

# **The European Employee Stock Ownership Plan a Vehicle for Business Succession in SMEs - Policy Considerations**

**Ten years of Public Policies for Employee Ownership  
in Europe - Past, Present, Future  
Brussels, 26 November 2010**

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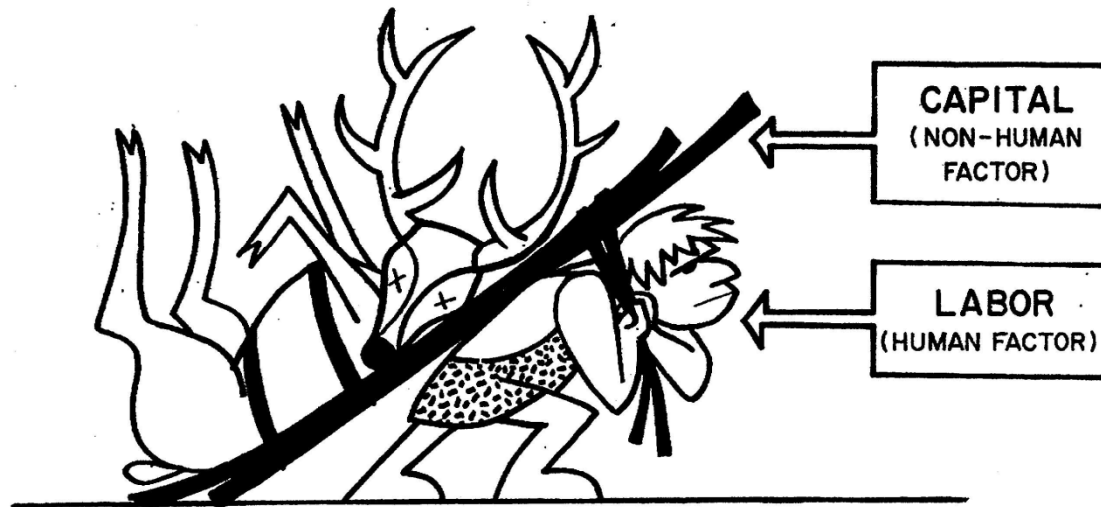
# Macro-economic Policy Issues to be addressed:

1. *The Achilles heel of the free market:  
The production-consumption gap (lack of purchasing power)*
2. *EU 2020 Strategy & Competitiveness:  
Intrinsic Advantages of Employee-owned firms*
3. *Business Succession in SMEs: Does it matter to Europe who  
the buyers of its old-line firms are?*
5. *Way to a European Framework: EESC Initiative Report  
of 21 Oct. 2010 – “Building Block Approach”*
4. *ESOPs: Combination of employee share ownership and  
profit-sharing as future trend in EFP*

# Human Productiveness as a Contribution to Overall Productivity

In 10,000 B.C. there were 2 (and only 2) factors  
of production:

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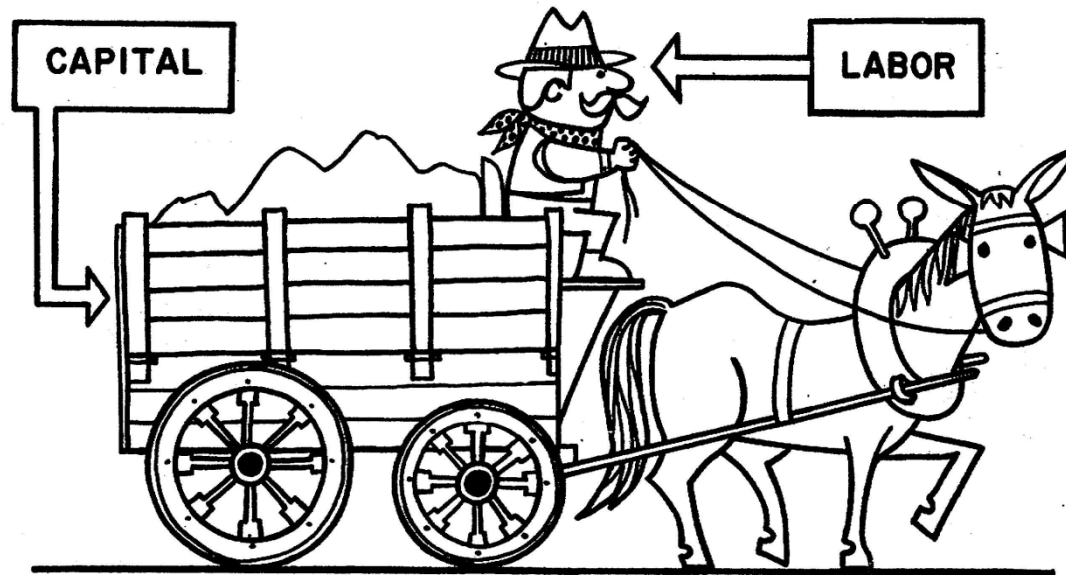
Here They Are Producing a Useful Service:  
" TRANSPORT OF GOODS "

Scetch courtesy of the Kelso Institute

# vs. Capital Asset Productiveness as a Contribution to Overall Productivity

In 1900 A. D. there were 2 (and only 2) factors  
of production:

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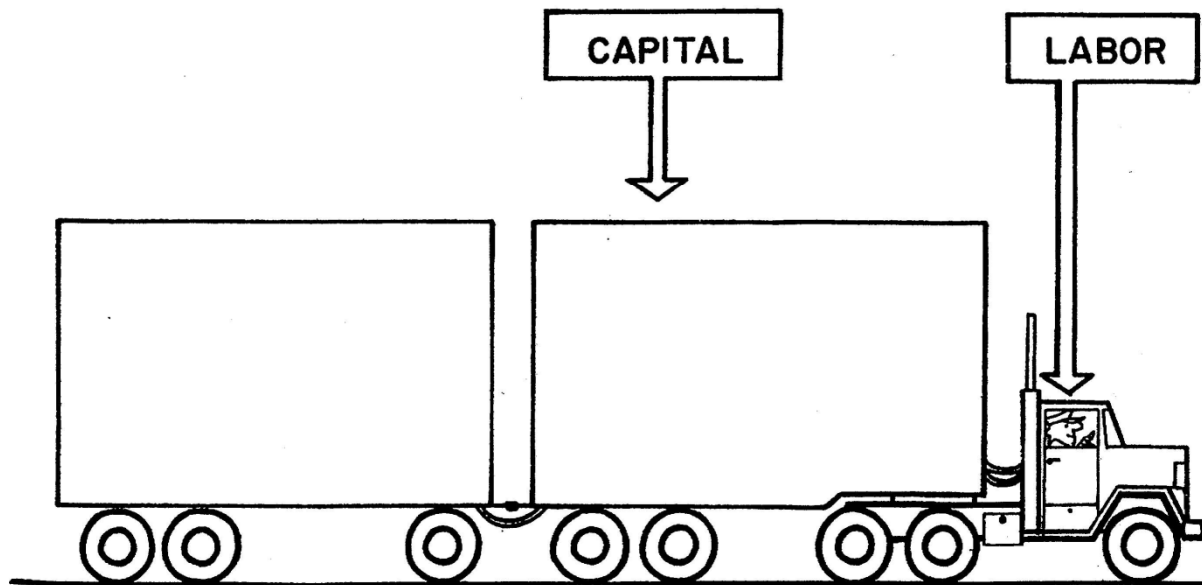
Scetch courtesy of the Kelso Institute

# America 1965 – Binary Economics

Louis O.Kelso (1913-92 Lawyer & Investment banker)

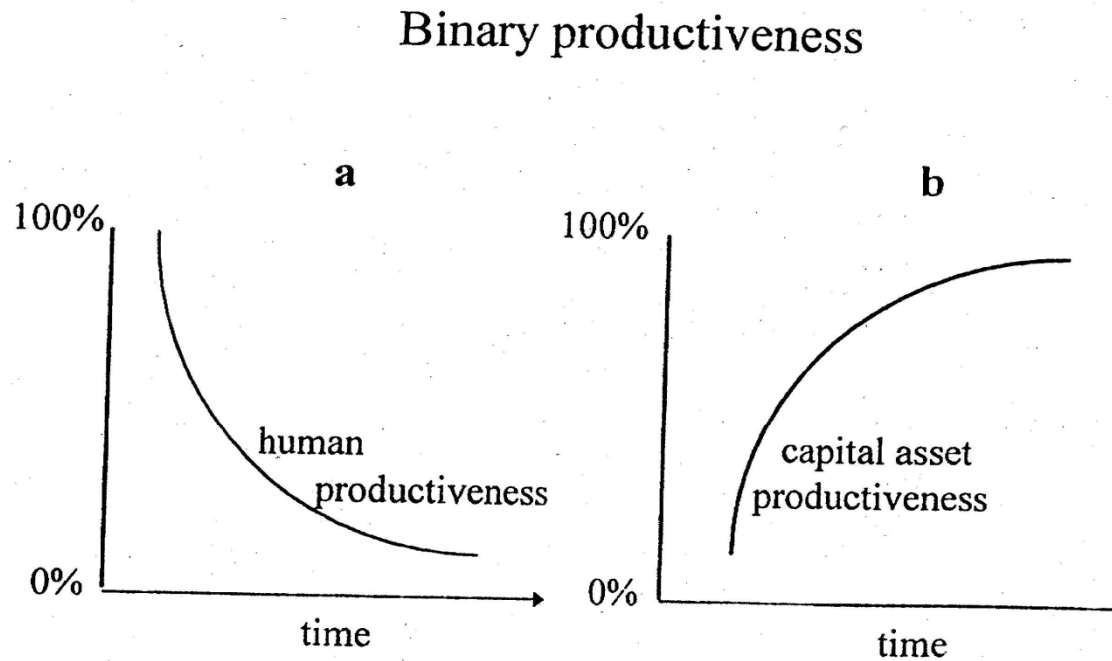
In 1965 there are still 2 (and only 2) factors  
of production :

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Scetch courtesy of the Kelso Institute

# Dynamics of Human Productiveness compared with Capital Asset Productiveness

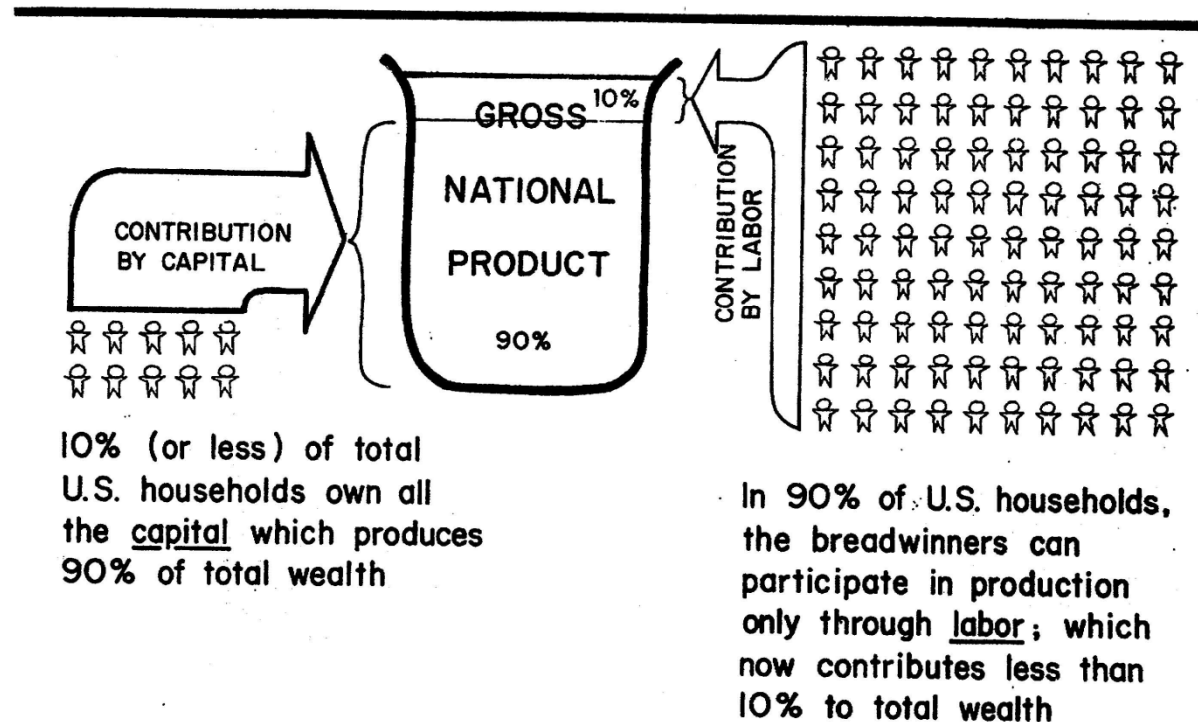


*Fig. 5 – 9. Overall human productiveness as a proportion of total input shifts downwards whilst capital asset productiveness shifts upwards.*

# Income Proportion: Human Labour/Capital Ownership

is becoming more and more disadvantageous to the worker:

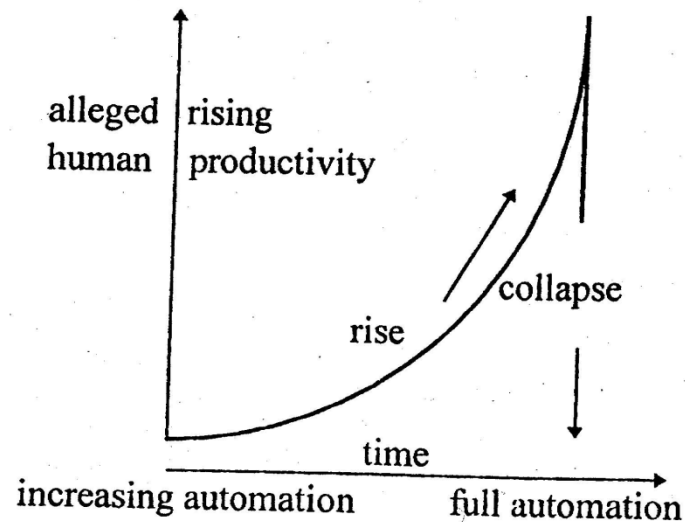
Concentration of ownership of productive capital in  
USA *in 1965*



## Example Germany, from 2003 until 2007

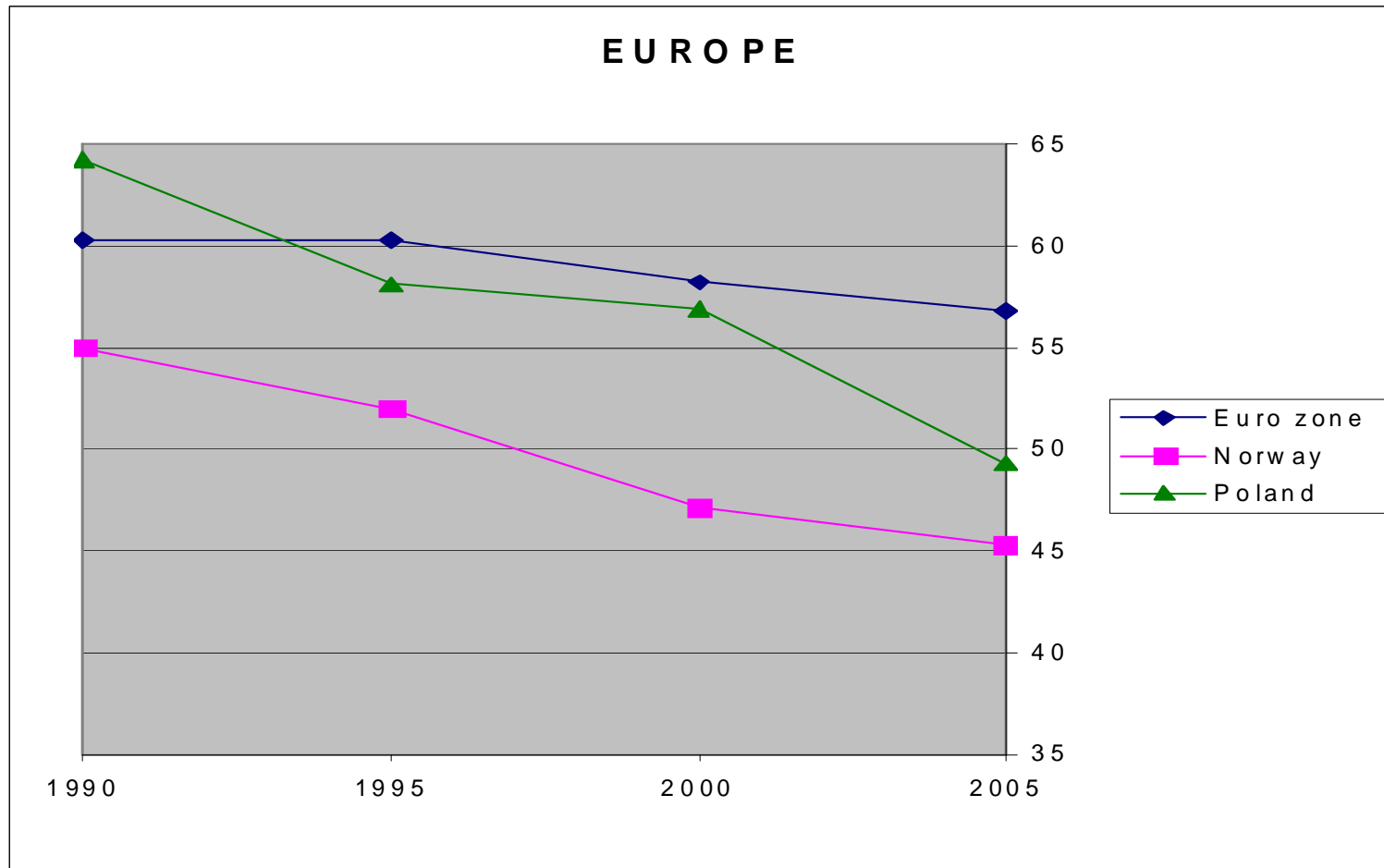
- Corporate and Capital Income rose by 37.6 per cent
- while the average Employee Income increased only by 4.3 per cent.

# Automation accelerates to this shift: low income sector increases – „Working Poor“



*Fig. 5 – 7. As more automation is introduced into individual tasks, conventional human productivity is exposed as being self-contradictory.*

# Wage share evolution in Europe, 1990-2005



Source: D. Vaughan-Whitehead, 2008 - ILO.

# From a legal and socio-economical point of view

## The Problem:

Most citizens in industrial society belong to category of non-owners

“Society of owners” simultaneously has to be understood as a “society of non-owners”

Social groups of owners and non-owners are drifting apart dramatically

## The Solution?

### Marxist Way:

- depriving private owners of their private property,
- thus eliminating private property at all

### Kelsonian Way:

- enable non-owners to become owners,
- participating as shareholders in the economical success / risk of their work

# Employee-owned companies have intrinsic advantages

In a globalised competitive environment

- They anchor both production and distribution in local communities.
- They generally do not move their headquarters or manufacturing operations to countries with the lowest costs.
- Profits distributed to employee shareholders generally do not end up in off-shore accounts.

Thus the income arising from production

- paid to workers as wages,
  - to suppliers as payments for goods and services
  - and to shareholders as dividends
- ends up in the pockets of those more likely to spend their income in the places where they live and work.

# **Does it matter who owns European SMEs?**

## **„Mature market economies“ have a massive Business Succession Problem**

### **Commission Communication 2006**

Due to aging of Europe's population

30% of entrepreneurs will withdraw  
within next 10 years

mainly those running family enterprises

This affects up to 690,000 SMEs and 2.8  
million jobs across EU *every year*

Primarily mature market economies:  
610.000 in EU-15

### **Who will the new owners be?**

Private Equity firms?

Sovereign wealth funds?

Hedge funds?

Oligarchs?

European conglomerates?

Or the companies' own  
employees...

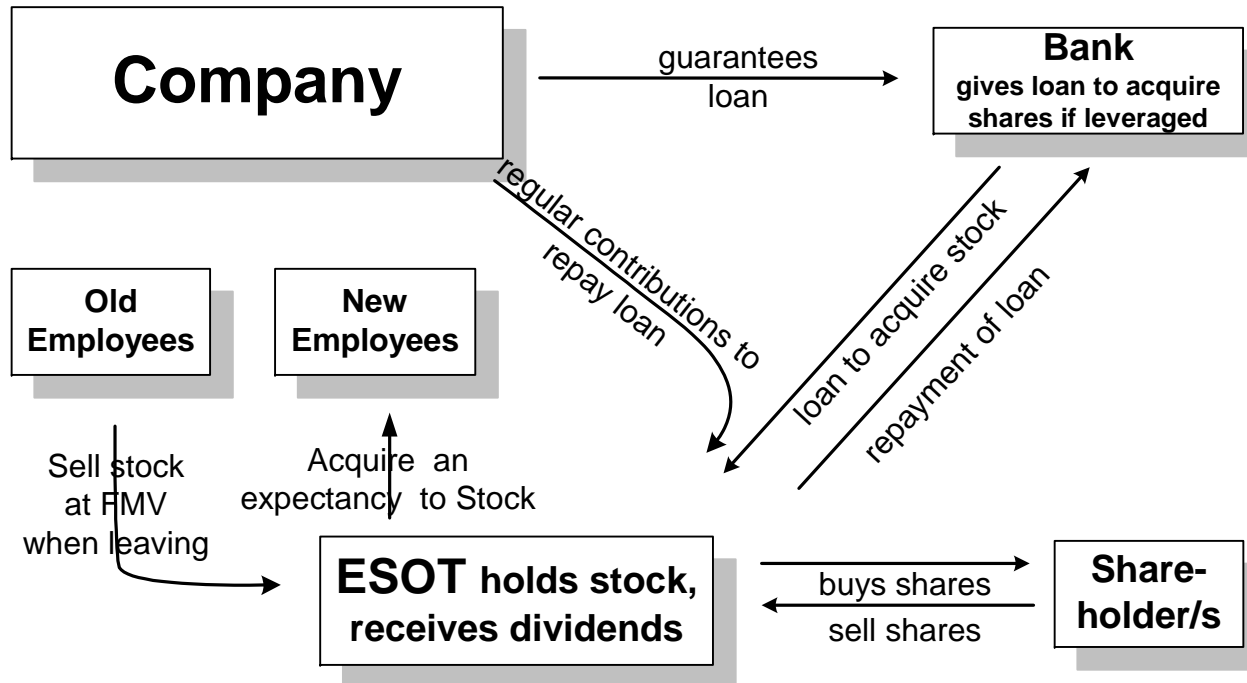
**Thus the identity of the new owners is already a serious policy question**

# **European Employee Stock Ownership Plans**

## **Acquisition of Shares via a Trusteed Fund is financed by a Profit Share paid in Addition to Wages**

- **Company sets up Employee Stock Ownership Fund (ESOP-Fund)**
  - Continental Europe: Corporation/Foundation/Association
  - UK / Ireland (Common Law): as a rule a Trust
- **Acquisition of Shares financed by a Combination of**
  - Company Contributions and Borrowings
  - Credit directly from Bank or from Company (takes Loan from other Lender)
- **Loan may be repaid by**
  - Direct Cash Contributions from the Company to the ESOP-Fund,
  - Dividends on the Shares held by the ESOP-Fund
  - Employees benefits from a Profit-sharing Scheme
- **ESOP-Fonds holds Shares in Trust for Employees**
  - Shares allocated to individual accounts/distributed after holding period
  - Period determined by Trustee, driven by the need to repay borrowings

# ESOP as a Vehicle for Business Succession in SMEs



- ✓ **Internal Market in unlisted SMEs without source of Liquidity**
  - ✓ **No Dilution in Equity per Share of current Stockholders**
  - ✓ **Attractive Alternative to selling the Business to Outsiders**
    - ✓ **Creates Market for retiring Shareholders at acceptable Price**
    - ✓ **Ownership transferred gradually to Employees - Firm remains local**

# EESC Initiative Report SOC 371 of 21 Oct. 2010

## Implementation at European Level?

### Supranational Instruments:

- Decree: Collision with National Legislation
- Directive on Financial Participation (Highly unlikely)
- Amending existing European Company Law, i.e. ECS  
(Time consuming and limited by competences)

EESC calls for:

- a **new Recommendation on EFP** based on *“Building Block Approach”*
- and **support by EU Budget** through *a Dedicated Budget Heading*

But: Not legally binding & Implementation in the Member States uncertain

Possible solution: Mutual Recognition Procedure by Member States

*“Building Block Approach”* details at <http://www.intercentar.de/en/research/focus-financial-participation-of-employees/>

also: - *“Financial participation for a new Social Europe”*, downloadable in English, French, German, Italian and Polish

- *“PEPPER IV Report – Assessing and Benchmarking EFP in the EU-27”*, updated summaries in EN/DE/FR/IT/PL

General Charles de Gaulle

***“To stick to wages alone is to maintain a permanent class struggle.”***

# Annex 1: Endorsement of EFP at EU-Level

“PEPPER III Report” 2006, foreword by Vice-President of EU Commission **Guenther Verheugen** > link to “Lisbon Strategy”

Dec. 2006: Assemble Nationale Report recommends “Building Block Approach”; 2008 Minister **Cristine Lagarde** endorses EU-Model

“Financial Participation for a New Social Europe” (EN/FR/DE) 2008, foreword by **Hans-Gert Pöttering**, then President of the EU-Parliament

“PEPPER IV Report” 2009, foreword by **Jean-Claude Juncker**, President of the Eurogroup, Prime Minister of Luxemburg

“La partecipazione finanziaria per una nuova Europa sociale” (IT) 2009, foreword **Mario Sepi**, President of the European Economic and Social Committee

Autumn 2010: Launch of EESC Initiative-Report on EFP (Rapporteur: **Alexander Graf von Schwerin** / Co-Rapporteur: **Madi Sharma**)

“Partycypacja finansowa w Nowej Europie Socjalnej” (PL) 2010, foreword by **Jerzy Buzek**, President of the EU-Parliament

Topic on the Work-Programme new EESC President **Staffan Nielsson** who hosts new Commission funded Project “**Week of EFP**” (<http://www.intercentar.de>)

## **Annex 2: The U.S. Experience in Numbers**

**As of 2007 around 11,000 ESOPs, covering 10 mln. employees**

**ESOP part of social/economic fabric of corporate America**

- Over 50% of *Fortune* 500 companies sponsor ESOPs
- Over 40% of *Inc.* magazine's 100 fastest growing private companies sponsor ESOPs

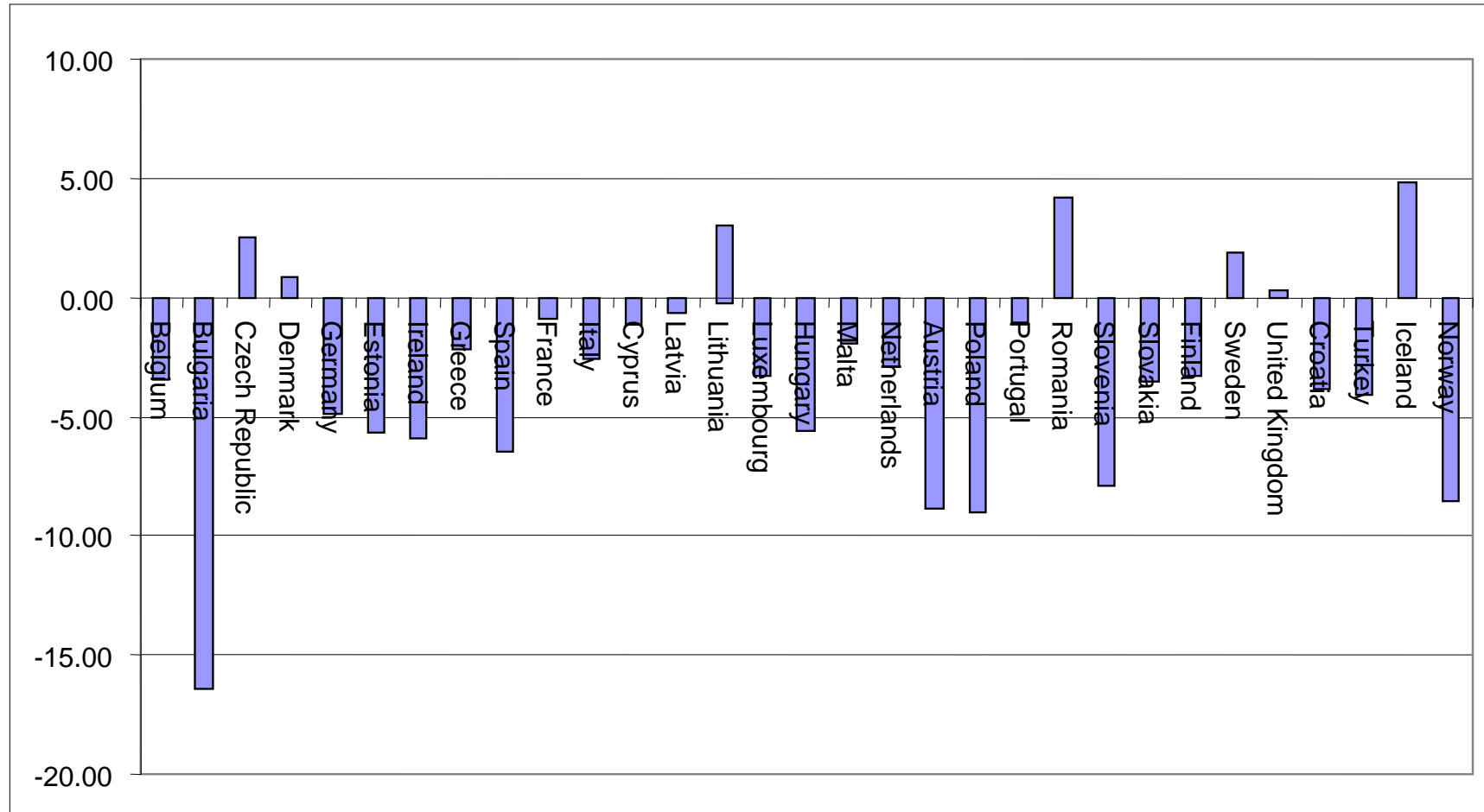
**Vast majority sponsored by privately-held firms**

- of which about 3,500 majority and
- 2,000 100% owned by ESOP

**2004 survey:** out of 108 million people in the private sector,  
21% of employees own company stock,

**The median value** of the employees' company stock ownership is over  
one-fifth of their annual pay

# Annex 3: Changes in Wage Share, 1996-2007



Source: D. Vaughan-Whitehead, *The Minimum Wage Revisited in the Enlarged EU*, 2010, Edward Elgar-ILO.

# **Annex 4: A “Common Ground” – the 2<sup>nd</sup> Council Directive on Company Law 77/91/EEC**

Allows MS to deviate from rules governing listed and unlisted Joint Stock Companies (Optional)

## **Art.19 III**

Permission to acquire companies own shares for its employees, limit: 10% of equity capital MC

**MC Implemented in 17**

**but possible in 26**

**CC Implemented in 1**

**not possible in 1**

## **Art.23**

Permission to advance funds, make loans, provide security, with a view to acquisition (Financial Assistance)

**MC Implemented in 22**

**CC Implemented in 1**