg, 2006, p. 15). The highest body of the ESOP is the general assembly composed by the members, who decide with simple majority, e.g., on provisions of the statute, adoption of the annual budget, election or recall of the administrative board as the representative body of the ESOP. The general assembly also decides on the conditions of the loan to be borrowed by the ESOP.

The ESOP is fully liable for its obligations. Participants of the ESOP are not liable for its debts, except for the securities already allocated to them. Until the shares are transferred to the plan participants, the ESOP owns the shares. As for the exercise of property rights, the participants enjoy voting rights in proportion to their registered shares, but only up to a maximum of five per cent of the property acquired by the ESOP. In contrast to the U.S. model, where the trust is a permanent vehicle to facilitate employee shareholding, the Hungarian ESOP ceases to exist when the shares have been paid off and the ownership has been transferred to the employees.[181] The ESOP also ceases to exist, if the average annual rate of the companies' employees participating in the ESOP is less than 25 per cent or if the company, where the ESOP is implemented, is liquidated.[182] It is less known that even in case the shares have been allocated to the ESOP participants, the ESOP can continue to exist conditional on prior provisions and regulations regarding its continuation.[183] A provision, which stipulated that the shares of retiring or leaving ESOP participants had to be withdrawn, was regarded as unjust and disadvantageous and thus abolished by a revision of the ESOP Act in 2003; since then, participants may decide to keep their shares after leaving the company and to retain their voting rights.[184]

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[178] See the preamble of the same law.
[179] Law CXIX of 2003.
[180] Law XLIV of 1992 on Employee Share Ownership Plan.
[181] Section 24 (1) (2) of Law XLIV of 1992 on Employee Stock Ownership Programme.
[182] See Section 15 of Law CXIX of 2003.
[183] See Section 12 (3) of Law CXIX of 2003 entered into force on 21 January 2004; see also Szántai (2007), p. 12.
[184] See Boda, Neumann and Víg (2006), p. 14. Compare Section 1 and 3 (1) of Government Decree 28 of 1991 on "Egzisztencia" Credit and Deferred Payments Benefit.

The ESOP Act enabled employees to acquire state property under preferential conditions, which, however, were limited by Law XXXIX of 1995 on Realisation of Entrepreneurial Property in State Ownership. This law required (i) credit facilities of up to 50 per cent of the value of the respective property to be purchased, with a ceiling of HUP 50 million; (ii) a discount corresponding to 150 per cent of an annual minimum wage. The total equity purchased by an ESOP was not to exceed 15 per cent of the nominal value of the company.[185]

The legal incentives are based on a governmental decree of 1991 on "Egzisztencia" credit and the amendments to the ESOP Act of 1992 still in force. This credit facility was introduced to grant start-up aid to aspiring entrepreneurs in the pre-privatisation period, when SMEs were offered for sale (Mihályi, 2011, 3.3.1). The loan may be used for acquiring state property among other entities also by ESOP organisations.

Prerequisite to apply for an ESOP loan is still the participation of at least 25 per cent of the employees.[186] For a credit up to HUF 5 million, the average equity contribution per participant of the ESOP scheme is two per cent. For a loan above HUF 5 million, the ESOP has to deposit own sources of HUF 100,000 and 15 per cent of the loan. The duration of the loan is 15 years and the organisation has a three-year grace period, during which only interest has to be paid. The loan is granted by the Hungarian Bank for Development[187], the interest rate for refinancing is three per cent per annum and the interest rate for the borrower is seven per cent p.a.[188]

Table 20: Terms for obtaining ESOP credits

Average amount of credit per person	Own sources in HUF and in per cent of the credit		Duration in years	Grace period in years
HUF 0–5 million (approximately EUR 17,000)	HUF 0 and	2%	15	3
Above HUF 5 million	HUF 100,000 (approximately EUR 340)	15%		

Source: Section 8 (2) of Governmental Decree 28 of 1991 on "Egzisztencia" Credit and Deferred Payments Benefit and Section 14 (4) of Law XLIV of 1992 on ESOP still in force in 2012.

A company, in which an ESOP is set up to acquire property of a former SOE, can deduct the amounts paid to the ESOP from the company's payable corporate tax up to 20 per cent (Lowitzsch, 2006, p. 165). However, these incentives are linked to the acquisition of state property. Currently, legislation does not provide for any tax allowances, which directly apply to non-privatisation ESOP organisations or their participants. The fact that no ESOP loans have been granted since 1998, although the decree is still in force, shows that these conditions need revision. In particular, it is recommendable to abolish the link of preferential credit conditions to the privatisation process, which has almost come to an end.

ESOP organisations became subject to corporate income tax in 1996 at 16 per cent; until then they were exempted from corporate income tax. Since 2010, the tax rate up to an amount of HUF 500 million (EUR 1.6 million) is ten per cent; above this amount, the tax rate is 19 per cent.[189] Two special rules apply to the calculation of the tax base of ESOP organisations: (i) Contributions to the ESOP by the employees or by the company as well

[185] Section 56 (1) of Law XXXIX of 1995 on Realisation of Entrepreneurial Property in State Ownership.
[186] Section 2 (1) of Law CXIX of 2003 on the Amendment of Law XLIV of 1992 on ESOP.
[187] Magyar Fejlesztési Bank (MFB).
[188] Section 9 (1) of Government Decree 28 of 1991 on "Egzisztencia" Credit and Deferred Payments Benefit.
[189] Section 19 (1) of Law LXXXI of 1996 on Corporate Tax and Dividend Tax.

as subsidies reduce the tax base (these payments would else be accounted as income).[190] (ii) The tax base on the other hand has to be increased at the same time by the value of the shares allocated to ESOP participants (this amount would else be accounted as expenditure, i.e. reducing the profit and, therefore, the tax amount).[191]

ESOP participants enjoy tax allowances during the acquisition of company shares through the ESOP.

According to the PIT Law, these shares are not considered income and thus are not subject to taxation, until the employee sells these shares and the proceeds are taxed at the CGT rate of 20 per cent.[192]

In 1993—the year with the most ESOP transactions—, the progressive tax rates ranged from zero per cent on incomes of less than HUF 100,000 to 40 per cent plus HUF 130,000 on incomes above HUF 500,000. The PIT rates have changed almost on a yearly basis. In 2011, a flat PIT rate of 16 per cent for incomes below the tax base of HUF 2,424,000 and 27 per cent for incomes above the tax base has been introduced.

6.7.3. Development of ESOPs in Hungary

At the beginning of the privatisation process, there were 2,250 state-owned enterprises. 1,857 enterprises of them were transferred under the managing operations of the National Privatisation Agency into private or joint-stock companies (Mihályi, 2011, 10.1). As soon as the incentives for the set-up of ESOP organisations were introduced and employees received collective preferential conditions in 1992 (Compensation Vouchers, E-credit, Leasing and ESOP), they used these techniques to purchase company shares. According to the Hungarian Employee Ownership Association, ten ESOP organisations were set up by 1992, with 1,100 participating employees. 124 ESOPs followed in the next year with a total number of 28,800 employees. The number of ESOP organisations established per year started to decline after 1994. While majority ESOP buyouts represented 80 per cent in 1993, this proportion decreased to below 50 per cent at the end of 1995.

Three quarters of the companies had less than 500 employees. More than half of the companies had own capital of HUF 100–500 million (approximately USD 1-5 million); five per cent had own capital of more than HUF 1 billion (approximately USD 10 million). By the end of 1994, 73 per cent of ESOPs were installed in SMEs. On average, employees owned 54 per cent of the assets in a privatised company, while the other half was owned by the ÁPV Rt. and another domestic investor (Galgóczy and Hovorka, 1998, pp. 4 f.; Boda, Neumann and Víg, 2006, pp. 29 f.[193]). By the end of 1995, the total transaction value of ESOP buyouts was at HUF 42 billion (approximately USD 340 million), representing 14 per cent of the total privatised state property assets (Galgóczy and Hovorka, 1998, Table 3). As a thumb rule, one can say, the larger the company was, the smaller was the share of employees. According to the data from the CSO, the largest number of ESOPs (309) registered at the county court was in 1996.[194]

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[190] Section 12 (2a and 2b) of Law LXXXI of 1996 on Corporate Tax and Dividend Tax.

[191] Section 12 (3) of Law LXXXI of 1996 on Corporate Tax and Dividend Tax. See also Boda, Neumann and Víg (2006), pp. 17 f.

[192] See Section 18 (4) of Law XLIV of 1992 on Employee Share Ownership Programme and Section 66 of Law CXVII of 1995 on Personal Income Tax; Securities acquired from already taxed personal income of the participant of the programme are not taxable.

[193] Data based on the Rész-Vétel Foundation.

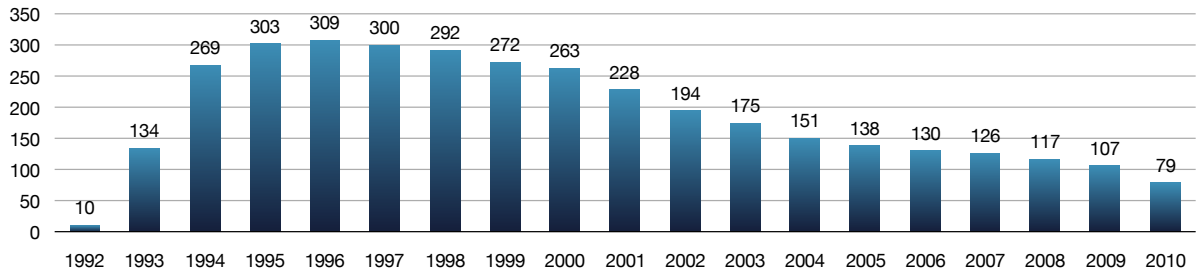
[194] The actual number of ESOPs could be even smaller, since they cannot deregister at the Courts of Registration like usual businesses. According to the Hungarian Employee Ownership Association, the total number of established ESOP organisations was 287 (Szántai, 2007, p. 10; also Szántai and Szántai (n.d.), p. 13).

Until 1995, in 47 per cent of the ESOP buyouts, the ESOPs became full or majority owners of the acquired company; in 24 per cent they managed to obtain controlling rights, i.e., a proportion between 25–50 per cent (Boda, Neumann and Víg, 2006, pp. 29 f.; Galgóczy and Hovorka, 1998, pp. 2 f.). With regards to the performance of companies in ESOP ownership, they did not perform worse than other companies, although in the course of time they increasingly faced lack of capital. However, by 1995, 75 per cent of them were profitable, while 20 per cent made losses (Galgóczy and Hovorka, 1998, p. 4).

Since 1996—one year after the amendment of the ESOP Act—, the absolute number of ESOP organisations declined continuously.

Following 1998, no more ESOPs have been established, and as of 1996 the number of ESOPs shrunk until 2010 to approximately one fourth, which is also the lowest point (see Figure 28 and Figure 29).

Figure 28: Number of ESOPs from 1992 until 2010

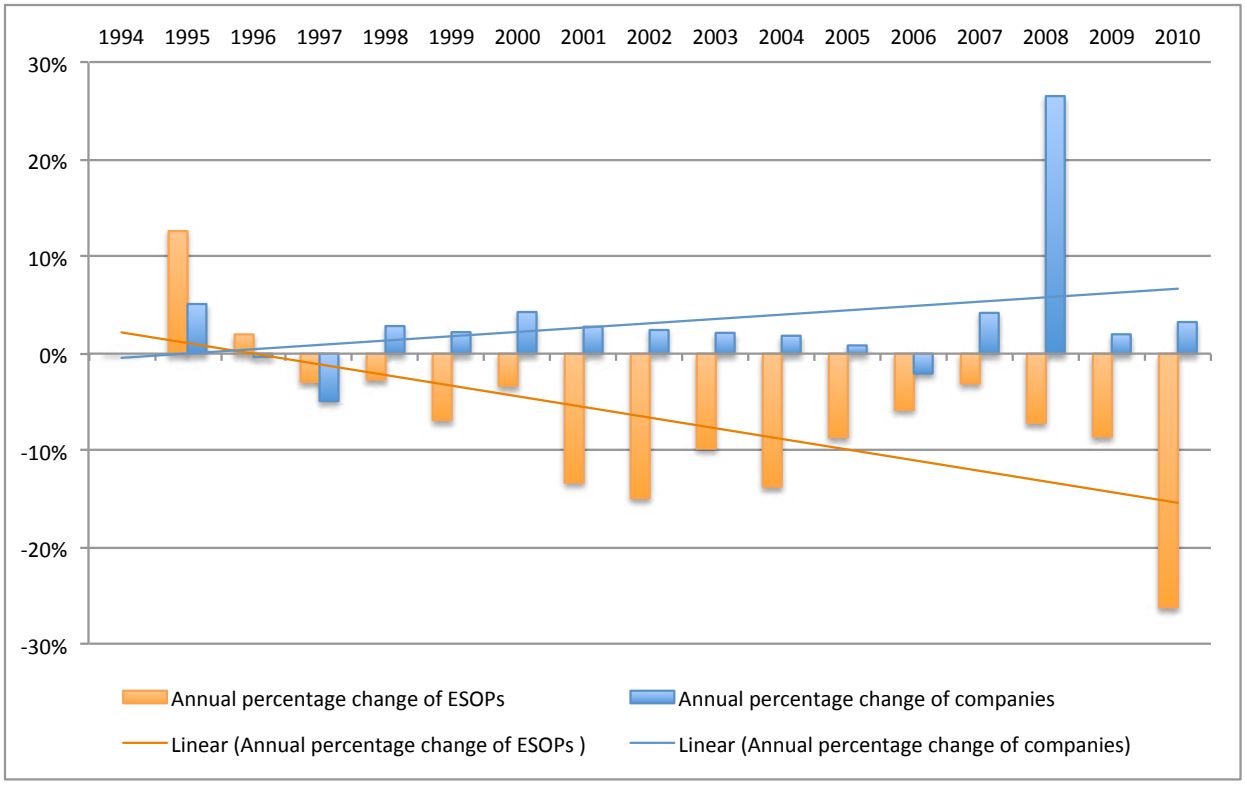


Source: For 1992–1994, Hungarian Employee Ownership Association; for 1994-2010, Hungarian Central Statistical Office, http://portal.ksh.hu/pls/ksh/docs/hun/xstadat/xstadat_eves/i_qvd001a.html, visited on 14 March 2012.

According to the Hungarian Employee Ownership Association, by the end of 1997, the total number of employees participating in ESOP schemes was approximately 80,000; about 70 per cent of the employees of the companies involved participated in ESOPs (see Table 21 and also Boda 2005, p. 63). By 2000, the share of companies with ESOP majority dropped from 58 per cent to roughly one third and in companies with ESOP organisations having controlling rights, their proportion shrank from initial 29 per cent to two per cent. By this time, approximately one per cent of the total net value of non-financial sector companies was manager and employee-owned[195] (Boda, Neumann and Víg, 2006, p. 31).

[195] The data is based on a survey conducted in 2000 with 67 companies.

Figure 29: Annual percentage change of ESOPs and business companies, 1994–2010



Source: Boda 2005, Table 10.

Table 21: Development of ESOP organisations, 1992–2000

Year	Number of new ESOPs established	Nominal value of transactions (in billion HUF)	Number of employees (cumulated)
1992	10	1.762	1,100
1993	124	22.079	28,800
1994	85	14.962	65,000
1995	40	3.653	72,800
1996	13	3.573	77,400
1997	11	3.597	80,000
1998	5	0.126	n.a
1999 - 2000	0	0	n.a
Total	287	48.625	80,000

Source: Szántai and Szántai (n.d.), p. 13.

6.7.4. Reasons for the decline of Hungarian ESOPs

As shown, the decline of ESOPs started in 1996–97, while the majority of ESOPs ceased to exist shortly after 2000. Since ESOP companies performed as good as non-ESOP companies, the question arises what the causes for this negative tendency were, leading to the sequential termination of ESOP organisations. There are multiple explanations ranging from implicit legal arrangements linked to certain provisions of the privatisation law, over skills and attitudes of the social partners to those of the public administration. The primary reason, however, lies in the legal framework for ESOPs.

In this respect, already the ESOP Law of 1992, which focussed only on the establishment of ESOPs in cases, in which employees acquired companies from a company in majority state ownership, was deficient. These privatisation ESOPs had a built-in termination timer: ESOPs could not be subject to further preferential conditions, once the majority state-owned enterprises were privatised. Furthermore, if ESOP participants lost their job or retired, they automatically dropped out of the organisation and had to dispose of their shares. This changed with the revision of the ESOP Act in 2003 and provided the option that employees retain their shares and voting rights, if settled in the ESOP statute, even after they left the company. But in several cases these changes were introduced far too late. Another remarkable shortcoming of the ESOP Act was that it did not differentiate between workers and management, but referred to them generally as "employees".

Unless the statutes stipulated that the ESOP organisation shall retain shares after the employees had repaid the loan, the ESOP had to be liquidated. The organisation had to distribute the shares and call for the general assembly to announce its termination.[196] Otherwise, it would have been too costly to set up a legal entity only to manage the shares. Only few ESOPs decided to keep the organisation, and the number of functioning ESOPs started to decline. Once the collective ownership was terminated employees became individual small shareholders. Another factor was that employees, who were eager to dispose of their shares (which they usually kept for more than 15 years), were not allowed to sell them during the vesting period (i.e., until the loan was repayed). Furthermore, they did not receive dividends during the vesting period, which meant that they did not see any cash until the debt was repaid. By 2000, one third of ESOPs had repaid their loans. Half of these ESOP companies remained in the ownership of employees. External investors appeared in the other half, which was typical for the post-privatisation period (Boda, Neumann and Víg, 2006, p. 31).

The ESOP legislation of 1995 could have facilitated ESOP incentives, but it rather tightened the conditions for loans and did not make constructive changes, which would have ensured the continuity of ESOPs. A Government Decree of 2001 further restricted the conditions for ESOP loans and assigned its disbursement to the competence of the Government. An amendment to the PIT Law of 2002 abolished the tax exemption for the transfer of repurchased shares by the ESOP and thus made the transfer of reallocated shares from employees, who have left the company, to new employees financially unattractive (Szántai, 2007, p. 12 f.). These changes were made at a moment, when the loans had expired and employees were eager to sell their shares. In addition, the employees' lack of information about the real value of their shares often brought them to sell their shares to internal or to external investors at a fraction of the real value.

[196] Section 24 (1) of Law XLIV of 1992 on Employee Share Ownership Plan. Here lies also the fundamental difference between the trust of an U.S. ESOP and the Hungarian ESOP: while the U.S. ESOP continues to administrate the shares on behalf of its members even after the credit has been repaid. In fact, other than the Hungarian ESOP, the U.S. ESOP as a rule foresees the continuation oft the ESOP after the repayment of debts.

Consequently, difficulties to find replacement for former ESOP members were accentuated, while at the same time the prerequisite for the further existence of ESOPs remained at a minimum of 25 per cent of the companies employees.

The amendment of the ESOP Act in 2003[197] brought some changes and fresh wind into the functioning of ESOPs. According to the preamble of the law, the legislator intented to further develop the established ESOP system, to ensure ESOP's further existence, to increase their operational opportunities and to broaden their rights. Under the new conditions, company shares were allowed to be transferred freely among the ESOP participants. If not stated otherwise in the contract of association between the company and the ESOP organisation, once the loan had been repaid, ESOPs could sell the shares to anyone, with the restriction that the company had the right to first refusal. ESOPs received the right of first refusal in cases, in which state-owned asset stakes of their companies were to be sold to investors. As of 2003, ESOP organisations were also allowed to engage in entrepreneurial activities as subcontractors of the employer company but also on the free market (Szántai, 2007, p. 11). However, again, these changes came at a time, when many ESOPs were already dissolved.

The ESOP managers' lack of management skills—in contrast to the company managers—, respectively their risk aversion and fear of the employer's power were other causes for the termination of ESOPs. This implies that time was too scarce for employees to feel comfortable as company owners and to develop an adequate management culture to exercise their decision-making rights, if necessary against the company managers.

6.7.5. Best or bad practice

Managers of companies, in which share ownership models have been introduced, were the main beneficiaries of the privatisation process. This is also true for companies, which have implemented ESOP schemes. The management could take advantage of the loopholes or loose formulations in legislation and could turn the various instruments to acquire company shares under preferential conditions to their own advantage. ESOPs, once intended to be open to all employees, became "hidden management buyouts" (Boda, Neumann and Víg, 2006, p. 7). The majority of the managers used employee share ownership schemes to preserve their tenure on the one hand, but also to take influence on decision-making and to preserve the own power position.

Looking at the outcomes of ESOP schemes in Hungary from a worker shareholder perspective, it turns out that the politically intended public capitalism (including ESOPs) turned into a "rent seeking" (Mihályi, 2011, 11.3.1), respectively into a power and control-seeking, individualistic process. Workers have received a notable one-time income, be it in the case of individual shares a few years after purchasing them at preferential conditions or after the longer vesting periods in the case of the collective ESOP. As for corporate governance, employees had decision-making rights according to their proportion of shares in the company, but due to a lack of managerial experience and proper information, management was often able to manipulate them. The majority of employees were seeking to turn acquired shares into cash as soon as the terms were met for selling them.

[197] Law CXIX of 2003 on the Amendment of the Law XLIV of 1992 on Employee Share Ownership Programme.

6.7.6. Conclusions

In the starting period, the privatisation environment was very much in favour of employee ownership. Especially at the beginning of restructurings, policy makers had set a corner stone to facilitate employee ownership in some form.

In the case of ESOPs, employees could unite their preferential purchasing rights and participate collectively in the privatisation process. If we take into consideration the harsh economic situation after the fall of the Iron Curtain, the population would not have been in the financial situation to play an active role in accumulating capital without these policy measures. Only policy and fiscal incentives could clear the path for employees to really participate and acquire at least some of the former state assets.

These provisions did not result though in a society of substantial shareowners. It rather led to capital concentration in the hands of a few, who already had experience in company management during socialism or had a better sense for the various methods of obtaining ownership, than the majority of regular workers. Nevertheless, it would be a mistake to blame only the management for the failure of the ESOP model. The primary cause was the lack of commitment to this idea and the lack of sufficient far-sightedness of political institutions. This is even more regretful, as companies in majority ownership of employees did not perform worse than other private economic entities.

The Hungarian ESOP was a premature model, because policy makers were sluggish or simply unwilling to change the provisions early enough, permitting the abuse of the original concept behind it. For these reasons, ESOP schemes were not as successful as they could have been in the long run, as they lacked the necessary sustainable provisions in the post-privatisation era. Furthermore, the time slot of three to four years, when SMEs were privatised, was a period too short to be able to measure the real outcomes of ESOPs and to make policy amendments, to foster employee ownership. Neither was there enough time to develop an employee share ownership culture, which could have taught the employees the risks but also the potential advantages of collective ownership schemes on the long term. As a result, ESOPs remained in the final outcome nearly insignificant.

6.8. Lithuanian employee share ownership resulting from privatisation

6.8.1. Introduction

The development of employee financial participation in Lithuania started in the early 1990s in the course of privatisation. Until 1994, Lithuania was in the vanguard of economic reform. Not only economic, but also political considerations of achieving complete independence from the Soviet Union led to the concept of fast privatisation. In addition, the leading politicians favoured egalitarian forms of employee ownership also supported by the trade unions. For that reason, the most popular privatisation forms were mass privatisation on the basis of vouchers and management-employee buyout, while sale to outsiders or liquidation were hardly used at all (Åslund, 2002, p. 270). Irrespective of the reasons for promoting employee ownership, the policy first led to a rapid growth of employee share ownership.

Due to this policy, by 1994, employees owned the majority of shares in the vast majority of privatised enterprises, including large companies with high capital intensity. However, the ESO rapidly declined after most legal and fiscal privileges of employees were abolished in 1995 (Darškuviene, Hanisch and Mygind, 2006, p. 21).

6.8.2. Legal and fiscal framework

The first stage of privatisation began when the Law on the Initial Privatisation of State-Owned Property was passed in February 1991. The employees could obtain from ten per cent (1991) to 50 per cent (1993) shares for vouchers distributed among all Lithuanian citizens and had the right to participate in the first round of the auction before the public offering (Mygind, 2002)[198]. Under the second Law on Privatisation of 4 July 1995, residual shares and some of the very large companies—including large utility and infrastructure enterprises—were to be sold. Vouchers could no longer be used. Under the third Law on Privatisation (PL), which was adopted on 11 April 1997, most significant preferences for employees in the privatisation process were abolished. However, a maximum of five per cent of shares can still be offered to employees (Art. 16 (3) PL). Since the substantial incentives for employees were abolished, the employee ownership decreased rapidly. Current legislation contains no special provisions or incentives. Employees who still own shares have voting rights at the general meeting, the right to call the general meeting and thus to participate in the decision-making process on the same ground as any other shareholder.

6.8.3. Development of employee share ownership: Empirical evidence

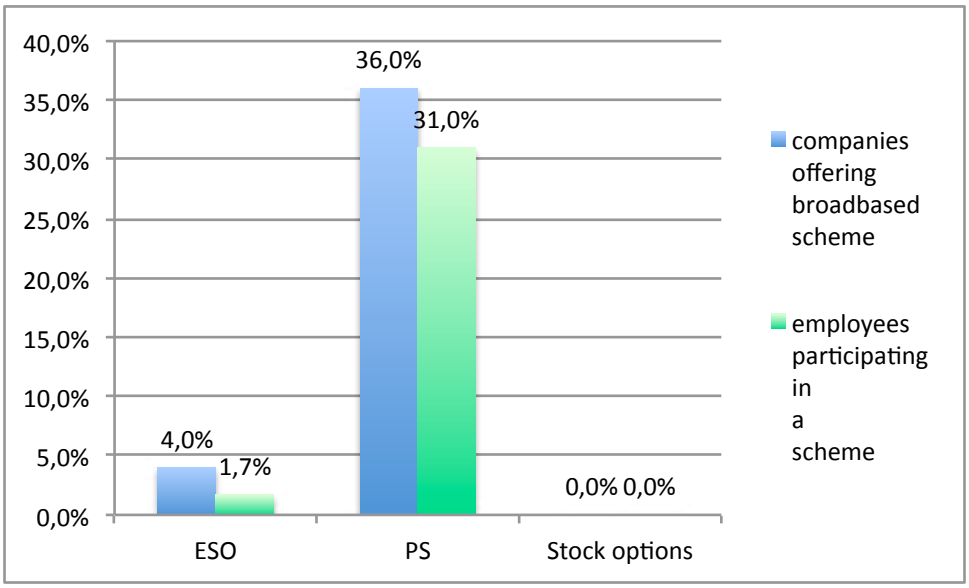
By 1994, less than five per cent of privatised firms in the programme implementing the Law on the Initial Privatisation of State-Owned Property had no employee ownership, while the percentage of enterprises where employees had taken over most of the privatised assets increased from three per cent in 1991-92, to 65 per cent in 1993 and 92 per cent in 194-95 (information obtained from the Privatisation Department at the Ministry of Economics).

However, the situation completely changed during the late 1990s and early 2000s. Whereas in 1993 approximately 50 per cent of employees were shareholders of their enterprises, in 1999 the percentage fell to one third. According to the survey conducted in connection

[198] The manager survey conducted in spring 2000 provides information on ownership in 1993, 1996, 1999 and spring 2000 with 405 respondents.

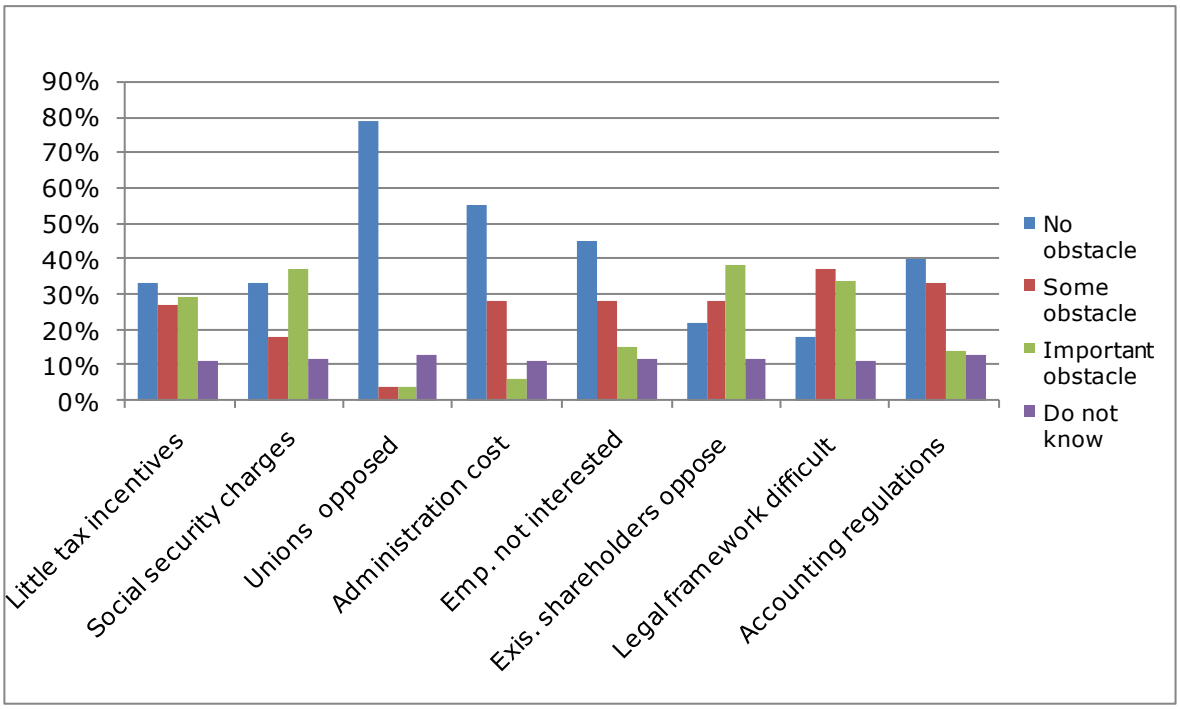
with the PEPPER IV report, only 4 per cent of Lithuanian companies offered broad-based employee ownership plans in 2007, and only 1.7 per cent of employees actually participated in such scheme (see Figure 30 below).[199]

Figure 30: EFP in 2007 in Lithuanian companies employing more than 100 employees



Source: PEPPER IV (Lowitzsch et al., 2009).

Figure 31: Obstacles to EFP in Lithuanian firms employing more than 100 employees (2007)



Source: PEPPER IV, 2009.

[199] See the survey of approximately 100 enterprises in the PEPPER IV report following the CRANET methodology (Lowitzsch et al., 2009).

6.8.4. Obstacles to employee share ownership

Whereas in the first phase of transition capital constraint for restructuring and low level of wages usually inhibited the development of EFP in Eastern Europe, at a later stage the lack of institutional and legal support was the key problem (Mygind, 2012, p. 1614).

Today, employee share ownership enjoys no legal or fiscal incentives. Furthermore, it appears that lack of tax incentives is a major cause for the decline of ESO schemes in Lithuania. According to the PEPPER IV survey, 56 per cent of respondents considered lack of tax incentives an obstacle to implementation of ESO schemes. Other major obstacles were high social security contributions (55 per cent); opposition of the existing shareholders (66 per cent); and an unduly complex legal framework (71 per cent).

6.8.5. Conclusions

The case of Lithuania exemplifies the importance of sustainability of legal and fiscal incentives. Whereas sufficient legal incentives—even if they are not the typical tax incentives—can lead to an almost incredibly rapid increase of employee ownership from nought to almost 90 per cent in only three years, the abolishment of the same incentives leads to a decline, which is just as dramatic as the increase was. Not the volume of incentives, but their stability can produce a long-term effect. It is not rational to provide substantial incentives, thus diminishing the income for the state budget, if there is no long-term interest in promoting employee share ownership.

The case of Lithuania, at a smaller scale, can be observed in most Eastern European countries, since the increase of employee financial participation was only a by-product of the privatisation and was not considered as worth of further support. In so far, the case of Lithuania is certainly not best practice, but, nevertheless, a typical case and a warning example. However, the Lithuanian enterprises with employees as majority owners did neither show a productivity bias nor selection bias to profitability (Mygind, 1997). Thus, the promotion of employee ownership would have been—and still is—an economically sound approach.

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