

# CASE Network Studies & Analyses

Employee financial participation  
in businesses:  
Is it worth discussing?

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## **Abstract**

This paper is an overview of the achievements in the area of employee financial participation (EFP) during the last fifty years. It addresses the question of the extent to which EFP is relevant in today's world. EFP is distinguished from participation in management (industrial democracy), and the various types of EFP are discussed. The major arguments for EFP are presented and discussed critically. The evolution of major forms of EFP, the scale of their operation in several advanced economies, and the legal and tax incentives for EFP are described. The efforts of European Union bodies to popularise this idea in all member countries are illustrated. Showing that EFP has become a broadly recognised principle of modern management in thousands of enterprises, we consider opportunities for disseminating these solutions on a wider scale, in particular in Poland. Finally, a number of directions for further research on financial participation are considered.



## 1. Introduction<sup>1</sup>

During the systemic transformation of the Polish economy in the late 1980s and early 1990s, a keen interest arose in various forms of participation of employees in the profits and ownership of the enterprises employing them. (For convenience we can refer to these various forms of participation as employee ownership.) This was linked to ongoing discussions about how to privatize the country's state-owned companies on a large scale. The author of this paper took part in these discussions, trying to popularize employee share ownership, which was well-known in Western countries. In our view then, this kind of institution could be used to build a new business model for certain groups of enterprises created as a result of privatization<sup>2</sup>. At that time, however, neither the Polish intellectual elite nor the working class was prepared for, or understood, the long-term advantages of the forms of employee ownership<sup>3</sup> implemented in some companies in the most developed Western countries. Even in these countries, however, these forms were not very common at that time. They were mainly perceived as marginal and, thus, were not taken into account as an option to be widely disseminated in the market economy (as opposed to the fairly widespread and partly mandatory use of employee participation in the management of companies in Europe). Nevertheless, the idea of employee financial participation (including profit sharing and employee shareholding), which since then has gone through various ups and downs, has survived and evolved into new forms, gaining ever wider acceptance and a firm legal grounding in some of the Western European countries and the United States. An international and European institutionalized movement has also been established to promote these solutions<sup>4</sup>.

In view of events in recent years that have revived certain doubts about the basic principles and durability of the traditional forms of capitalism, we again notice a growing interest in employee financial participation, including widespread employee ownership. We observe its growing popularity in Europe and a strong commitment

<sup>1</sup> The author would like to thank U. Grzełowska, P. Kozarzewski, K. Madej, L. Pietrewicz, R. Woodward and A. Zabkowicz for valuable inputs, comments and discussion of the first version of this paper and for editorial help. The author presented the idea of employee share ownership as one of the possible options for privatization in Poland (Błaszczuk, 1993).

<sup>2</sup> The author presented the idea of employee share ownership as one of the possible options for privatization in Poland (Błaszczuk, 1993).

<sup>3</sup> It is, however, important to note that beginning in 1956 Poland had seen a current of thought supporting the participation of employee councils in the management of state-owned enterprises. In 1981, this idea began to be implemented in Poland, and gained force in 1989, when the collapse of the communist system made the councils in the enterprises genuinely autonomous.

<sup>4</sup> In Europe, the European Federation of Employee Share Ownership (with headquarters in Brussels) and in the USA, the National Center for Employee Ownership, located in Oakland, California.



of the European Commission (EC) to popularize it. Much empirical material has been gathered, new instruments have been designed, and their implementation is being advocated by the most important bodies within the EU. This article is intended, first, to remind us about the relevant legacies of the past and, second, to present new concepts of financial participation, examining the opportunities for their implementation and the conditions necessary for this to be successful, and providing a critical evaluation of their relevance in Poland and elsewhere.

The first part of this article starts by making a clear distinction between employee financial participation and employee participation in management (non-financial participation). After presenting the theoretical justification for financial participation, addressing its main values and objectives, it outlines the classical concepts and types of employee financial participation. The second part of the paper briefly reports on the evolution of the most important forms of financial participation, such as the American and English Employee Stock Ownership Programs (ESOPs), German Kapitalbeteiligung or French participation, and includes a brief discussion of the legal and financial instruments in the business environment fostering their implementation. This part also includes an outline of the extent to which these solutions are being used in the most advanced countries and a short summary of conclusions drawn from the latter's experiences. The third part of this report discusses the efforts to disseminate financial participation, supported by the EU and presented in subsequent reports on the subject prepared for the European Parliament, the EC and its bodies. The final part discusses the potential relevance of these solutions for the emerging new economic order. It also considers opportunities for disseminating these solutions on a wider scale, in particular in Poland. In the conclusion, a number of new questions for further research on financial participation are considered.

## **2. Financial participation vs. workers' participation in management**

Financial participation<sup>5</sup> is the participation of employees in the profits and / or assets of the company. It refers to financial benefits, property and rights resulting from this fact. By contrast, workers' participation in management (non-financial participation)<sup>6</sup> means employee representation in business management (on various levels) and refers to employees as social partners. Both forms of employee participation have very different ideological roots and different practical justifications, which does not prevent them from sometimes occurring simultaneously in one company.

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<sup>5</sup> German term: "materielle Beteiligung der Arbeitnehmer".

<sup>6</sup> German term: "Mitbestimmung" (English: "codetermination").





## **2.1 Non-financial participation**

The rights of employees to take part in the decision-making process (sometimes referred to as co-management) are derived solely from a labor-based legitimization; that is, they result from employees' share in work, not in property<sup>7</sup>. Ideologically, these rights are derived from the non-financial needs of the workers, such as their need for involvement and self-realization, as well as to a broadly understood need for work "empowerment". But advocates of these arrangements make other arguments on the basis of economic efficiency as well: employees engaged in issues concerning the enterprise will be able to find new motivations to improve work efficiency and innovation, making it possible for their full potential to be used for the benefit of the company. By enhancing the position of employees in the company's management system, the participation schemes may also significantly improve the material well-being of personnel. In most countries of continental Europe, non-financial participation is regulated by law (at least since the 1980s) and operates in the majority of large companies<sup>8</sup>. Institutions supporting non-financial participation have been created at different levels of business management and have taken different forms in different countries (including, in particular, direct and indirect, or "representative", participation). The most common and most popular form of indirect participation involves employee councils, which are usually elected at the department level throughout the entire company. Their primary role is to serve as information and consultation bodies and, in some areas, to enable participation in the decision-making process. In some countries, where trade unions are not able to operate at the shopfloor level, employee councils can take their place, and in others, these two representative institutions co-exist within the company<sup>9</sup>. Another important form of indirect participation is co-management at the level of entire company, which involves the participation of employees' representatives in the supervisory boards of public limited companies. Since 2001, in addition to national legislation regulating this type of co-management, European companies are subject to an amended EU-Joint Stock Company Statute, which includes the participation of employees' representatives in the governing bodies of such companies<sup>10</sup>.

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<sup>7</sup> In its most extreme form the labor-based argumentation was encompassed in the concept of the classic self-governing enterprise (owned collectively by the employees). The analysis of this form can be found in Blaszczyk (1990).

<sup>8</sup> Details can be found in Blaszczyk (1988) and more up-to-date information can be found in Lowitzsch (2011).

<sup>9</sup> This does not change the fact that in some countries trade unions were vehicles for the introduction of non-financial participation. A detailed description of employee councils' rights in Western European countries can be found in Blaszczyk (1988, pp.102-124).

<sup>10</sup> This affects multinational corporations operating in several EU countries.



It seems that, in Europe, this type of non-financial participation at the enterprise level has already reached its maximum possibilities. The most far-reaching forms have not always proven to be the most beneficial for the business or for the employees themselves. For example, the supervisory council “parity co-management”<sup>11</sup> set out in the 1951 Act (the so-called “Montanmitbestimmung” Act), which was compulsory for enterprises employing more than 1,000 workers in the coal and steel industry in the Federal Republic of Germany (FRG), led to a mass exodus of businesses wanting to avoid this law. These businesses used various strategies, such as redeployment of production, division of the companies into smaller units and / or dismissal of employees<sup>12</sup>. Similarly, the less radical<sup>13</sup> Co-management Act of 1976, mandatory in all German joint stock companies employing more than 2,000 people, led to a similar business “escape strategy”, which began during the negotiations regarding the legislation in the first half of the 1970s and took on such forms as changing the legal form of companies, reducing the number of employees, changing the companies’ by-laws to reduce supervisory council authority, forming internal committees and advisory teams to the supervisory board composed solely of shareholder representatives, etc.). According to some critics of the most far-reaching forms of employee participation in management, these were merely healthy attempts to escape from wrong-headed requirements that would have limited their ability to make rational management decisions. Analyses of the German economy of the late 1980s have shown that companies with far-reaching employee rights to co-manage at the supervisory board level avoided risky decisions and developed strategies focused mainly on maintaining existing jobs and not attempting deep restructuring (Benelli 1983, FitzRoy & Kraft, 1987).

Having said this, the author of this paper does not intend to question the legitimate arguments for employee representation at different levels of management or to deny the benefits of the different forms of workplace democracy, in particular those ensuring better communication in the workplace. However, some forms of employee representation at the highest levels of management have become highly politicized over time and, in most cases, have served the interests of trade unions’ leaders and majority shareholders, rather than benefitting the entire company. However, assessing different forms

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<sup>11</sup> This refers to an equal number of employee representatives and shareholder representatives in the Supervisory Council, and the human resources director selected by the employees (Błaszczuk, 1988, pp. 82-82).

<sup>12</sup> There were 100 large companies employing one million people subject to this law when it was approved in 1951. In 1980 the group consisted of only 35 companies employing half a million people.

<sup>13</sup> Under the terms of this act, the shareholders’ representation on the Supervisory Board has the majority thanks to the additional voice of the Board’s chairman (representing the shareholders).



of employee participation in management is not the aim of this study, so we will not continue this discussion further.

It should be noted that, in addition to the legally required forms of participation in management, many companies (especially smaller ones) voluntarily offer additional forms of non-financial participation as a result of the particular needs of the companies. This type of participation often arises in connection with the introduction of financial participation and the need to attract employees and involve them in the process. An interesting, though less popularized, form of non-financial participation is the so-called direct workplace participation, which consists in creating autonomous working groups, quality circles and other similar institutions that enable employees to manifest their initiative and creativity in shaping both the work environment and work process. This form was introduced particularly in the Scandinavian countries (Rudolf 1982), but despite promising results, did not spread on a wider, more general scale in Europe. It seems that this type of non-financial participation deserves special attention in the current situation, taking into account both the needs of today's businesses (the ability to introduce rapid changes and innovations), as well as the characteristics of the work environment (the increasing level of education and growing aspirations).

## **2.2 Financial participation**

Moving on to the main topic of this paper, employee financial participation in companies, one first needs to stress that this term covers a very wide spectrum of solutions ranging from participation in profits, through individual shares in equity and employee stock options, to employee ownership systems like ESOPs, specially designed to serve this purpose, which combine employees' participation in the profits and capital of the companies<sup>14</sup>. Financial participation is thus an umbrella term referring to various forms of supplementing employees' fixed remuneration with a variable component of earnings, the value of which depends on the profit or loss of the company. However, the term should only be used to describe solutions used regularly and universally and covering the majority of employees of a given company<sup>15</sup>. One of the main features of financial participation is that it is introduced voluntarily, on the initiative of the entrepreneurs. However, legal and tax incentives play an important role as well.

Financial participation creates additional economic and legal bonds between the company

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<sup>14</sup> The term employee financial participation concerns individual property rights, hence it does not cover the legal form of cooperative which assumes collective ownership of an economic entity.

<sup>15</sup> This far-reaching interpretation stems from the 2002 EC report.



and its employees. All financial participation schemes are based on a similar idea: to make the employees co-beneficiaries of the company or, in the most far-reaching systems, co-owners. The justifications for these ideas include ethical, psychological, economic, and systemic motivations. At the forefront are the demands for greater fairness in the compensation of workers, who are not treated merely as a cost but also as the most creative factor of production. In this context, we are reminded of the demand for workers' empowerment in the discussion of non-financial participation, though in this case, its implementation would have to be based on a solid financial foundation: the participation of employees in profit-sharing and ownership, as well as in the resulting rights.

One of the most frequently cited economic reasons to implement financial participation is the aim to improve individual and collective motivation at work. By introducing additional benefits linked with the company's performance, it is expected that employees will show greater interest in the quality of their work, greater ability to work in teams, and greater identification with their own company. Employees receive various benefits, including an increase in revenues and, above all, solid insurance for the future, consisting of support for old age and accidental events, security for the future needs of their families, as well as support in the event of employment loss.

However, for the entrepreneur, the important justification lies in the ability to enhance the flexibility of remuneration in response to market conditions and the company's profit and loss. For smaller companies implementing employee equity-sharing, it is also important for the improvement of their capital structure (increase in shareholders' equity) and for the ability to resolve succession issues when the owner retires. In the case of large companies, the key arguments supporting the existence of financial participation are the improvement of internal communication, the greater achievement of social goals, and the implementation of a more effective HR policy (Guski and Schneider, 1986, p. 28). For all types of companies it is argued that financial participation is positively linked with sustainable employment and the tendency to promote the development of employees' human capital.

On the macroeconomic scale, social and economic benefits linked with financial participation should result in a more equitable distribution of wealth (without expropriation or redistribution) and consequent changes in social stratification and attitudes (this is most aptly described by the slogan "people's capitalism" which was popular in the 1950s-1960s). This argument again becomes valid in the present context, due to the rapidly increasing socio-economic stratification of modern societies and concentration of wealth and property in the hands



of a few over the past few decades<sup>16</sup>. Employee financial participation, if introduced on a large scale, could somewhat mitigate these changes. Another important goal of financial participation is to increase society's capacity to save and invest, as well as to promote knowledge of the market economy and the acceptance of its rules. The introduction of the most far-reaching form of financial participation, employee share ownership, extends an awareness of responsibility for the issues of business efficiency, investment, capital market rules, etc., to large numbers of people who had formerly been excluded from this. Finally, in many countries, financial participation is meant to strengthen directly the pension system by allowing employees to accumulate large savings on their supplementary pension accounts.

### **2.3 Types of financial participation**

Due to differences in the manner and degree to which employees are linked with the finances of their companies, we can distinguish three basic forms of financial participation (Błaszczuk, 1992, page 12):

1. Employee sharing in company surplus, calculated in various ways (e.g., based on profit, income, etc.), also called „pure” profit-sharing<sup>17</sup>;
2. Employee share ownership (e.g. stock, shares, equity<sup>18</sup>); and
3. Mixed systems (including both profit- and equity-sharing).

In the „pure” profit sharing systems, an additional source of employee income, supplementary to their contractual remuneration, is established, albeit without the employee empowerment implicit in share ownership. However, if employees are given the right to re-invest this income in the company, profit-sharing systems gain a new role as the basis for financing equity. More and more often, company profit shares are becoming the initial phase of the establishment of employee share ownership, and sometimes the two systems (profit- and equity-sharing) go on to function simultaneously (in the mixed form). However, because of their different economic implications, we need to describe each form separately.

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<sup>16</sup> For example, according to research conducted in Germany in 1997, the one million wealthiest households owned more wealth than the 25 million poorest households put together (Lowitzsch, 2011, p. 119). The situation is more extreme in the United States, where, according to the latest (2007) data on the distribution of net wealth, the richest 1% of Americans owned 33.8% of the country's total wealth, the richest 10% held 71.5% of total wealth, and the poorest 50% owned only 2.5% of the country's total wealth. There are similar disparities with respect to income. According to the author of an article published in the Business Insider in November 2011, there has never been such wealth and income inequality in the United States since the onset of the Great Depression in 1928 (Lubin, 2011).

<sup>17</sup> German term: „Erfolgsbeteiligung”.

<sup>18</sup> German term: „Arbeitnehmer-Kapitalbeteiligung”.



## **2.4 Employee Profit-sharing**

The most traditional form of profit-sharing, also referred to as cash-based profit-sharing, is a direct bonus payment based on the share of profits allotted to the employee. This does not include a personal bonus<sup>19</sup> based on measures of individual performance, but rather bonuses paid under a collective, pre-determined profit-sharing program, linked with the overall profit of the company.

Under deferred profit-sharing, the allocated profit share is held for a given period of time either in a special individual savings account or reinvested in the company. In deferred profit-sharing systems, the premium may also be awarded in the form of company shares, which are also retained for a fixed period and may only be sold by the employee after this period.

## **2.5 Employee Share Ownership**

Employee share ownership is a qualitatively different form of employee financial participation, since employees become co-owners and investors in the company by acquiring shares. This means that, through their financial contribution, employees purchase shares and hold the legal right to a given part of the company's assets and to the profits generated by these assets. The employee becomes the owner of the share (including the real appreciation in its value, or capital gain) and, depending on the type of participation, he or she has a right to take part in business decisions, bearing the risks and sharing in the benefits associated with the company's performance. Thus, in such a system, employees receive dividends on profits based on the amount of their investment, in addition to their salaries. Here we propose a broad definition of employee share ownership, including any form of employee investment in the company aimed at bringing profit. Some of these forms (e.g. loans) are not strictly considered equity-sharing; however, since they fulfill a similar economic function, they will also be the subject of our analysis.

Employee share ownership exists either in the form of direct employee shareholding, i.e. individual acquisition of shares in joint stock companies and other types of individual equity-sharing (in other types of companies), or in indirect forms<sup>20</sup> included in special shareholder plans. In addition to individual acquisition of shares, direct employee ownership

<sup>19</sup> Individual bonuses (gain-sharing) create a flexible part of income, dependent on performance and supplementary to the fixed salary. Performance is measured in various ways and depends on the employee's position and his/her level of responsibility. Bonus systems include piece rates and bonuses based on productivity or cost-cutting..

<sup>20</sup> In this case, shares are at first owned by the institutions representing employees and are later transferred to individual employee accounts after a grace period (most often when the credits used for their acquisition are repaid from the company's profit).



includes the rights of employees to acquire future shares (share options). Either company or employee funds can be used to purchase employee shares. Employees may also purchase company bonds or lend their money to the company in a different way.

As mentioned above, in addition to individual equity-sharing, there exist collective employee ownership programs, referred to as Employee Stock (or Share) Ownership Plans (ESOPs). These plans are equipped with specialized institutions (most often trusts) that act as intermediaries between the company and its employees in matters related to the creation and management of capital held on behalf of the employees. Whereas individual employee equity-sharing is popular mainly in continental Europe, ESOPs are much more common in Anglo-Saxon countries.

There are several different ways in which employees obtain their shares in enterprises: in some systems, employees bear the acquisition costs at least partially, and in others, the acquisition of shares or stocks is fully covered by the employing company, through a bank loan or a combination of financing mechanisms, often supported by the state<sup>21</sup>. Shares are most commonly distributed through equity or share savings plans<sup>22</sup>, which allocate shares to employees on an individual or collective basis at the issue price, with a discount or deferred payment option<sup>23</sup>.

Granting employees stock options or the rights to acquire shares at a later date, but at a price fixed in advance, is yet another form of employee ownership. The advantage of this form is that employees are given the opportunity to profit on the difference between the purchase and selling price of shares if the price increases. However, this type of benefit is not universally recognized as a type of financial participation per se because, at the moment of sale, employees most often keep the profit but do not become co-owners of the enterprise shares for a longer period of time. Similarly, the previously mentioned employee bonds and loans to companies cannot be regarded as classic employee equity-sharing, as they increase the company's debt rather than build its capital. However, taking into account their long-term nature and the right of employees to the interest on the borrowed capital or to dividends in the case of bonds, they can be seen as similar in character to equity-sharing. Moreover, such instruments enable the company to obtain funds for a lower price than on the market.

The previously mentioned forms of collective employee ownership (ESOPs) are characterized by a different way of acquiring shares. ESOPs are based on special financial

<sup>21</sup> In the form of tax relief, reduced or cancelled social contributions, or various kinds of subsidies.

<sup>22</sup> In share savings plans employers regularly bring input in cash or shares.

<sup>23</sup> The payment can be deferred and paid in installments, often with an employer's subsidy or a bonus.



engineering, whereby the institutional intermediary between employees and the company (usually a trust) purchases the shares (usually using a bank loan) and allocates them to individual employee accounts for deferred use. The bank loan can be repaid either from the company's profit or from dividends on employees' shares, but rarely by the employees themselves<sup>24</sup>.

Broad privatization in the UK and other Western European countries in the 1970s-1980s provided an excellent opportunity for the introduction of employee financial participation on a wider scale. Massive privatization of state-owned companies in the former Eastern Bloc began a bit later, in the 1990s and early 2000s. Both waves of privatization led to significant changes in the structure of ownership, in part including the "top-down" creation of specific forms of employee ownership, which often turned out to be less stable<sup>25</sup> than the financial participation schemes steadily developed from the bottom up over many years.

It should also be noted that, in practice, employee ownership of a company's shares or bonds does not guarantee influence on business decisions. Most often, employees are represented at shareholder assemblies by proxy, and if they participate in person, their proportion among shareholders is too small to constitute the deciding vote. Some forms of employee ownership are deliberately designed so as not to give workers the full voting rights of their shares (for example, by giving them non-voting shares). However, the problem of linking employee ownership to the appropriate form of non-financial participation is another topic, which we must omit here.

### **3. Financial participation: Experiences and achievements**

#### ***3.1 A little history***

The tradition of employee financial participation dates back to the early nineteenth century, when the first attempts were made to create systems enabling employees to receive regular shares in profit. In the middle of the nineteenth century, profit-sharing schemes were already successfully implemented in companies across Great Britain and Germany. One of the best-known cases was the system of financial participation in profits introduced in 1847 by the German economist J.H. von Thünen in his own estate of Tellow in Mecklenburg (Thünen, 1850). Interestingly, the capitalized profit shares in this system were assigned to the creation of future employee retirement security. This system lasted until the owner's

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<sup>24</sup> The description and classification of various institutional solutions fostering equity-sharing, both individual and through ESOPs, can be found in Blaszczyk (1992, p.45-51).

<sup>25</sup> Comparative studies, conducted at the end of the 1990s in several Central and Eastern European countries, showed that post-privatization changes in the ownership structure of enterprises privatized with a predetermined allocation of shares are usually quick and in many cases lead to the concentration of capital in the hands of a few shareholders (Blaszczyk et al. [eds.], 2003).





death and the estate's subsequent sale at the end of the nineteenth century. Attempts to implement financial participation also have a long history in France, where at the end of the nineteenth century it was attempted to pass a law imposing employee financial participation in company profits. Employee participation systems were developed in a systematic way from the bottom up in European countries, in Great Britain and in the United States until the Great Depression in the early 1930s, when they collapsed along with the economy<sup>26</sup>. The renewed development of financial participation began after World War II.

Another early example of overall financial participation (both in company profit and equity) was the pioneering system of "workers' enfranchisement" established in Poland in 1916 and developed on a wider scale in the 1920s by engineer Marian Wieleżyński in his mining enterprise Gazolina (Wieleżyński 1985). Initially, shareholder status was offered to a selected group of the most trusted employees, and then (after 1922), it was made gradually accessible to all permanent employees of the company. According to the by-laws of 1922, permanent employees were entitled to an annual bonus equal to their monthly salary, dividends on stocks and a large severance payment based on the duration of employment. They were, however, obliged to invest one month's salary per year into the company's shares. Employees demonstrated their engagement in the company's fate several times. First, they supported the reinvestment of a large surplus instead of demanding a pay raise. Later, they successfully replaced the owner who, when arrested by the Ukrainian occupation authorities, was absent for more than a year. They proved their commitment again in 1921, when they refused to take part in the general strike organized by the trade unions of the entire region. The decision was justified by the fact that the salaries and social benefits of Gazolina's employees were much higher than those demanded by unionists from other factories. Finally, another positive example of the employee ownership system was the employees' refusal to sell their shares despite the proposed 45-fold gain relative to the nominal price, which was offered by a foreign company that wanted to buy Gazolina out in 1929. The company was developing and flourishing until the outbreak of World War II. Despite these impressive results, the system was not adopted in other Polish companies in the interwar period (Wieleżyński 1985, pp. 145-172)<sup>27</sup>.

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<sup>26</sup> It was estimated that in Great Britain in 1929, over a quarter of a million employees participated in such systems (Estrin et al. 1987).

<sup>27</sup> According to L. Wieleżyński, Poland's President Ignacy Mościcki and Economy Minister Eugeniusz Kwiatkowski were considering introducing a similar system in "Wspólnota Interesów", a large nationalized coal conglomerate in the Silesian region, in the late 1930s. The idea was dropped, probably due to the very poor industrial relations in this company, characterized by great mutual hostility between workers and managerial staff (Wieleżyński 1985, p. 177-188).



### ***3.2 The development of financial participation after World War II***

The evolution of financial participation can be divided into two periods. The first period lasted from the end of the war until more or less the end of the 1980s, when systems were developing separately in various European countries and the United States. The second period (from the early 1990s onwards) is increasingly characterized by a supranational approach to financial participation, in particular with the development of the EU and its institutions. Furthermore, European countries have attempted to use American solutions, and vice versa. Recently, the European Commission and the European Parliament have undertaken initiatives to promote financial participation and to find common institutional solutions, so as to implement them on a broader scale.

### ***3.3 Examples of national solutions***

Financial participation systems implemented in European countries after the war differ significantly. They depend, on the one hand, on the political situation and position of particular governments and, on the other hand, on the attitudes of trade unions and employers. The earliest attempts at creating a legal framework for financial participation, as well as the greatest efforts to implement these laws, were observed in France, Great Britain, Belgium and Germany. Different approaches were used in each of these countries in their repeated attempts to ensure financial participation of employees in their companies. At the same time, intensive activities were undertaken in the United States, leading to the creation of other institutional forms of financial participation, which will be described below.

#### ***France***

In France<sup>28</sup>, which is one of the few countries where financial participation is required by law, efforts were first concentrated on programs enabling employees to share in profits and to participate in corporate savings plans. In 1959, under President de Gaulle, the government passed a decree obliging all enterprises to introduce so-called participatory systems giving employees the right to a share of the company's profits. The decree was then reviewed in 1962 and 1967. Initially, these were cash payments out of profits. Later, deferred payments were added<sup>29</sup>, which were made into special participatory funds, where they had to be held for three years in exchange for tax benefits. The form

<sup>28</sup> Historical information concerning France is taken from Blaszczyk (1992), and newer data are taken from Lowitzsch, Hashi, Woodward (2009) and Lowitzsch (2011).

<sup>29</sup> Since 1967, deferred payments out of profits have been obligatory in all companies employing more than 100 people and, since 1986, in all those employing more than 50 people.



of profit distribution is usually determined by collective agreements. Since 1967, increasingly broad employee savings plans, implemented voluntarily by entrepreneurs, have been introduced in addition to the required profit-sharing. Participation in these plans is voluntary for employees and most often requires a financial contribution from both parties. These savings funds are later used to purchase company stocks or shares in external investment funds. In the first case, employee share ownership is created and can be further enhanced by the right of employee savings funds to acquire company stocks while enlarging its capital, if employees hold less than 3% of shares in the company's capital stock. In the 1980s these legal solutions were supplemented and expanded. Furthermore, financial participation was placed high on the political agenda with the passage of a law requiring financial participation programs to be part of negotiations between employers and trade unions. In the 1990s additional tax benefits were extended to employees exercising the right to purchase options, provided that they did not sell them within a given period. In 2001, two new types of savings plans were introduced: one designed for employees of small businesses, and the other for pension purposes. Today, as a result of the implementation of these laws, France has a rich and multi-faceted system of employee financial participation.

## **Belgium**

In Belgium<sup>30</sup>, various proposals to create mandatory or voluntary forms of profit-sharing were hindered by both the uncompromising attitude of trade unions and the reluctance of the majority of political parties. As a result, it was not possible to implement any incentives for financial participation until the early 1980s, when efforts were undertaken to introduce financial participation in a different way, i.e. by creating financial facilitation projects for employee shareholders, which were gradually transformed into laws. Subsequent bills, passed in 1982, 1983, 1986 and 1987, introduced an incentive system to encourage employees to purchase shares in their own companies, whereby a specified amount<sup>31</sup> set aside for the purchase of shares would be tax exempt, if these shares were frozen for five years. This facilitation concerned the purchase of newly issued shares by all employees in joint stock companies, limited liability companies, and foreign companies and their subsidiaries subject to taxation within the country. The supplementary act of 1990 stipulated that shares issued to employees alone could not exceed 20% of the company's capital stock. A law was also passed in 1984 to regulate employee rights to purchase stock options and associated privileges. These rights apply to all employees of the types of companies listed above. The law also specifies a maximum amount<sup>32</sup> for which an employee may purchase options and stipulates that the options must be frozen for at least two years and that the capital

<sup>30</sup> Historical information concerning Belgium is taken from Blaszczyk (1992), and newer data are taken from Lowitzsch, Hashi, Woodward (2009) and Lowitzsch (2011).

<sup>31</sup> In the beginning, the sum amounted to 40,000 Belgian francs but was later lowered to 20,000.

<sup>32</sup> This was 500,000 Belgian francs or 25% of the employee's income from the previous year.



gain derived from the difference between the purchase price and selling price is not taxable. In 1999, the revised law on options determined that no social contributions should be paid on the employee capital gains on stock sales. These regulations have made financial participation very attractive for both employers and employees in Belgium, where the high tax progression and relatively high social security payments can be avoided by paying out a part of employee income in the form of options. For the same reason, these solutions have met with opposition from trade unions, which have demanded higher primary wages and the protection of high social security contributions instead of participation. At the end of the 1980s, many Belgian enterprises introduced voluntary employee profit-sharing programs in the form of share certificates. The 2001 act on employee ownership and profit-sharing schemes brought all existing tax advantages related to financial participation programs under a single regulatory umbrella and introduced common systemic rules, including requirements of universal participation of all employees in such schemes, approval of schemes by an employee representative, and the right of employees owning shares to vote. At the same time, it also introduced limits<sup>33</sup> for financial participation programs in companies and allowed institutions for collective management of employee shares to be established. An important element of the act is the introduction of the foundations for establishing savings funds based on deferred employee profit-sharing in small companies. Despite considerable political difficulties in Belgium, a multifaceted employee financial participation system, with extensive possibilities in practice, has thus been established.

## **Germany**

In the post-war period West Germany<sup>34</sup> began the first activities aimed at fostering employee financial participation from a different angle, i.e. by supporting savings and efforts to reduce financial inequalities among citizens and by rebuilding the middle class. Laws introduced since 1961 aimed to support these attempts by creating financial incentives for systematic saving in various forms, including the acquisition of shares in companies and incentives for employers to partially finance these acquisitions<sup>35</sup>. As part of the national policy to create wealth, a new term was coined, namely “wealth-increasing expenditures”<sup>36</sup>, which refers to regular payments by the employer (excluding payroll) for the benefit of employee savings, subject to an additional state premium. The upper limit of annual savings and the premium amount were determined by the state<sup>37</sup>, whereas specific amounts

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<sup>33</sup> The yearly expenditures on financial participation programs cannot exceed 10% of annual remuneration and 20% of the company's profit before tax.

<sup>34</sup> Most of the data concerning Germany are taken from Blaszczyk (1992), which also contains detailed information on regulations implemented in Germany, together with their financial engineering.

<sup>35</sup> Vermögensbildungsgesetze”.

<sup>36</sup> “Vermögenswirksame Leistungen”.

<sup>37</sup> Initially the limit was 312 DM per year, which was raised to 936 DM at the end of the 1980s.



were negotiated by the employer and employee representatives in collective or workplace agreements. Initially, public benefits referred equally to all forms of long-term savings (e.g. construction, housing or insurance savings, or savings on the purchase of shares or bonds). After 1984, clear legal priority was given to savings in the form of capital aimed at creating wealth in the hands of employees, either in their own company or with institutional investors. The Participation Act of 1986<sup>38</sup> differentiated the premiums that could be obtained from different types of savings, in favor of equity-sharing<sup>39</sup>. It also greatly expanded the range of possible forms of employee equity-sharing schemes that could benefit from these premiums, to include stocks, bonds, shares in limited liability companies, as well as other less-known forms of investment in one's own business and beyond<sup>40</sup>. These benefits were conditional upon meeting some formal requirements and providing employees with the freedom to choose the form and location of their investment. In order to receive an untaxed savings premium from the state, the savings had to be frozen for a period of six years; however, the company's subsidy to the employee is subject to taxation and social security payments. Additional incentives to invest in equity-sharing were introduced with changes in fiscal law, whereby the capital gain resulting from the difference between the market price of shares and the price at which they were issued to employees<sup>41</sup> was exempted from income tax (and from social security payments). As a result of these long-standing forms of support for employee savings and investments, stemming partially from employers, partially from the state and only in small part from the employees themselves, such employee capital savings programs exist in most German businesses. The most widespread form of employee participation is profit sharing via profit-sharing systems created by combining savings plans with employee shareholding promotion measures.

### **Great Britain**

In the UK<sup>42</sup>, legislation supporting employee ownership in companies was initiated in the 1978 Finance Act and then expanded in 1984 and 1988 by the Income and Corporation Taxes Act and the 1989 amendment to the Finance Act. Originally, the facilities only included tax relief for employees participating in "approved all-employee profit-sharing schemes", recognized by the Inland Revenue, which meant that the employees received grants consisting

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<sup>38</sup> "Vermögensbeteiligungsgesetz".

<sup>39</sup> Savings in the form of capital shares (and housing construction savings) were given a 23% premium, while other forms of savings received a 16% premium.

<sup>40</sup> Such as employee loans to their company, attestations and usage rights, shares in silent partnerships, cooperative shares, as well as fund shares, share certificates and foreign securities accepted in the FRG.

<sup>41</sup> However, only up to the amount of 500 DM per year.

<sup>42</sup> Most of the data used in this section are taken from Blaszczyk (1992), and newer data are taken from Lowitzsch (2011).

of company shares, with a fixed upper limit<sup>43</sup>, free of charge or at preferential prices. These shares could be sold after two years; however, only after a five-year period could the granted amount be exempted from income tax. The tax on capital income was maintained regardless of the length of the grace period. In subsequent years, other facilities for employee stock options were introduced, related to regular savings plans (“savings-related share option schemes”). These facilities covered employees who declared having saved a certain amount of money (up to 150 pounds) every month for a period of 3-5 years. By the end of this period, the total amount saved could be spent on acquiring shares at a price that was 20% lower than the issue price (at the beginning of the savings period).

By establishing the institution of a “qualifying employee share ownership trust” (ESOT) and introducing special exemptions from corporate income taxes on the amounts invested by companies into these trusts, the act of 1989 significantly expanded the opportunities for investing within the framework of employee share ownership. The ESOTs can use the money received from the company to purchase its shares, repay loans with the interest received, pay dividends and shares to shareholders, as well as cover other expenses. To obtain a corporate tax exemption, the company is required to fulfill a number of conditions, such as extending the benefits to all employees and disbursing the money received by the trusts from the company in a timely manner. The employees have similar tax advantages and withdrawal periods, as in the case of profit sharing and saving schemes described above. The legislation of 1989 was designed to facilitate the establishment of employee equity-sharing schemes and to increase their popularity among all companies, not just those listed on the stock exchange. ESOTs can be set up in smaller companies, which do not issue stock, in which case they serve as an internal market for the company’s shares. Additionally, the ESOT can invest outside the company as a collective fund.

Legislation on employee share ownership was last revised in 2000 in the framework of the Share Incentive Plan (SIP). The SIP confirmed and extended the tax advantages for both employees and employers on savings intended for share purchases. Up to a specified amount, the money set aside for share purchases is deducted from taxable income. Furthermore, employers may transfer their shares to employees free of charge; the latter can then sell their shares after five years without being subject to income tax or social security contributions<sup>44</sup>. Due to the significant administrative burden on businesses in carrying

<sup>43</sup> Initially the limit was 10% of annual employee income or 5,000 pounds per year, which was raised to 6,000 pounds in 1989.

<sup>44</sup> Four categories of employee shares were distinguished in the SIP framework: “free shares”, i.e. stocks obtained for free from the employer, with a maximum value of 3,000 pounds per year; “partnership shares”, i.e. stocks that employees can purchase from non-taxable remuneration, with a value of up to 1,500 pounds per year or 10% of the annual income; “matching shares”, i.e. double stocks that employers can add to every “partnership share” they purchase; and “dividend shares”, i.e. dividends obtained from the other three types of stocks, which can be reinvested into these stocks for up to 1,500 pounds per year. All of these stock types may be sold immediately,



out such a plan, the law allows for the plan's administration to be outsourced to third parties, which is often done in practice. Thus, the UK offers many financial advantages to employees and companies introducing financial participation schemes. The process, however, is controlled by detailed regulations and scrutinized by the tax office<sup>45</sup>.

## **United States**

In the United States modern forms of support for employee participation were preceded by a long-term state policy aimed at supporting equity-savings among employees and at encouraging employers to allocate their funds for this purpose. In the mid- to late 1940s, high economic prosperity was accompanied by rigorous control of wages and high tax progression. This prompted several companies to develop plans for employee profit-sharing, under which the transfer of income to employees was exempt from income tax, if the shares were frozen for a ten-year period. Most of the plans introduced at that time were designed as supplementary pension funds for employees and included either employee profit-sharing systems within the company or systems whereby the shares were transferred to pension funds outside the company. In the following years, despite the abolition of wage controls, profit-sharing plans developed rapidly and their number doubled every five years.

In the 1970s state policy priorities changed, and the state began to give more and more support to employee share ownership in companies. The initiator of the original institutional solutions for American employee ownership was Louis O. Kelso, a lawyer, economist and visionary, who in 1956 organized the first buyout of a company by its employees under an employee stock ownership plan. Kelso actively promoted this type of ownership<sup>46</sup> until his death in 1991.

In 1974 the Congress passed the first law<sup>47</sup> in support of employee ownership plans called ESOPs ("Employee Stock Ownership Plans"). The ESOP is an institutional solution in which case they are subject to regular taxation and social security payments. If the stocks are kept in the system for 3-5 years, they are subject to lower tax and social payment rates, and if they are kept for over 5 years, the employee is exempt from paying taxes and social contributions. If the employee leaves the company before the grace period, s/he pays lower taxes and social contributions or, if justified, is completely exempt from them.

<sup>45</sup> According to a high-ranking official of the Ministry of Finance, state budget costs related to tax reliefs for employee financial participation were estimated at approximately 100 million pounds per year in 1989. In his opinion, these expenditures are justified if they serve the interests of the employees; however, they should not be abused by employers trying to lower the wage costs (Błaszczyk, 1992, pp. 62-64).

<sup>46</sup> Among Kelso's numerous publications, two deserve special mention: *The Capitalist Manifesto* (1958) and *Democracy and Economic Power: Extending the ESOP Revolution Through Binary Economics* (1986).

<sup>47</sup> Employee Retirement Security Act (Erisa). Its author, Russell Long, was a Democratic senator from Louisiana, although ESOPs were also supported by Republicans, including three Republican presidents.



that allows for collective acquisition of shares/stocks by employees in the companies employing them, on credit, which is later repaid from the profits of the enterprise. The employees become full-fledged owners of their individual shares after the loan is repaid by the trust managing the ESOP. However, they cannot freely dispose of their shares until they either retire or leave the company. In the following fifteen years, the Congress passed 15 more acts favoring the ESOP concept, the most important of which was the Tax Reform Act of 1983 enacted under President Reagan. This act provided tax relief to all parties interested in setting up and running ESOPs, under the condition that the plans did not lead to discrimination and were available to all employees. Under these provisions, the taxable income of the company was decreased both by the company's contribution to the ESOP on behalf of its employees (up to 15% of the wage bill per year) and by contributions used to repay bank loans used for purchasing employees shares, including interest. ESOPs were exempt from income tax, bank income on the loans to ESOPs were subject to a 50% tax relief, and the owners of the companies who gave shares to ESOPs were exempt from capital gain tax, conditional upon the reinvestment of these assets in other stocks. The employees were obliged to pay income tax only after the withdrawal of their shares from the ESOP trust, usually when they retired<sup>48</sup>. In such favorable conditions, the employees could become owners without incurring any costs on their part. Hence, a proliferation of ESOPs began. All these facilities were subject to numerous restrictions aimed to prevent fraud, which in turn has led to considerable complexity of fiscal regulation and a high degree of administrative control. These factors in turn mean that helping to set up an ESOP has become a profitable business for several thousand legal and consulting firms. It has also had a negative impact on the federal budget. Due to the reliefs and tax exemptions discussed above, lost revenues to the budget between 1977 and 1983 were estimated at US\$3 billion<sup>49</sup> to 9.9 billion<sup>50</sup>. Despite this fact, the idea of the ESOP as an institution promoting employee financial participation assisted by loans turned out to be very interesting and has survived not only in the United States but has also been adopted in many countries around the world. In the United States, the ESOP as an institution has remained almost unaltered, though amendments to and interpretations of the law have become too numerous. An important feature of the ESOP is its universality, i.e. the possibility for it to be set up in almost any type of business, regardless of legal form and size. This has enabled ESOPs to be set up in even the smallest family-owned companies. So far, Europe has not introduced such a flexible legal form of financial participation.

As popular as establishing ESOPs in United States was in the late 1970s and 1980s, in the 1990s a wide dissemination of employee stock option plans began. While ESOPs

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<sup>48</sup> The financial architecture of ESOPs is shown in a more detailed way in Blaszczyk (1992)

<sup>49</sup> According to data of the ESOP Association.

<sup>50</sup> According to Estrin et al. (1987)





were created mostly in smaller and unlisted companies, the stock option purchase plans could be introduced in large companies. In 2000 it was estimated that the number of stock option owners equaled or exceeded the number of ESOP members<sup>51</sup>. The scale of particular types of financial participation in the United States will be discussed further below.

### **3.4 The scale and impact of financial participation in the United States and Europe**

At the beginning of 2012 in the United States, according to the US National Center of Employee Ownership (NCEO), there were about 11,000 ESOP-type plans, covering more than 10 million employees. About 10 million people were participating in stock option plans. In addition, approximately 5 million employees participated in older types of savings plans, investing mainly in company shares. Furthermore, more than 11 million employees had bought shares under a share purchase plan. Eliminating double counting, it is estimated that about 28 million people participated in one of the employee share ownership plans. At the end of 2010 it was estimated that approximately 17.4% of all private sector employees had shares or stock options in their companies and about 8.7% had stock options. In all limited liability and joint stock companies as much as 36% of employees had stock options. It is estimated that the capital included in employee ownership now constitutes about 8% of the total capital of all commercial companies. While ESOPs are present in most of the companies not listed on the stock exchange, only 3% of public companies have ESOPs. The forms dominating in public companies include stock option purchase plans and other ownership savings plans. It is estimated that each employee of a company that has an ESOP receives an annual average revenue equivalent to US\$4,443 and has an account worth an average of US\$55,836. At the end of 2009, ESOP capital resources were estimated at approximately US\$869 billion. It is hard to assess such data for other types of employee ownership and profit sharing plans, as the reporting obligations are much less strict than in the case of ESOPs. Although companies that are majority-owned by employees are rare in the United States, large and well-known global companies are among them<sup>52</sup>. It is also worth noting that more than half of Fortune magazine's "100 Best Companies to Work for in America" has an ESOP or another employee share ownership plan (National Center for Employee Ownership, 2012).

In Europe, in the 15 old EU Member States, 17% of private sector employees work

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<sup>51</sup> According to Joseph Blasi from the National Center of Employee Ownership, in 2000 in the United States there were approximately 8.5 million ESOP members in approximately 11,000 companies and 7-9 million share option owners in several thousand companies (Blasi et al. 2000, p. V).

<sup>52</sup> These include the sales network Publix, which employs 15,000 people, the construction company McCarty, the companies Nypro and Lifetouch (employing 18,000 each) or W.L. Gore and Associates (with 8,000 employees).

for an employer offering some form of employee shareholding, and if we broaden our view to include various forms of profit-sharing, then 36% have the opportunity to participate financially in the companies where they are employed” (Lowitzsch et al. 2009). Taking a closer look at the data (Lowitzsch 2011), we see that in all of these countries there is a fairly high percentage of companies practicing various forms of financial participation (from several to several dozen percent in different categories), but the percentage of employees who actually benefit from these programs is much lower (a few percent, typically less than 10). For example, in Belgium, 21% of companies employing more than 200 people offer shareholding plans, but only 4.3% of the potential beneficiaries use these opportunities. There is a similar situation in France, where the respective percentages are 34% and 5.3%. This means that the potential scope of financial participation is much greater than its use in practice. However, when analyzing the data, one must take into account the fact that they are based on estimates, as the summarizing reports use a variety of sources, with varying methods and research tools that are difficult to compare<sup>53</sup>. Moreover, the kinds of financial participation practiced in Europe differ significantly across countries and are sometimes so particular that they cannot be easily compared. These peculiarities stem from the different ways financial participation evolved in those countries, as well as different legal systems. Thus, in some countries the dominant forms are various kinds of profit-sharing (for example, in France in 2004, deferred profit-sharing affected as much as 53% of employees, or 6.3 million people, and in Sweden, the Netherlands, Luxembourg and Finland, 15%, 13.8%, 13.5% and 11% of employees, respectively, were affected by profit-sharing), whereas there is a more even balance between profit-sharing and shareholding in Germany (with 12% of employees participating in profit-sharing, and – as of 2006 – shareholding plans in practice in more than 3,000 companies employing 2.3 million people) and the UK (where, in 2006, for example, shareholder-approved plans associated with participation in profits and stock options were present in 5,000 companies and included approximately one million people, and other savings plans were present in more than 4,000 companies covering 2.6 million workers) (Lowitzsch 2011, pp. 28-31).

In most of the countries we notice a similar pattern, in that – as in the United States – stock option purchase plans are most prevalent in the largest companies, which are often listed on the stock exchange. When examining the percentage of beneficiaries of these programs in large companies, one sees that stock option purchase programs are present in as much as 83% of listed companies in Finland, 80% in the Netherlands, more than two thirds in Germany, approximately 50% in France, one third in Denmark, about 25%

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<sup>53</sup> Outstanding research in this field is conducted by The European Foundation for the Improvement of Living and Working Conditions, whose reports and studies are conducted for the EC (European Foundation 2004). Another important source is the Cranet Survey, concerning European companies employing more than 200 people (Lowitzsch 2011)



in Luxembourg, and 40% of companies employing more than 50 people in Belgium. Sweden is the only country where share option schemes are non-existent. In the UK it is difficult to specify the number of beneficiaries of stock options, as in many companies these programs are combined with other employee share ownership schemes, as discussed earlier. In most of the countries where there are employee ownership schemes, the latter have either an individual (employee share ownership) or (temporarily) collective character (ESOPs), though in Finland the dominant form is the collective employee fund, which was also in force in Sweden until 1991 (Lowitzsch 2011).

According to reports prepared by the European Federation of Employee Share Ownership (EFES 2010), employee share ownership developed strongly in the first decade of the 2000s. While in 2001, 40% of large European companies offered employee share ownership plans, these plans were present in as many as 83% of such companies by the end of 2010. Moreover, newer plans have included all employees, and not just selected groups as was the case earlier. The question how often employees actually exercise such rights to financial participation in their companies, however, remains open.

There is a fairly widespread view that the implementation of financial participation in Europe in its various forms is most advanced in France and the UK. These two countries have the most experience and longest tradition in implementing legal solutions (over 50 years in France and more than 30 in the UK). Within the EU-15 the lowest achievements are in the Southern European countries, i.e. Italy, Spain and Portugal. The reasons for this differentiation are not fully clarified and need to be studied. In conclusion, despite the inability to determine the exact number of people benefiting from various forms of financial participation in the 15 old EU Member States, it must be said that employee financial participation has already been introduced on a large scale, and it is likely that the benefits of these programs affect millions, or even tens of millions, of people in Europe. Existing legislation, which in many countries strongly supports the development of financial participation, provides an additional opportunity for its further significant development.

In the New Member States, financial participation is much less widespread and far from achieving its maximum potential. Although in most of these countries employees benefitted from acquiring stocks and shares at preferential prices during the privatization of their companies in the early transition period, there were neither incentives to keep these shares nor the will on the part of employees themselves to do so. It seems that this willingness is linked to a certain standard of living on the one hand, and the level of economic education of rank and file employees, and awareness of managers (in particular their expertise in the field of business culture and modern management methods) on the other.



## **4. Activities of the European Community to foster employee financial participation**

### ***4.1 EU initiatives in the 1990s and at the turn of the century***

At the European level, the debate on employee financial participation began in the early 1990s. The first report of the European Commission, entitled PEPPER I (full name: Promotion of employee participation in profits and enterprise results), was written in 1991. On the basis of this report, in 1992 the Council of the European Union issued a recommendation concerning the promotion of employee participation and the European Parliament adopted a resolution on the same subject.

Within these recommendations, the European Council formulated the basic principles that must be met so that employee participation programs obtain EU support. These rules remain in force today, in the more precise formulation contained in the Commission Communication of 2002 (European Commission 2002); hence, we quote the complete version below:

1. Employee financial participation must be voluntary (for both employers and employees).
2. Participation programs are a supplement to the existing remuneration system and not a substitute.
3. Programs must not discriminate; the benefits of financial participation must be extended to all employees.
4. Programs must be understandable and transparent.
5. Rules of financial participation in companies should be based on a clear, predefined formula.
6. Firms are obliged to provide information and training to employees on the model introduced and participation details.
7. Unreasonable risk for employees in the programs implemented must be avoided, and if it exists, objective information and warnings must be given to employees.
8. Participation programs must take into account the employees' right to mobility between enterprises and countries.

Subsequent PEPPER reports, which were designed to diagnose progress in the field of financial participation in Europe, were written successively in 1997 (PEPPER II), 2006 (PEPPER III) and 2009 (PEPPER IV) and referred only to the forms of participation that met



the requirements specified above and, consequently, obtained EU support<sup>54</sup>.

The last report (PEPPER IV, 2009) gave a complete picture of financial participation in all EU Member States and candidate countries and not only described various participation programs and their popularity in individual countries but also presented the government policies and the attitudes of social partners. It also discussed the obstacles for implementation of the programs and legal, fiscal and other incentives for their application. Hence, a large amount of information on financial participation in individual countries and legal solutions fostering their implementation is available. Nevertheless, a single common legal framework for the EU still has not been created. This is justified by the fact that the EU has no decisive competences on internal regulations concerning enterprises or tax and fiscal systems within Member States. So far, the EU could only advise on good practices and provide recommendations on the mutual recognition of their rights in other countries.

Since 2010, the EU has made efforts to support employee financial participation and, after an in-depth discussion, the European Socio-Economic Committee adopted an opinion on the matter on 21 October 2010. “The aim [of the opinion] is to encourage Europe to draw up a framework concept which promotes Europe’s economic and social cohesion by facilitating the application of EFP at various levels” (European Committee for 2010). In the opinion, the Committee first recalls the basic principles of financial participation (listed above) and then lists various social and economic benefits resulting from the introduction of participation programs (for workers, for businesses and for entire communities). The document lists concrete examples of practical solutions for employee participation in the profits and assets of companies, and, finally, calls for joint efforts to disseminate these solutions. In the part devoted to benefits for businesses, it is stated that special attention should be paid to the positive impact of financial participation on corporate governance in the company.

The Committee also proposes to develop a transnational “Building Block Approach”, which would include all forms of financial participation practiced, so that individual countries can choose the combinations of modules that are most suitable for their needs<sup>55</sup>. Within this approach, the Committee differentiates between three basic forms of financial participation: profit-sharing, individual share ownership, and the ESOP model. The Committee recommends a combination of profit-sharing and individual share ownership and, in the case of SMEs, the ESOP model.

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<sup>54</sup> Hence, stock option programs for management alone, share ownership available for selected employees, and irregular profit-sharing or individual merit-based bonuses are not included.

<sup>55</sup> The “Building Block Approach” has been described in Lowitzsch (2011).



Recent recommendations of the European Socio-Economic Committee steer towards combining various forms of financial participations in such a way as to make employee shares funded by profit-sharing. In its opinion, the Committee indicates that in some large European companies there already exist models of employee ownership where purchasing shares through trusts is financed by a profit share paid in addition to wages. Usually, for this purpose, a separate intermediary entity<sup>56</sup> is created, which, acting as a trust, manages the shareholding of the employee. The governance of this entity should be a direct expression of the will of all employee shareholders, with no influence from management, in a democratic way. The Committee lists examples of such companies and describes the stated goals of their financial participation schemes. These include: AUCHAN (France), HOMAG AG (Germany), Pfalz Flugzeugwerke PFW Aerospace AG (Germany), Voestalpine AG (Austria), Oktogonen Foundation (Sweden), Herend-ESOP (Hungary), Tullis Russell ESOP (United Kingdom), the Eircom ESOP and AerLingus-ESOP (Ireland). In three of these cases, the declared purpose of introducing financial participation was “enhancing the loyalty and motivation of employees”, in three others “privatization and strategic shareholding” and in others “financing of the company’s growth”, “business succession” or “spin-off”.

#### ***4.2 Proposals for long-term measures in the European Union***

Today, the European Socio-Economic Committee proposes to develop the “Building Block Approach” and its gradual implementation in the Member States, as well as coordination, streamlining and mutual recognition of the principles of financial participation for companies operating across borders. For the future, however, the Committee sees the need for closer cooperation, for instance in relation to the increasing mobility of employees and enterprises between Member States, which does not go in hand with the limited mobility of participatory solutions.

While tax incentives, according to the Committee, are not a must for financial participation, they have been shown to provide positive and important leverage for its wider implementation. However, in the opinion of the Committee, since the EU lacks competence over taxation issues, there is a need to develop “a facultative, simple, uniform incentive model, with the same tax arrangements and incentives throughout the EU, [which] could considerably boost the number of cases where there is a willingness to introduce EFP.” (European Socio-Economic Committee 2010) It also proposes to take deferred taxation as the lowest common denominator for the development of the proposed model. Before the European model is established, the Committee calls for mutual recognition

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<sup>56</sup> In continental Europe it is a limited company, foundation or association, and in Anglo-American countries it is usually a trust.



of individual Member States' schemes for businesses operating across borders. As Europe unites, the differences in employees' rights to financial participation in their companies become particularly visible and can have an adverse effect on both labor mobility and enterprise competitiveness. Therefore, an important argument can be made in favor of the attempt to give equal rights in this regard to all employees within the European Union.

## **5. Questions for future research, in particular in Poland**

For the past 30 years, employee financial participation, i.e. profit-sharing and employee share ownership, has proved effective in the leading European economies and the United States. This paper clearly shows that financial participation cannot be treated as a socio-economic experiment in today's economy. It is rather a widely-acclaimed operating principle in thousands of companies that have recognized it as a good practice and included it in the modern management of business and human capital.

In Poland, we also need to realize this and start giving financial participation the attention it deserves. However, while bearing in mind the important human aspect of financial participation, many questions need to be answered regarding the economic dimension of this issue. For example, what could be expected as a result of the implementation of participation on a broad scale in our companies? What might be its impact on productivity? How might it change the behavior of companies, and under what conditions would it support their development? How could the interests of employers and employees be taken into consideration without harming the efficiency of management? In what institutional framework could financial participation generally be beneficial for raising the competitiveness of companies? What might be its impact on corporate governance?

The influence of financial participation on companies' performance has been the subject of studies too numerous to discuss at length in this article. Generally, it can be stated that participation has a positive influence on the survival of a company in a difficult situation and on maintaining employment. Judging by the recent American experience, companies with financial participation have adapted better to harsh crisis conditions and provided more protection for disappearing jobs than other companies (National Center 2012). A more controversial issue is the advantage of such companies in the area of raising labor productivity and other economic outputs, because the impact of participation on efficiency seems to be less direct and depends on many additional factors. At this point, we can say that not only are these benefits different across countries but also across different



types of financial participation. Therefore, we plan for the next stage of our work to investigate this issue and to deliver a study devoted to the economic results of different forms of financial participation, based on a review of research conducted in Europe and America.

Another question concerns the main purposes for introducing financial participation in our country and whose interests should be addressed by doing this. We think that these interests may exist among employees, managers, employers, individual consumers, pensioners and the whole society. As we suggested earlier, maintaining jobs and ensuring fair incomes can be seen as one of the purposes of financial participation, and this lies in the interest of employees. Enhanced loyalty and work motivation, better work quality and more flexible pay lie in the interest of managers and owners of companies. More and richer sources of funds for the time after retirement are in the interest of each working person. Finally, higher savings would benefit the whole society in a country with a very low savings rate. A deeper and more precise investigation of the nature of these interests is in our future plans, too.

Another important question is how to deal with the fear of risk among working people. Our observation from the privatization process is that employees are willing to invest in their companies, but they are strongly determined to avoid any kind of risk. All forms of employee share ownership (including stock options) bear some kind of risk. Without this, there is no true co-ownership. But if the employees don't accept risk at all, we have to avoid or to limit this kind of financial participation schemes and limit ourselves only to profit sharing schemes.

Taking in consideration the particular model of privatization in our country that included in many cases employee buy-outs, we could try to find out in our future research, what is the today's heritage from this privatization model – taking into account the remaining scope of employee ownership and the attitudes of working people to it. This could partially explain the status of and potential for financial participation in Polish companies. The question is whether employee ownership and broader: financial participation is considered by the people as a temporary form or rather as a stable feature of a modern company.

Another question to answer is whether financial participation is consistent with the evolution of the modern business and contemporary forms of work. Taking into consideration the high work force mobility and the various forms of flexible work that are needed in today's economy, we have to ask how these can coexist with financial participation that favors stability of employees in their company.

A final important question for us is to find the sources of differences between countries that have led to differences in the scale and scope of financial participation. One can





assume that differences in organizational culture and the historical legacies of individual countries have played an important role. In particular, the historical character of industrial relations could play a role: where cooperation has been given priority over conflict, financial participation could play an important role. In places dominated by class conflict, this, or any other kind of participation, is not likely to find fertile ground. But these factors only partially explain the high or low achievements of each country in this area. These questions need to be investigated further.

## 6. Conclusion

There are many important arguments in favor of employee financial participation. The benefits for employees are obvious in schemes that follow the rules described above. Taking the broader socio-economic context into consideration, we can see other crucial arguments. One of them is the recognition of employees as the most important factor influencing a company's success and, as a result, aiming to better meet their financial and spiritual needs. An employee who is co-owner of the company has a higher self-esteem and a different, better attitude towards the problems of his/her company. This is especially essential during the current technological revolution, when employees are much better educated and the existence of the company often depends on their attitudes and innovativeness. Thus, from the point of view of an employer, the successful implementation of a financial participation scheme seems to be a "win-win" situation for both sides: the employee and the company.

Another important argument is that modern profit- and asset-sharing schemes raise the savings rate, with the savings accumulated over the years providing employees with higher pensions. The argument that profit- and asset-sharing schemes contribute to reducing income and wealth disparities in society also seems to be very relevant today and worth further investigation.

All the arguments given above are also valid in Poland, so it seems reasonable to undertake efforts to learn about various forms of financial participation and to consider their implementation. Their success, however, depends on several factors.

The first is availability of the necessary legal and technical solutions. Research on that topic is already in progress<sup>57</sup>, and even if Polish law lacks such solutions, it would not be too difficult to adopt legal models developed in other EU countries and the United States.

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<sup>57</sup> For example research conducted by the Allerhand Institute in Krakow (Allerhand Institute, 2011).



The second and most important factor is the will of the shareholders, management elites and the working people, who have to decide whether they want such solutions in their companies. This question cannot be answered easily, as the answer is related not only to the interests of these groups, but also to deeply-rooted values that might not favor financial participation. Equally important is the attitude of trade unions towards financial participation, which seems, to date, to be neutral. What we need is to clarify these attitudes with the help of research, education and promotion in a broad, open discussion.

The third factor is the political will to address this problem. So far, there is no such clear intention in Poland. However, this could change under the pressure of interested social groups.

To conclude, we need to learn from the most advanced countries and companies how to make financial participation work for the mutual benefit of enterprises, employees and society as a whole.



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