

# **Employee Financial Participation in Public Services in the European Union**

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A study commissioned by CEEP under the framework of a project co-funded  
by the European Commission

April 2012

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# Employee Financial Participation in Public Services in the European Union

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## Abstract

This is the first study of the extent of Employee Financial Participation (EFP) schemes in enterprises providing Services of General Interest (SGIs) in the European Union.

The study is divided into five chapters. The first chapter provides a systematic overview of the forms of EFP practised in the European Union. Chapter two utilizes the information on some 8,000 SGI enterprises from the European Company Survey (2009) to analyse the existence (or lack) of EFP schemes in different branches of public services. It compares the level of development of the schemes in public services with that in other sectors of the economy. The data shows that the extent of EFP varies widely in different branches of public services with a much higher level in utilities and a much lower in public administration. This broad statistical picture is supplemented by case studies of fifteen public service enterprises in France, Italy, Spain, Sweden, Finland and the United Kingdom through in-depth interviews and the analysis of legal arrangements regarding EFP in these six countries.

Chapter three reviews the nature of employee financial participation in public administration in three EU Member States: Germany, Sweden and the United Kingdom. Chapter four analyses the development of conditions and institutions affecting the participation of employees in the financial results of their company in the new Member States (and candidate countries) of the European Union in the specific conditions of transition to a market economy. Finally, a review of the literature on financial participation of employees summarises the previous research on the subject in chapter five.



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## Abbreviations

<b>CC</b>	Civil Code
<b>EBIT</b>	Earnings before interest and taxes
<b>EESC</b>	Economic and Social Committee
<b>EFP</b>	Employee financial participation
<b>ECS</b>	European Company Survey
<b>ESO</b>	Employee share ownership
<b>ESOP</b>	Employee Stock Ownership Plan
<b>EU</b>	European Union
<b>EVA</b>	Economic value added
<b>EWCS</b>	European Working Conditions Survey
<b>FCPE</b>	Fonds communs de placement d'entreprise
<b>GS</b>	Gain sharing
<b>IPO</b>	Initial public offering
<b>ITL</b>	Income Tax Law
<b>LLBO</b>	Leveraged lease buyout
<b>NACE</b>	Nomenclature statistique des activités économiques dans la Communauté européenne (Statistical Classification of Economic Activities in the European Community)
<b>PEE</b>	Plan d'épargne d'entreprise
<b>PEPPER</b>	Participation by Employed Persons in Profits and Enterprise Results
<b>PERCO</b>	Plan d'épargne pour la retraite collectif
<b>PIT</b>	Personal income tax
<b>PPP</b>	Public-private partnership
<b>PrivL</b>	Privatisation Law
<b>PRP</b>	Performance-related pay
<b>PS</b>	Profit sharing
<b>SGIs</b>	Services of general interest
<b>SME</b>	Small and medium-sized enterprises
<b>SO</b>	Stock options
<b>STI</b>	Short-term incentive system
<b>TFEU</b>	Treaty on the Functioning of the European Union
<b>UK</b>	United Kingdom



# Introduction: The setting of EFP in Europe and the implications for its implementation in services of general interest (SGIs)

*Jens Lowitzsch and Iraj Hashi*

## ***I. Scope of the project***

In the past, scientific literature as well as political discussions on employee financial participation (EFP) almost exclusively focused on private-sector activities. In contrast, the role of EFP schemes in enterprises providing SGIs (commonly referred to as public services) was widely neglected. Considering the very low ratio of EFP schemes in these firms reported in this study, this is not surprising.

*The role of EFP in enterprises providing SGIs has been less studied*

### **1. Services of general interest: Definition with regards to EFP**

For the purpose of this report, we use the term SGI as defined in the 2010 CEEP mapping report (CEEP, 2010). In terms of EFP, the character of the service provider (e.g., state/local administration, or private company, etc.) and the nature of its ownership is important since this will have implications for the implementation of EFP schemes. For example, a state-owned enterprise or a local-administration unit not having share capital cannot implement an employee share ownership (ESO) scheme. On the other hand, a corporation in 100 per cent state ownership may be supplying social services that are not profit-oriented and thus not be able to offer a profit-sharing scheme. This division of 'public services' is reflected in the category of services of general interest (SGI) with its subcategories, i.e., services of economic and of non-economic interest, now referred to in Art. 14 of the Treaty on the Functioning of the European Union (TFEU).

*The character of the service provider and the nature of its ownership will have implications for the implementation of EFP schemes*

However, as these definitions were not developed with EFP in mind, in this study we distinguish between the nature of the service and the ownership status of its provider. A service may be public (e.g., utilities or health), but it may be provided by: a commercial company, being partially or fully either in public or private ownership (e.g., an energy company); a company jointly owned by private and public sector (as in public-private partnership (PPP) arrangements or partially privatised joint-stock companies); a state company/organisation; the public administration or the local government organisation.

*Distinguish between the nature of the service and the ownership status of its provider*

## 2. Structure of the Report

In order to give the reader a brief introduction to the main forms of EFP, we start with a brief systematic overview in **Chapter 1**. The following literature review in **Chapter 2** gives an overview of the benefits and possible pitfalls of EFP in general and—where available—in public services.

Focussing on SGI, **Chapter 3** looks into both the available empirical data as well as the attitudes of social partners. In order to give the reader an idea of the actual incidence of EFP in SGI, we first provide a comparative statistical overview across the EU. As statistical data comprising the public services is scarce, we rely on the European Company Survey (ECS) 2009 data. Then, against the background of the statistical panorama, the analysis of the results of 15 in-depth interviews in companies providing SGI in six EU Member States (France, Spain, Italy, Sweden, Finland and United Kingdom) is presented. Relations and opinions of the social partners towards EFP in general and towards different EFP schemes in particular as well as the legal context are highlighted.

Because the setting for EFP is fundamentally different in the public administration, we have decided to deal with this topic separately in **Chapter 4**. Since public administration—as a rule—is neither profit-oriented nor organised in the form of corporations, the scope for possible EFP schemes is limited and the practice of ‘performance-related pay’ (gain sharing) has become common in some countries.

Finally, **Chapter 5** assesses the background for EFP in Central and Eastern Europe (CEE) and summarizes the legal changes that have affected EFP in the Central and Eastern European new Member States (EU-10)<sup>1</sup>.

Conclusions and Recommendations are presented in **Chapter 6**.

**Annex I** provides overview tables summarising EFP in the six target countries (France, Spain, Italy, Sweden, Finland and United Kingdom) plus Germany and the EU-10. The focus is on social partners’ attitudes and legal changes that affected EFP.

**Annex II** contains a documentation of the interviews.

**Annex III** investigates the financing effects of EFP schemes, referring to companies providing SGI in the form of private corporations, i.e., firms operating under company law, publishing a balance sheet, etc.

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<sup>1</sup> Czech Republic, Estonia, Hungary, Lithuania, Latvia, Poland, Slovakia and Slovenia, which joined the EU on 1 May 2004, Bulgaria, Romania on 1 January 2007.

**II. The specific setting for EFP in companies providing SGI**

Following the functional distinction described in the introductory paragraphs, for the purpose of this study, SGI are divided into four broad categories provided by the four types of organisations mentioned above:

- i. private companies (i.e., full or majority private ownership);
- ii. public administration bodies;
- iii. public/state-owned enterprises;
- iv. commercial companies set up either as a PPP or for externalising the activities of a state-owned company or public body.

Obviously the first category (e.g., a privatised electricity company, where the state may at best be a minority shareholder) does not require any further explanation here as—with regards to implementation of EFP schemes—it does not differ from classical private sector firms. As the specific situation of EFP in public administration is separately dealt with in Chapter 4, the following paragraphs and table focus on the two remaining options (iii, iv).

**Table 1. EFP possibilities in enterprises providing SGIs in full/partial state ownership**

<i>iii. Public / State-owned enterprises</i>		<i>iv. Different forms of commercial companies</i>		
<i>State-owned / majority state-owned joint-stock companies</i>	<i>100% publicly owned enterprises governed by specific laws</i>	<i>Public-private partnership (joint provision of public services)</i>	<i>Externalisation (outsourcing)</i>	<i>Spin-out ('right to demand')</i>
Joint-stock companies only constitute a minority among companies in state-ownership and are mainly found on the national (administration) level. Employees may receive or be enabled to buy company shares and thus become minority (or small) shareholders of the state-owned company. All EFP schemes are possible.	As these enterprises are entirely owned by state authorities, granting shares to employees is not an option.  Profit/gain sharing or performance-related pay (see Chapter 3 on EFP in public administration) may be practised.  Only profit/gain sharing or performance-related pay are possible.	With regards to the public actor of the PPP constellation, the possible introduction of EFP is described in the second column of this table; only profit/gain sharing or performance-related pay are possible.  For the private partner, the rules for private-sector companies apply.	Both provider and provision are outsourced to the private sector and the rules for private-sector companies apply.  All types of EFP schemes are possible.	Together with the ownership, the responsibility for the service is transferred to employees (and sometimes private investors); the rules for private-sector companies apply.  All types of EFP schemes are possible.

State-owned companies can be organised in several different ways, i.e. according to public or private law, entirely state-owned or with a non-state minority shareholder, etc. Hence, the possibilities to implement EFP schemes in state-owned companies vary and depend on their respective organisational forms. Generally, employee share-ownership schemes are rather unlikely in such enterprises. If the service is sold then, there is possibility of profit or gain sharing. But if the service is free (or largely free) for customers, then, there is no profit to share and performance-related pay (PRP) becomes the only vehicle. Under profit sharing (PS), employees may receive a bonus according to the performance of the entire enterprise or of a certain part of it and payments may be based on individual or group performance. In the case of performance related pay the bonus will be treated as a variable proportion of an employee's remuneration rather than as a share of the company's profit.

Two forms of private companies supplying SGIs may be distinguished: public-private partnership (PPP), where public and private actors jointly supply the SGI, and outsourcing (or externalisation), where a private company is authorised to provide the service. Additionally, UK authorities have developed the concept of the so-called spin-outs (It's our business, 2011)<sup>2</sup>, which could be described as an externalisation of both the service and the provider through employee buyouts.

### III. Background and context

*The past decade has seen a significant expansion of EFP in the EU-27*

A review of the more than 30 years covered by PEPPER<sup>3</sup> Reports indicates that EFP, though slow to take off, has picked up surprising momentum. In fact, the 2009 PEPPER IV Report presents conclusive evidence that the past decade has seen a significant expansion of employee financial participation in the EU-27. This is true of both profit sharing and employee share ownership, although profit sharing is more widespread. The CRANET<sup>4</sup> survey showed that between 1999 and 2005, the percentage of companies offering broad-based share ownership schemes increased from an average of 13 to 18 per cent; for profit-sharing schemes, the increase was from 29 to 35 per cent (weighted country averages for all countries included in both samples).

<sup>2</sup> However, the UK spin-outs have been mainly brought about as a result of the governments austerity programme (see UK Interview report below).

<sup>3</sup> PEPPER = Participation by Employed Persons in Profits and Enterprise Results.

<sup>4</sup> This is a survey of companies with more than 200 employees undertaken by the Cranfield School of Management (Cranfield University, UK) approximately every four or five years. It is largely a postal survey, sent to the Human Resources Departments of companies with the main aim of investigating the HR characteristics and practices.

On the other hand, the EWCS<sup>5</sup> data showed that the percentage of company employees taking advantage of these schemes is much less although it is also growing. Here the availability of the new European Working Condition Survey (EWCS) 2010 enables us to compare the growth of the take-up rate of EFP schemes over a decade. The proportion of employees taking up ESO schemes increased from a weighted average of 1.44 per cent in 2000 to 2.34 per cent in 2005 and 3.28 per cent in 2010. Over the same period, the proportion of employees participating in PS schemes rose from 6.42 per cent in 2000 to 9.06 per cent in 2005 and then 13.50 per cent in 2010.<sup>6</sup>

This background section describes the setting of EFP in Europe in order to investigate the implications for its implementation in SGI in depth in the following chapters.

### 1. EU initiatives with regards to EFP

The 1992 Council Recommendation<sup>7</sup> encouraged all Member States to actively promote EFP formulating—among others—the basic principle that financial participation should cover all workers. However, the vast majority of EFP schemes apply to private limited or public limited companies, where implementation is relatively simple. Certain types of enterprise, particularly in the non-profit sector—and thus their employees—are either excluded from this possibility by definition or have very limited access to this arrangement. Most recently, policy actions to extend broad-based EFP schemes to SGI were called for by the European Economic and Social Committee (EESC)<sup>8</sup> stressing the significance of EFP particularly with a view to the EU 2020 Strategy. However, the subject so far has received little attention in research and it remains unclear to what extent such claims are feasible.

In an effort to promote a European approach to EFP, the Commission published a Communication in 2002 on a framework for the promotion of employee financial participation.<sup>9</sup> Opinions drafted by the EESC and a European Parliament resolution with a subsequent Parliament report further underline the importance of financial participation, particularly in relation to small and medium-sized enterprises (SMEs). In order to link various EFP models

*The vast majority of EFP schemes apply to private companies only.*

*The European Commission has promoted work on a 'Building Block Approach'*

<sup>5</sup> The European Working Conditions Survey is a large-scale survey of working conditions across Europe undertaken by the European Foundation every four or five years to investigate a variety of factors influencing individuals working and living conditions.

<sup>6</sup> In calculating weighted averages, the population of each country is used as its weight.

<sup>7</sup> Concerning the promotion of participation by employed persons in profits and enterprise results 92/443/EEC.

<sup>8</sup> Own-initiative opinion of the European Economic and Social Committee on employee financial participation in Europe SOC/371 of 21 October 2010.

<sup>9</sup> On a framework for the promotion of employee financial participation, COM(2002) 364 final.

used in EU Member States, the European Commission has promoted work on a ‘Building Block Approach’, which includes all forms of financial participation practiced (Lowitzsch, 2008). Endorsed by the EESC and based on the principle of voluntariness, this approach takes into consideration existing national participation models and best practice with regards to both the type of participation scheme and the possible incentives.

## 2. Social partners’ attitudes towards EFP

*Low priority of EFP on social partners’ agenda in the past*

We observe a generally low priority of EFP schemes on social partners’ agenda. In the past,—with some exceptions—neither unions nor employers’ organisations have attached much importance to the issue of employee financial participation throughout the EU. Employer organisations almost universally oppose obligatory schemes. Even when they support the introduction of tax incentives for EFP schemes, they almost always advocate leaving the actual decision about whether to introduce schemes or not to the company, on a voluntary basis. In some countries, union attitudes tend to constitute a fairly significant barrier to the promotion and expansion of EFP schemes.<sup>10</sup>

*However, the last decade has seen an increase in support for EFP*

The, EU eastward enlargement does not seem to have enhanced the climate for EFP significantly. Slovenia is the only country among the new Member States and candidate countries, where the social partners on both sides of the employment relationship have had very supportive attitude toward EFP in the last two decades. However, e.g., in Poland most recently there is a positive development and more interest in the topic.

In general, the last decade has seen an increase in support for EFP schemes over time. Trade unions are largely shifting from scepticism to more supportive attitudes. But this does not only affect trade unions; in France and the UK for example, we observe a similar shift in the stance of the employers’ associations.

<sup>10</sup> Unions generally reject precisely that aspect of profit sharing (substitution for inflexible wages) which would give it positive effects on employment; they seem unwilling to accept income insecurity in exchange for greater employment security, though this may be motivated by fears concerning to the ability of management to manipulate profit accounting. (See PEPPER IV Report, 2008, p. 84)

### 3. The gap between old and new Member States of the EU

The developments in the new Member States of Central and Eastern Europe (see the PEPPER III Report) have been rather different. Very few laws specifically address EFP, and these refer almost exclusively to employee share ownership<sup>11</sup>; legislation on profit sharing is rare. Although employees were frequently offered privileged conditions for buying shares of their employer companies, the aim was not to promote EFP. Rather, this method was simply an expedient method for privatising state-owned enterprises for which at the time there were no buyers. Essentially it was a decision made by default (Uvalić & Vaughan-Whitehead, 1997). The comparative analysis of the general attitude of governments and social partners shows the lack of concrete policy measures supporting EFP schemes, as well as limited interest of both trade unions and employer organisations.<sup>12</sup> Rather than being actively promoted as in some old EU Member States, EFP has most frequently not even been considered, or is viewed with suspicion.

*In the EU-10, the development of EFP has been different*

However, against the background of the different genesis of EFP schemes in the old and the new EU Member States, it is surprising that the data examined in the benchmarking project seem to indicate that a West-East divide exists only with regard to profit sharing (see below Chapter 5).

### 4. Mobility and portability — Mutual recognition of EFP

One important issue in the incidence of EFP throughout the EU affecting both employees and employers is the problem of mutual recognition of EFP arrangements in different countries. The most common obstacles are different legal frameworks and the taxation of the benefits. The legal framework supporting a specific EFP scheme in one Member State cannot be easily, and without problems, transferred to other Member States. Similarly, participation schemes across different Member States are subject to different types of tax (e.g., income tax or capital gains tax) as well as different rates of tax. A related problem is the position of employees moving from one country to another and facing different tax and benefit rules.

*The most common transnational obstacles to EFP are different legal frameworks and the taxation of the benefits*

<sup>11</sup> Employee share ownership has largely developed in the course of privatisations, with different methods including sales of shares to insiders on privileged terms; employee-management buyouts; leasing; mass privatisation, and ESOPs and ESOP-type schemes.

<sup>12</sup> Only occasionally have trade unions been supportive of employee ownership, but they remain rather critical of profit sharing. The employers have been generally indifferent towards financial participation, despite a few cases of active support (as in the case of ESOPs in Hungary).

*Solution: Development of a mutual recognition procedure for EFP schemes*

One solution could be the development of a mutual recognition procedure by Member States for financial participation schemes. In this way, the possibility to apply the incentives offered in the country of origin for a scheme ‘imported’ from abroad could serve for similar schemes in the country of recognition. Examples that this procedure may work exist, as in Germany with the recognition of the French FCPE (a vehicle unknown in Germany) and its deferred taxation being extended to German schemes similar to the FCPE.<sup>13</sup>

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<sup>13</sup> Circular released on 8 December 2009 by the German Federal Ministry of Finance “On the Taxation of Capital Gains starting in 2009” (§ 3 Nr. 39, § 19a EstG — Law on Income Tax); reference number IV C 5 - S 2347/09/10002; Doc 2009/0810442.



## Chapter 1. EFP — A systematic overview

*Jens Lowitzsch and Stefan Hanisch*

### **I. Introduction**

Employee financial participation refers to any scheme, which enables employees to participate in profits and enterprise results. (Uvalić, 1991) In this report, we distinguish between profit sharing (including gain sharing) and employee share ownership (excluding executive stock options). This distinction is important since there are fundamental differences between the two (e.g., in taxation). A third type of financial participation is through asset accumulation or employee savings plans which offer a vehicle to allocate and invest sums received in other schemes. Financial participation, therefore, provides employees with a form of remuneration that is in addition to the regular pay system.

Thus, the term ‘financial participation’ refers to all schemes, which give employees, in addition to a fixed wage, a variable portion of income directly linked to profits or some other measure of enterprise performance (Vaughan-Whitehead, 1995, p. 2 ff.).<sup>14</sup> The main feature of this bonus is that it is specifically linked to enterprise results and is not just a predetermined proportion of pay. There are two basic ways in which employers can distribute the financial results of improved enterprise performance to their employees: profit sharing and employee share ownership (which are often combined).

### **II. Profit sharing**

In profit sharing, part of an employee's remuneration is directly linked to the profits of the enterprise. This can be collective or based on individual incentives. The formula, depending on the national scheme, may include profits, productivity or return. Since profit-sharing schemes are related to measures of company performance in general, they are perhaps the most widespread form of financial participation.

Although profit-sharing bonuses can take several different forms, two main types should be distinguished:

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<sup>14</sup> Vaughan-Whitehead includes gain sharing in the definition of financial participation.

### 1. Deferred profit sharing

Distribution on a deferred basis, commonly covered by the term 'deferred profit sharing', with the bonus being:

- i. invested in enterprise funds or frozen in special accounts for a specific period;
- ii. granted as a number of shares in the company, frozen in a fund for a certain period before employees are allowed to sell them (deferred share-based profit sharing).

### 2. Cash-based profit sharing

Direct payment of profit-sharing bonuses to the workers in cash, is usually referred to as 'cash-based profit sharing'.

### 3. Gain sharing

A related form of financial participation is gain sharing, which is designed to provide variable pay, and usually to encourage employee involvement, by rewarding employees for improvements in individual and organisational performance. Gains, measured by a predetermined formula, are shared with employees, usually through cash bonuses. Gains constitute an addition to the basic salary paid to all employees, usually in order to reward individual or small unit performance. The formulas for measuring employee performance vary considerably; piece rates and productivity bonuses are most common, but other performance indicators may be employed, such as profit, productivity, costs, sales, etc. (Vaughan-Whitehead, 1995, p. 2 ff.)

### 4. Performance-related pay (PRP) in public administration

PRP is an opportunity for employees to receive in addition to their wage/salary a variable part of remuneration. PRP may be qualified as profit sharing (if related to unit or group performance) or gain sharing (if related to individual performance) when productivity can be measured and performance assessed. Profit sharing is usually linked to an increase in the company's results (measured, e.g., as productivity) resulting in higher corporate profits. In case of public administrations, actually not generating profits, it is only possible to participate in the increase of productivity. For instance, civil servants from Registration Departments or Public Administration Offices may obtain additional pay when processing a certain number of applications (e.g., identity cards or passports) in a limited and agreed period. In some cases, additional pay would depend on whether the employee has met the targets agreed at the beginning of the period.

### III. Employee share ownership

Employee share ownership is the second major form of financial participation. Funds can be raised either from the company or from employees. In the latter case, employees might voluntarily purchase company stock (thus acquiring equity) or might lend money to the company or purchase company bonds (thereby increasing corporate debt).<sup>15</sup> In the case of company equity, the shares are transferred directly or indirectly to employees, who may receive dividends and/or capital gains that accrue to company shares.

Employee share ownership in practice—whether shares are held individually or under some form of trust—does not automatically entitle employee shareholders to have a say in the operation of the company.<sup>16</sup> Employees may be issued either non-voting stock or voting shares, but they have little or no control over the management of shares held in trust. Trustees may be appointed by management rather than elected by employees.

#### 1. Direct purchase of shares / Share savings plans

At one end of the spectrum of models, there are various forms of ‘share plans’ in which shares are distributed free or sold at market price (non-discounted) or on preferential terms.<sup>17</sup> These preferential conditions can be sale at a discount rate (discounted stock purchase plan), sale at a lower price through forms of delayed payment (usually within a capital increase), or by a grant of priority in public offerings to all or a group of employees. (Vaughan-Whitehead, 1995, p. 2) Finally, the purchase may take place through periodic deductions from pay, with or without the employer’s matching contribution or bonus. When the employer does contribute an (equal) amount in cash or shares, the plan is called a ‘share savings plan’.

Other forms of direct purchase include producer co-operatives, in which its workforce owns all the firm’s shares, and employee buy-outs, under which exclusively its individual workers purchase company shares.<sup>18</sup> For example, Poland implemented an employ-

<sup>15</sup> In the case of corporate debt, no share ownership is generated, and the revenue of the employees takes the form of interest and principal payments or only interest payments if a debt to equity swap is foreseen later. If employees are holding bonds from the company, they receive dividends.

<sup>16</sup> In the majority of cases in the U.S. and France (outside workers’ co-operatives), employee share ownership is associated with little or no employee influence on entrepreneurial decisions. Even if they hold the largest block of shares, employee shareholders are not automatically represented on the board of directors. (Pérotin, 2003, p. 8)

<sup>17</sup> E.g., in Great Britain, see Treasury Public Enquiry Unit (1998); also Nuttall (1999). As to the ‘method of choice’ in Eastern Europe, see Weitzman (1991).

<sup>18</sup> Often dominated by managers, especially in the U.S. form of management-led buyouts.

ee buy-out programme in the context of privatisation, which took the form of so-called leveraged lease buy-outs (LLBO) (Jarosz, 1995; Jarosz, 1996; Jarosz, 2000).

## 2. Individual stock options

Individual stock options are call options on the common stock of a company, issued as a form of cash compensation. Restrictions on an option (such as vesting and limited transferability) attempt to align the holder's interest with those of the business shareholders. If the company's stock rises, holders of options generally experience a direct financial benefit. These stock options are mostly offered to management as part of their executive compensation package. They may also be offered to non-executive level staff, especially by businesses that are not yet profitable, insofar as they may have few other means of compensation.

## 3. Broad-based stock options

Employee stock options (Pendleton, Blasi et al., 2002; PriceWaterHouseCoopers, 2002), unlike those granted to individual employees or small groups (especially managerial) to reward individual performance ('executive stock options'), are broad-based. The company grants employees options over shares, which entitle them to acquire shares in the company at a later date, but at a price fixed when the option was granted. The option has an expiration term and a vesting period commencing with the grant date. It can take various forms, mainly depending on grant and exercise price.<sup>19</sup> The possibility of gains arising from upward movements in stock prices is the primary reward emanating from options. Unlike 'conventional' options, employee stock options—as a rule—cannot be traded, and the holder usually cannot hedge against the risk of declines in option value. Furthermore, employee stock options normally are subject to forfeiture prior to vesting should the employee voluntarily leave the firm.

## 4. Employee stock ownership plans

Forms of share ownership, where a profit share paid in addition to wages, e.g., Employee Stock Ownership Plan (ESOP), finances the acquisition of shares via a trustee fund, exist in different European countries. This is normally done via a separate intermediary entity, which manages the shareholding held in trust for employees<sup>20</sup> (as for instance in British and Irish ESOPs) or, at the enter-

<sup>19</sup> Johnson and Tian (2000) distinguish six types: premium options, performance-vested options, re-priceable options, purchased options, reload options, and indexed options.

<sup>20</sup> In continental Europe, this is usually a limited company, foundation or association, in the UK and North America it is a trust.

prise level using the combination of a savings plan and a mutual investment fund (e.g., in France using PEE<sup>21</sup> and FCPE<sup>22</sup>).

In the United States (Blasi and Kruse, 1991), the most popular form of employee share ownership is the ESOP (in 2010 around 11,500 plans with more than 10 million participants representing more than private sector union members) (Kelso and Kelso, 1991), which has also been implemented in Europe<sup>23</sup> and Japan (Jones and Kato, 1995, pp. 391-414). An ESOP usually involves a loan to an employee benefit trust, which acquires company stock and allocates it through periodic contributions to each employee's ESOP account. The loan may be serviced by payments from the company out of company profits, out of dividends paid on the stock held by the ESOP or (in rare instances) from employee salary reductions.

### 5. Privatisation-related voucher/coupon schemes

In post-socialist countries, employee share ownership developed in the process of privatisation: in the form of shares, which were distributed or sold to employees of privatised companies, or through the use of vouchers or coupons that were distributed to all citizens. Although the second option does not correspond strictly to the definition of financial participation, under which only the workers of the company should be involved, it can lead in practice to substantial employee share ownership.

Thus, for example, voucher privatisation in Slovenia, Poland and Croatia created the opportunity for employee ownership in conjunction with the privatisation process. Although the privatisation framework did not aim at the creation of employee ownership by giving employees the right to acquire shares of their companies under favourable conditions, neither did it prevent employees from converting their vouchers into shares of the employer enterprises. Some companies (e.g., in Slovenia) did explicitly encourage employees to invest in their shares (Uvalić & Vaughan-Whitehead, 1997).

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<sup>21</sup> Plan d'épargne d'entreprise.

<sup>22</sup> Fonds communs de placement d'entreprise.

<sup>23</sup> E.g., for the U.K., see Walley and Wilson (1992), pp. 126-151; for Hungary, see Galgóczi and Hovorka (1998).

## Chapter 2. EFP in services of general interest

### *1. A statistical overview (European Company Survey 2009)*

*Iraj Hashi and Alban Hashani*

The European Company Survey (ECS) was conducted in 2009 with nearly 30,000 establishments in the EU and three candidate countries, Croatia, Macedonia and Turkey (EU-30).<sup>24</sup> It contains the latest available data on the extent of EFP in European companies and, most importantly, the only dataset containing public as well as private enterprises. This section reviews some of the broad features of EFP in companies and organisations producing different public services (or services of general interest) in EU countries, and compares them with those in companies producing other goods and services. The dataset contains information on the broad activity of companies in the sample according to one-digit NACE classification (Rev 1.1) and therefore it is possible to identify the incidence of EFP according to the broad activity of the enterprise.

#### **1. Sample and its characteristics**

The ECS 2009 was carried out in a representative sample of establishments employing more than 10 people<sup>25</sup> from all sectors of activity, except for agriculture (NACE classification Group A) and fishing (NACE classification Group B), which were excluded for practical reasons. In addition, activities of households and extra-territorial organisations (NACE classification Groups P and Q) were also excluded due to their low quantitative importance as regards the universe of the survey. Unlike most other surveys, ECS covers organisations both private companies and publicly owned enterprises (or organisations).

Because of the ambiguities of the term ‘public services’, the classification of companies and organisations producing such services is not always straightforward. This is clear from the mapping document (CEEP, 2010), which identifies the NACE classification of all SGI activities. However, the ECS dataset provides information on the activity of surveyed companies at one digit level only (highest level of aggregation).

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<sup>24</sup> Portugal is excluded from the data on employee share ownership schemes because the data on ESO is not compatible with that in other countries (European Foundation, 2010, p. 41).

<sup>25</sup> By its nature, this survey consists of predominantly small firms, where EFP schemes are less common. Other surveys such as CRANET (used in PEPPER III and PEPPER IV Reports) focus on companies with more than 200 employees and therefore demonstrate a higher incidence of EFP schemes.

**Table 2. Number of sample companies in the services of general interest (SGI) according to country**

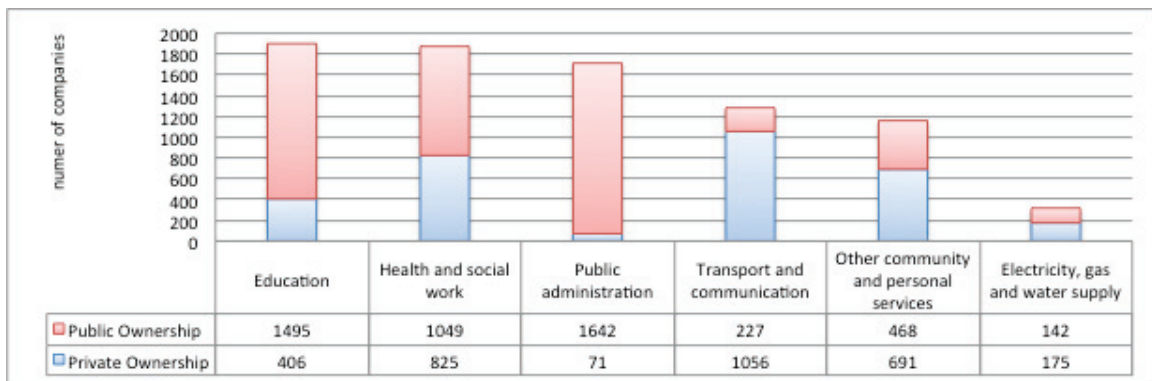
Sector and NACE classification	Electricity, gas and water supply (NACE E)	Transport and communication (NACE I)	Public administration (NACE L)	Education (NACE M)	Health and social work (NACE N)	Other community and personal services (NACE O)	Sample Total
Austria	11	44	43	50	48	71	267
Belgium	13	65	81	92	75	28	354
Bulgaria	4	28	39	36	25	1	133
Croatia	13	16	30	30	30	50	169
Cyprus	3	24	20	31	16	15	109
Czech Republic	24	55	61	95	51	74	360
Denmark	13	35	21	72	171	64	376
Estonia	8	39	25	22	22	15	131
Finland	18	48	95	37	66	51	315
France	11	90	42	68	65	70	346
Germany	11	50	140	54	171	80	506
Greece		16	31	30	35	25	137
Hungary	19	40	93	112	28	19	311
Ireland	22	65	139	99	198	78	601
Italy	13	72	232	136	59	55	567
Latvia	6	33	49	67	35	23	213
Lithuania	8	28	38	74	38	30	216
Luxemburg	3	28	13	7	27	15	93
Macedonia	6	30	20	23	25	7	111
Malta		14	19	26	18	13	90
Netherlands	3	40	26	143	84	23	319
Poland	36	62	89	187	106	69	549
Portugal	10	61	46	26	24	32	199
Romania	7	20	35	30	20	3	115
Slovakia	20	32	28	32	33	26	171
Slovenia	16	21	17	57	42	26	179
Spain	3	40	70	64	50	12	239
Sweden	9	68	33	49	127	72	358
Turkey	6	83	75	84	65	18	331
UK	1	36	63	68	120	94	382
Sample Total	317	1,283	1,713	1,901	1,874	1,159	8,247

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

Therefore, if any SGI activity is a sub-sector of a predominantly non-SGI sector, that activity (and companies involved in that activity) cannot be identified and included in the analysis.<sup>26</sup>

Table 1 shows the total number of establishments producing SGIs in EU countries in 2009, divided according to their main activity (NACE 1-digit Classification). The total number of SGI companies in the survey was 8,274 (the total number of all companies in the survey was 27,160). Although there is some degree of inaccuracy in identifying enterprises producing SGIs (discussed in footnote 26), the table broadly reflects the size of the SGI sector.

**Figure 1. Number of sample companies in the services of general interest (SGI)**



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

Although the number of enterprises in some SGI sectors is very small in some countries (and in the case of a few countries there are no companies in the sample in one sector), there is still a reasonable coverage of all SGI sectors in the sample.

As the survey identifies the ownership of enterprises<sup>27</sup> (public or private ownership), it is interesting to consider the composition of

<sup>26</sup> This means that the data analysed in this chapter only broadly represent SGIs but with some inaccuracies. According to NACE classification, sectors producing largely SGIs are: sector E (Electricity, Gas and Water Supply), sector L (Public Administration and Defence Compulsory Social Security), sector M (Education), and sector N (Health and Social work). None SGI sectors are: C (Mining and Quarrying), D (Manufacturing), F (Construction), G (Wholesale and Retail Trade; Repair of Motor Vehicles, Motorcycles and Personal and Household Goods), H (Hotels and Restaurants), J (Financial Intermediation) and K (Real Estate and Business Activity). Sectors A (Agriculture), B (Fishing), P (Activities of Households) and Q (Extraterritorial Organisations) were excluded by the European Company Survey (European Foundation, 2010). Some SGIs such as Research and Development (sub-sector 73) should be included in SGIs but, given that this sub-sector falls in a non-SGI sector, it cannot be included in the analysis. On the other hand, enterprises in Sectors I (Transport and Communication) and O (Other Public and Private Services) are partly in the SGI sectors (classifications 60.1, 61, 64 for sector I and 92.2, 92.5 and 93.03 for sector O) and partly in non-SGI sectors. But because of the impossibility of separating them, these two sectors are also included in the analysis of SGI enterprises.

<sup>27</sup> The ownership of establishments was determined by question number MM104: Does this establishment belong to the public sector? A: (1) Yes, (2) No, (3) No answer. Companies that selected option (1) Yes, have been treated as being in the public sector. However it must be noted that this question is rather ambiguous and might trigger dif-



the sample according to ownership. Figure 1 shows the number of companies in different SGI sectors by their ownership. As expected, in Education, Health and Public Administration sectors, the majority of companies belong to the public sector while in Transport and Communication and Other Community and Personal Services the majority of sample companies are in private ownership. In Electricity, Gas and Water Supplies, the ownership is equally divided between public and private.

Within the SGI sector, there are wide ranging levels of employee financial participation both in different sectors and in different countries. In the following sections, we will show the level of EFP (both employee share ownership and profit sharing) in different sectors (comparing SGI and non-SGI sectors) and then within each sector in different countries. In all of these, a distinction is made between companies in the private and public ownership. It is important to note that the Survey does not provide any information on other types of employee financial participation schemes such as gain sharing or stock options.

## 2. EFP in SGI and non-SGI sectors

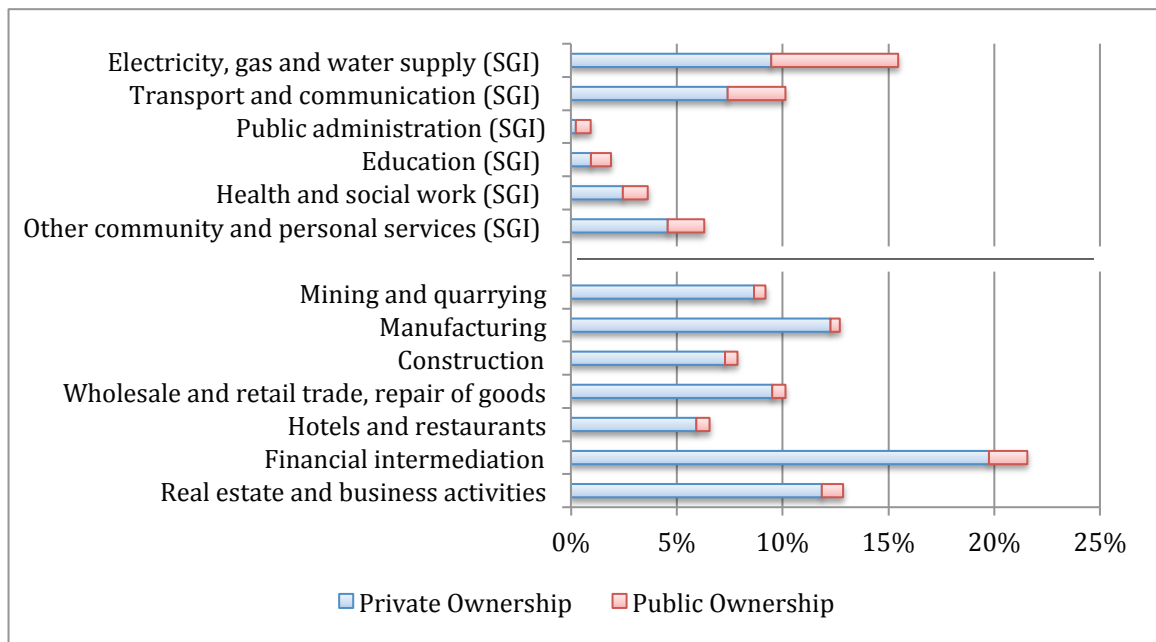
The survey identifies companies that offer narrow and broad-based profit sharing (PS) and employee share ownership (ESO) schemes to their employees. Given the definition of EFP used by the European Commission and institutions (since the early 1990s and the PEPPER I report), and in order to produce results comparable with previous studies (such as PEPPER Reports), we concentrate on the incidence of ‘broad-based’ EFP schemes, i.e., those offered to all employees.<sup>28</sup> Figures 2 and 3 show the incidence of profit sharing (PS) and employee share ownership (ESO) in companies belonging to SGI as well as to other sectors of the economy (on the basis of 1-digit NACE classification) respectively.

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ferent answers depending on whether the respondent refers to ownership or to the activity of the company. For instance, a company in private ownership, which provides public services (especially in education or public administration), might have answered that it belongs to the public sector because of its activity and not its ownership.

<sup>28</sup> The survey asks the following questions regarding profit sharing schemes. Q MM460: Is there any profit sharing scheme offered in this establishment? A: (1) Yes, (2) No, (3) No answer. This is then followed by QMM461: Is this offered to all employees of your regular workforce or is it offered to employees in specific positions only? A: (1) To all employees, (2) To specific categories of employees only, (3) Both types of schemes are offered in the establishment, (3) No answer. For the purpose of this study we have focused on companies which have selected option (1) and (3). Similarly, the following question is asked about employee share ownership schemes. Q MM463: Is there any share ownership scheme offered in this establishment? A: (1) Yes, (2) No, (3) No answer. This is followed by QMM464: Is this offered to all employees of your regular workforce or is it offered to employees in specific positions only? A: (1) To all employees (used as a proxy for broad based scheme), (2) To specific categories of employees only and (used as a proxy for narrow based scheme), (3) No answer. Again, for the purpose of this study we have focused on companies which have selected option (1).

**Figure 2. Percentage of privately and publicly owned companies in all sectors offering broad-based profit-sharing (PS) schemes to their employees**



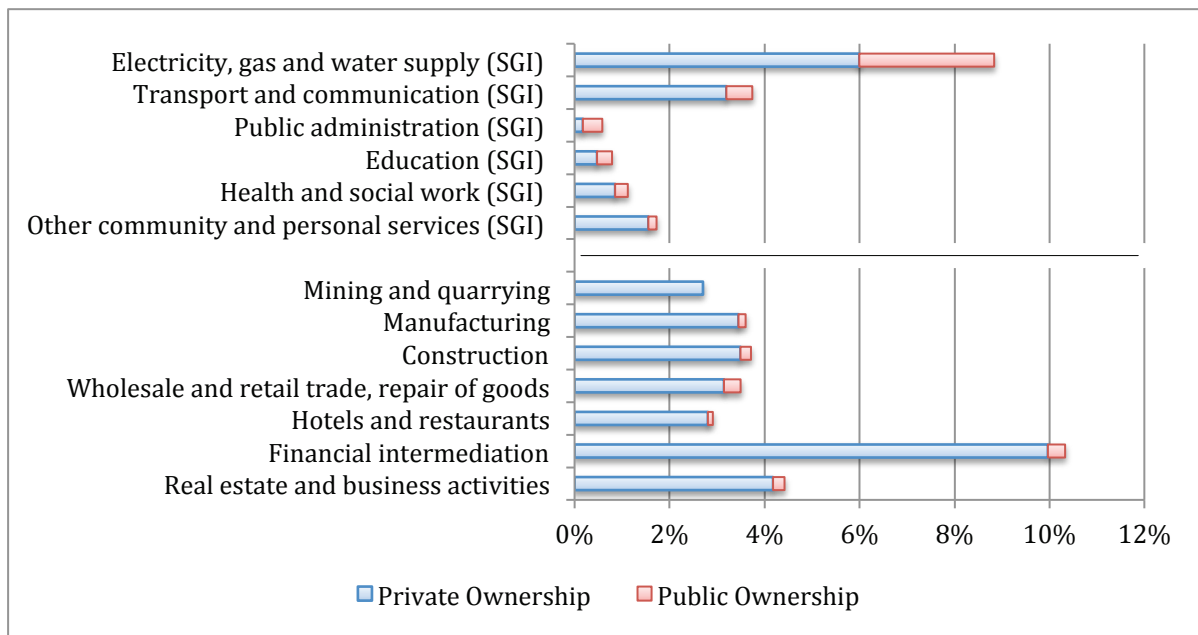
**Source:** Authors' own calculations (based on ECS dataset, 2009)

**NOTE:** Companies in sectors providing services of general interest are marked '(SGI)'.

The upper six bars of both diagrams represent the SGI sectors while the remaining bars of each diagram represent the other sectors of the economy. Generally, in all sectors, PS schemes are more prevalent than ESO schemes. The incidence of PS schemes is highest in Financial Intermediation, Electricity, Gas and Water Supply, Real Estate and Business Activities, Manufacturing, Wholesale and Retail Trade, and Transport and Communications, with over ten per cent of companies offering such schemes. In terms of ESO schemes, the same sectors, together with Construction and a slightly changed order, show the highest incidence, with over 3 per cent of companies offering such schemes. Apart from Electricity, Gas and Water Supply and Transport and Communication sectors, the incidence of PS and ESO schemes are much lower in SGI companies than that in other companies.

As far as the ownership of the establishments offering EFP schemes are concerned, the bulk of enterprises in the non-SGI sectors are privately owned whereas the publicly owned companies play an important role in SGI sectors, particularly in the Public Administration, Education, Health and Utilities.

**Figure 3. Percentage of privately and publicly owned companies in all sectors offering broad-based employee share ownership (ESO) schemes to their employees**



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

**NOTE:** Companies in sectors providing Services of General Interest are marked "(SGI)".

While Figures 2 and 3 showed the incidence of EFP schemes in SGI and non-SGI sectors for the sample as a whole, the following two diagrams (Figures 4a and b) focus on SGI sectors, showing the incidence of EFP schemes in these sectors in different countries.

Only in Ireland and Slovakia, over 10 per cent of organisations providing SGIs have any profit-sharing schemes. The proportion is over 3 per cent for most countries with Malta and Greece having no profit-sharing schemes in their SGIs at all.

The incidence of ESO is even lower than PS, with the proportion of enterprises offering such schemes going over 2 per cent in only five countries.

### 3. EFP in different SGI sectors

In this section, we focus on individual SGI sectors and consider the incidence of broad-based profit sharing and employee share ownership schemes. We also show the share of companies offering EFP schemes by their ownership in different countries. Figures 5a and b represent the incidence of PS and ESO schemes in the Electricity, Gas and Water Supply sector respectively.

In countries with available data, there is widespread incidence of EFP schemes (particularly profit sharing) even in countries where the sample enterprises were largely owned by the state.

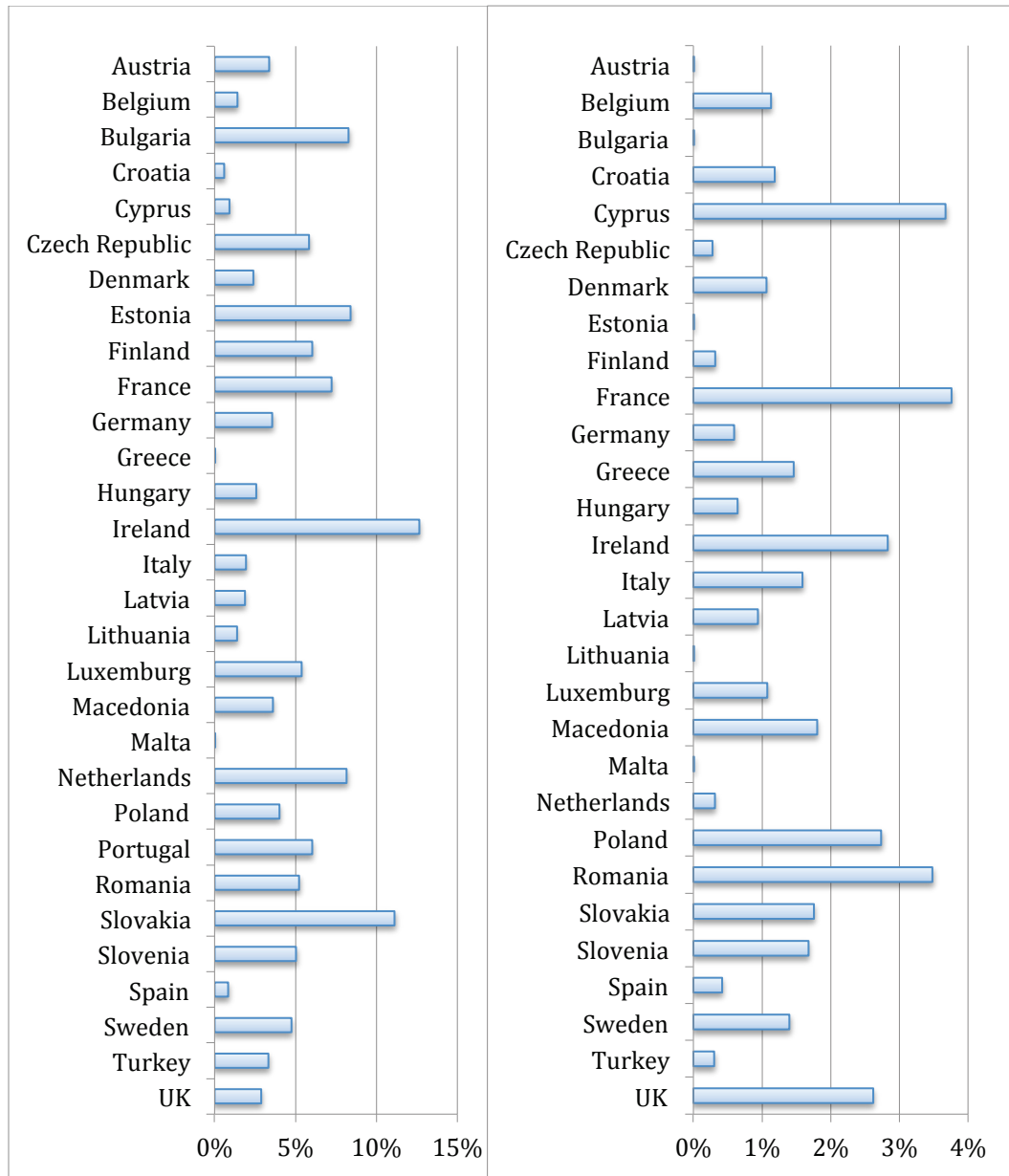
Figures 6a and b illustrate the incidence of EFP schemes in the Transport and Communication sector. In this sector, too, there is widespread use of EFP schemes (again, more frequently the PS schemes), and the large proportion of these are in privately owned companies. The proportion of companies offering PS schemes is especially high (with Ireland and the Netherlands, over 20 per cent and seven other countries over 10 per cent).

Figures 7a and b illustrate the incidence of EFP schemes in Public Administration. While, there is some degree of profit sharing in firms in this sector, there is hardly any employee share ownership scheme. The main reason for this is that, as expected, most firms in this sector are publicly owned and therefore there is little room for share ownership. The only exceptions are the firms in the Czech Republic and the United Kingdom samples, which include a number of privately owned companies with some EFP scheme.

Figures 9a and b show the extent of profit sharing and employee share ownership in the Health and Social Work sector, respectively. In many countries, profit sharing is practiced by both privately and publicly owned companies whereas employee share ownership is available in a small number of countries and mostly in private companies.

Figures 10a and b show the extent of profit sharing and employee share ownership in the Other Community and Personal Services sector, respectively. In many countries, profit sharing is offered by both privately and publicly owned companies, whereas employee share ownership is almost always offered in private companies. It must be noted that this sector contains many non-SGI enterprises, which explains the larger incidence of EFP schemes than some of the previously discussed sectors.

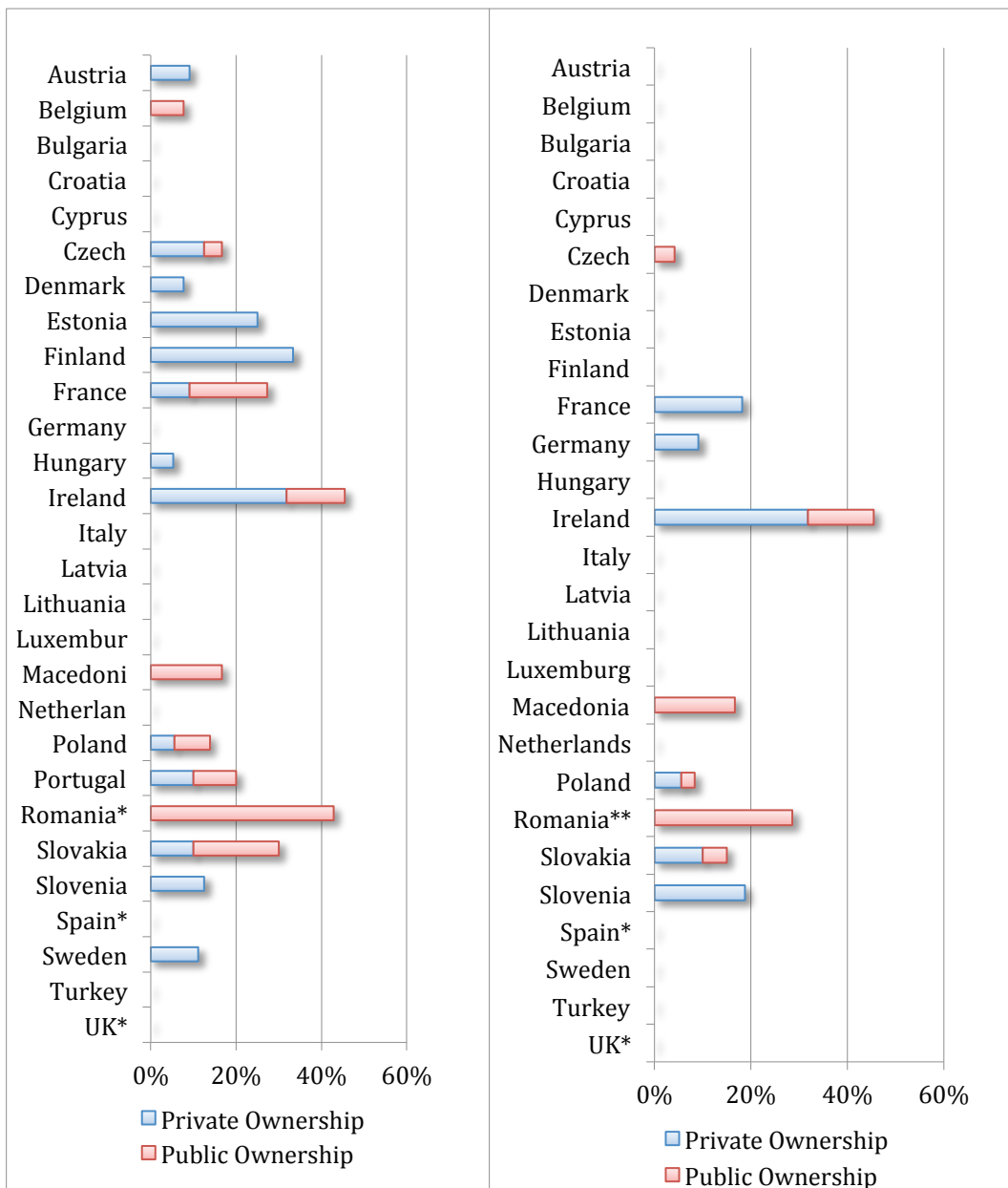
**Figure 4a and 4b. Percentage of companies in SGI sectors offering broad-based PS schemes (left) and broad-based ESO schemes (right) to their employees in the EU-30**



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

**NOTE:** Portugal is excluded from the data on employee share ownership schemes (see above, footnote 24).

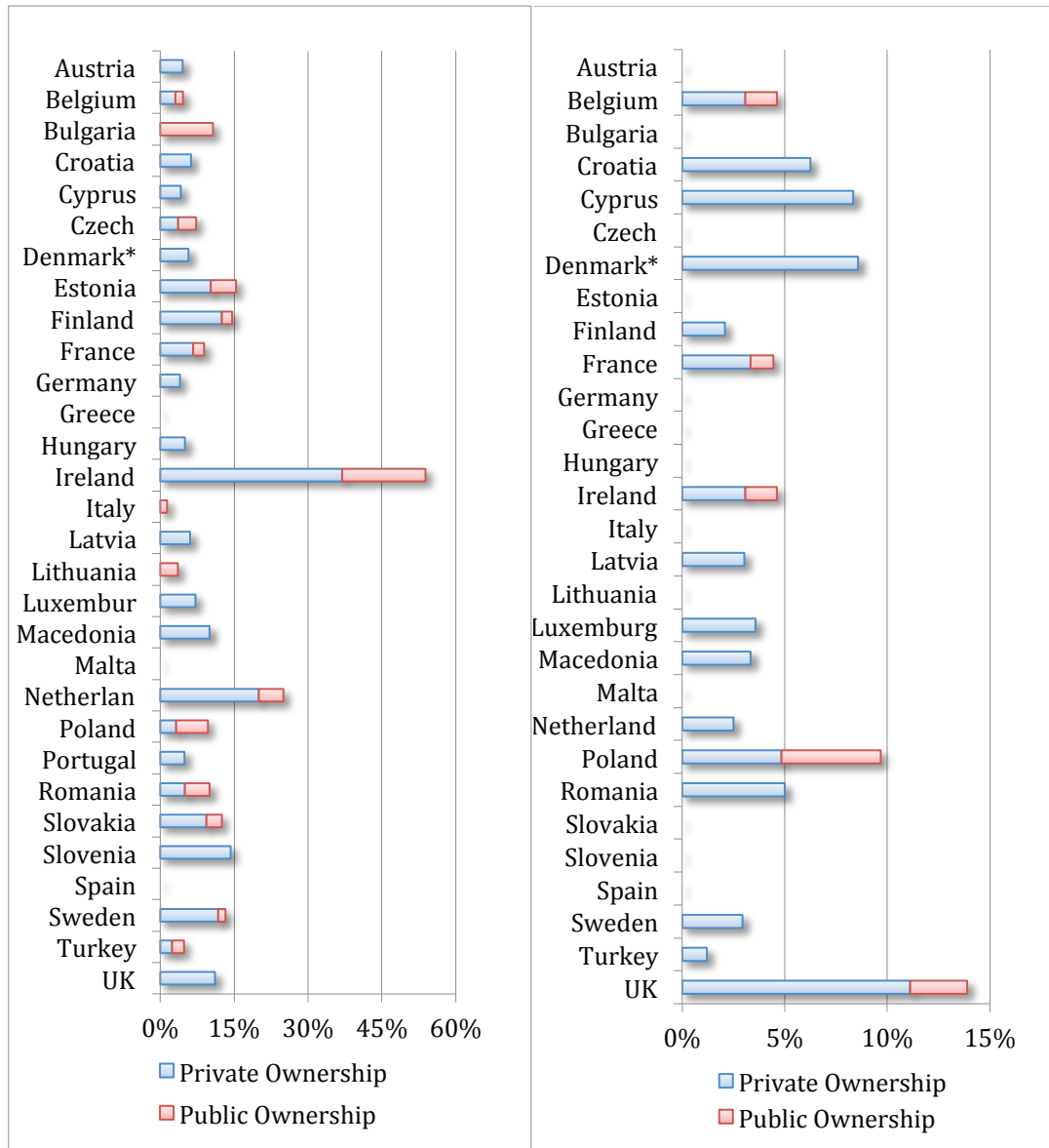
**Figure 5a and b. Percentage of companies offering broad-based PS schemes (left) and broad-based ESO schemes (right) in Electricity, Gas and Water Supply sector in the EU-30, in both privately and publicly owned companies**



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

**NOTE:** \*For UK and Spain, the proportion of privately owned companies offering PS/ESO is zero. There are no publicly owned companies in the sample and therefore it is not possible to give an indication of the extent of PS/ESO in publicly owned companies. \*\* In Romania there are no privately owned companies in the sample and therefore it is not possible to give an indication of the extent of PS in privately owned companies. For all other countries, the absence of a bar in the diagram (or a bar of a particular colour) means that the proportion of companies (of either or both ownership types) offering PS/ESO is zero. Greece and Malta are not represented in the diagram, as there were no companies from these two countries in the ECS sample. Portugal is excluded from the data on employee share ownership schemes (see above, footnote 54).

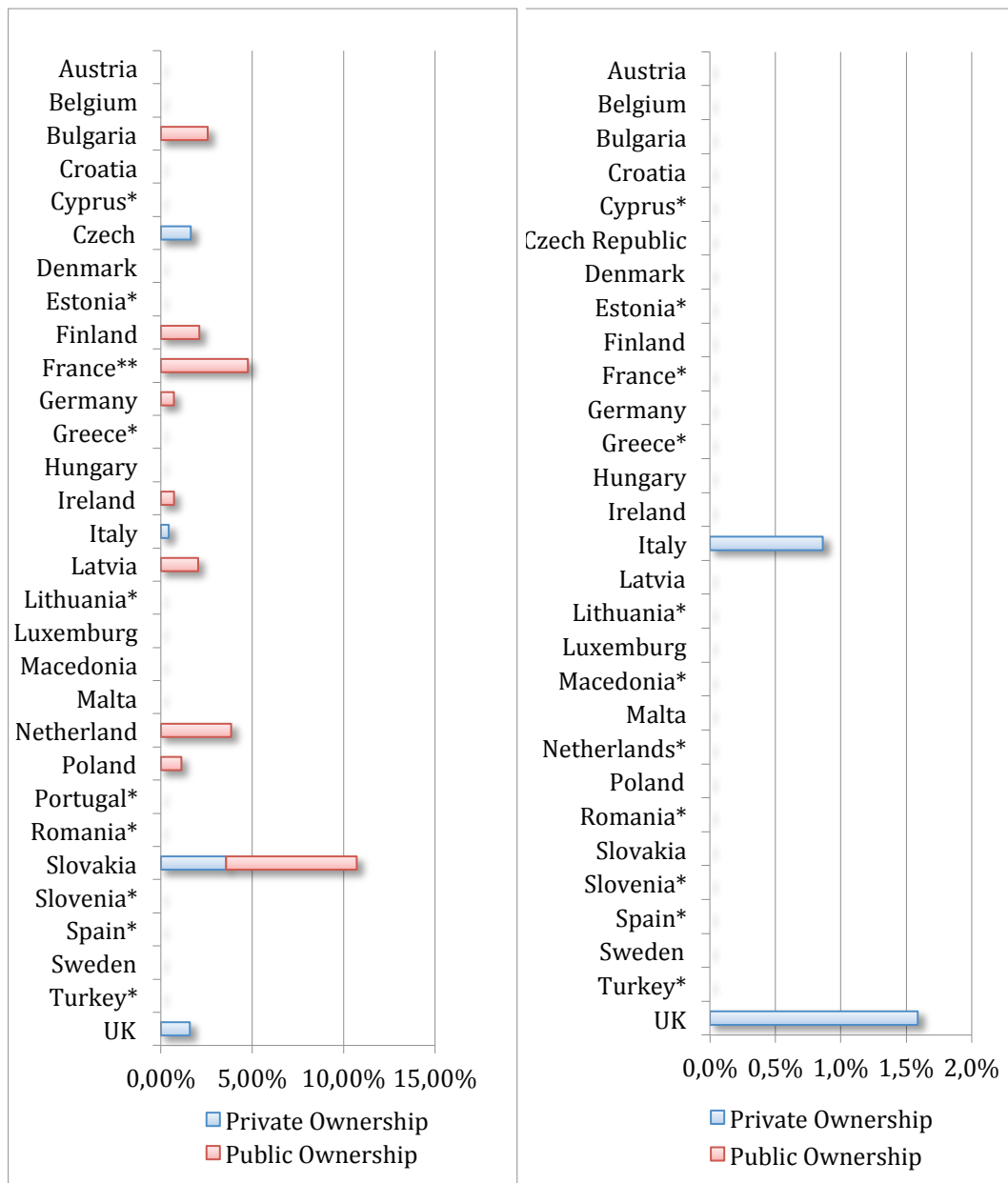
**Figure 6a and b. Percentage of companies offering broad-based PS schemes (left) and broad-based ESO schemes (right) in Transport and Communication sector in the EU-30, in both privately and publicly owned companies**



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

**NOTE:** \*In Denmark, there are no publicly owned companies in the sample and therefore it is not possible to give an indication of the extent of PS/ESO in publicly owned companies. For all other countries, the absence of a bar in the diagram (or a bar of a particular colour) means that the proportion of companies (of either or both ownership types) offering PS/ESO is zero. Portugal is excluded from the data on ESO schemes (see above, footnote 54).

**Figure 7a and b. Percentage of companies offering broad-based profit-sharing schemes (left) and broad-based employee share ownership schemes (right) in the Public Administration sector in the EU-30, in both privately and publicly owned companies**

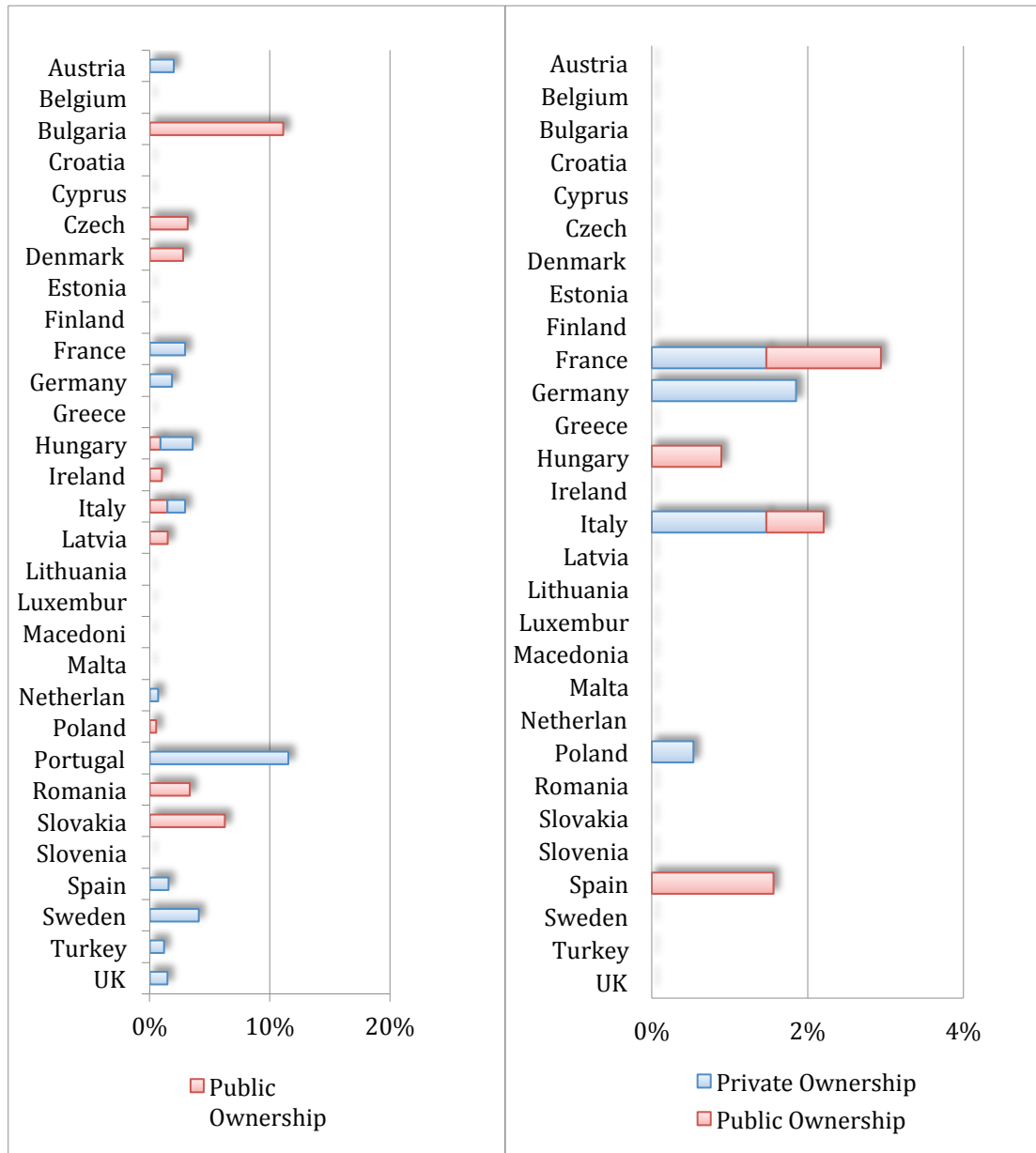


**Source:** Authors' own calculations (based on ECS dataset, 2009)

**NOTE:** \*For these countries, the proportion of publicly owned companies offering PS/ESO is zero. There are no privately owned companies in the sample and therefore it is not possible to give an indication of the extent of PS/ESO in privately owned companies. \*\*For Netherlands and France there are no privately owned companies in the sample and therefore it is not possible to give an indication of the extent of PS in privately owned companies. For all other countries, the absence of a bar in the diagram (or a bar of a particular colour) means that the proportion of companies (of either or both ownership types) offering PS/ESO is zero. Portugal is excluded from the data on ESO.



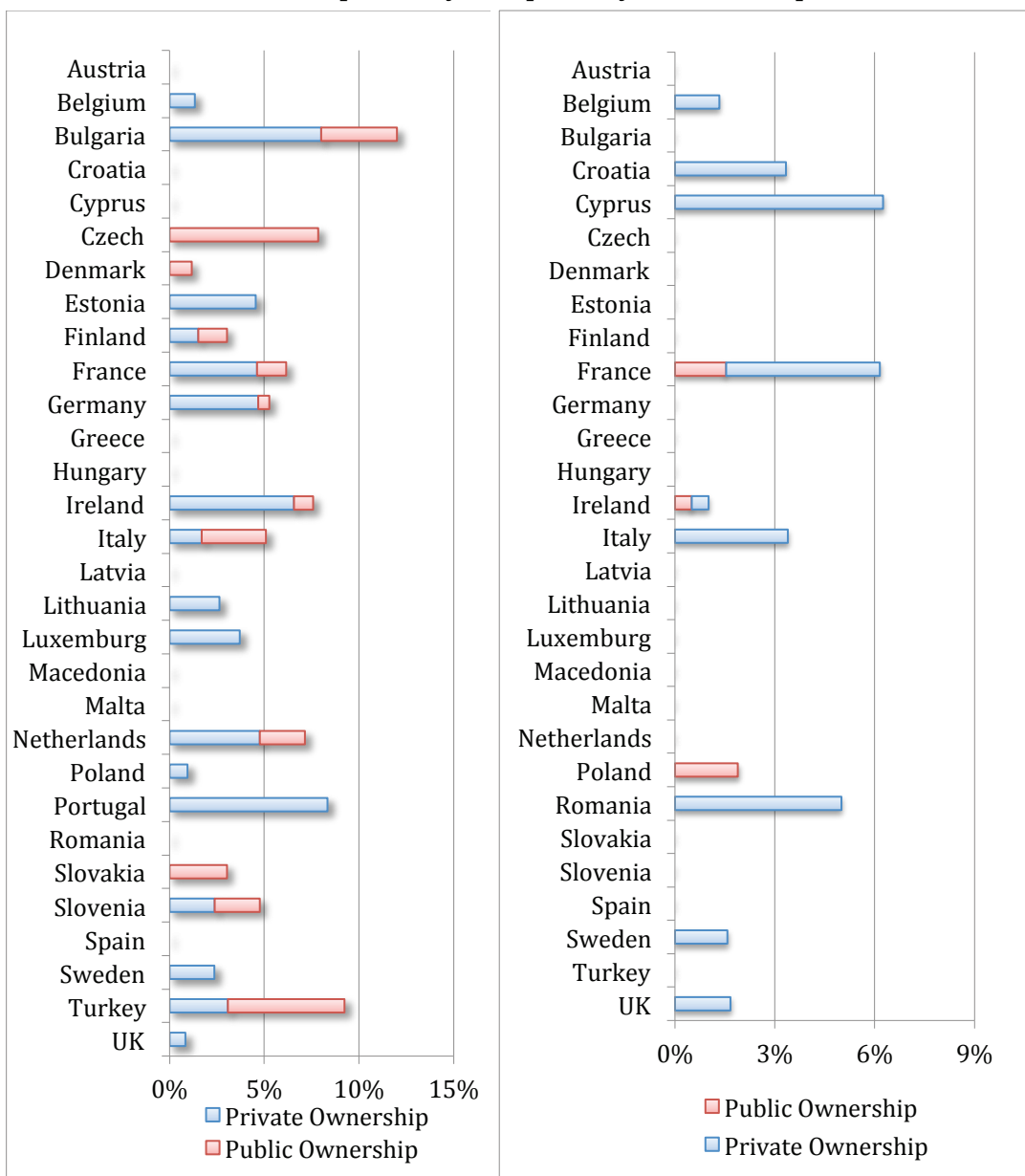
**Figure 8a and b. Percentage of companies offering broad-based PS schemes (left) and broad-based ESO schemes (right) in the Education sector in the EU-30, in both privately and publicly owned companies**



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

**NOTE:** For all countries, the absence of a bar in the diagram (or a bar of a particular colour) means that the proportion of companies (of either or both ownership types) offering PS/ESO is zero. Portugal is excluded from the data on ESO schemes (see footnote 24).

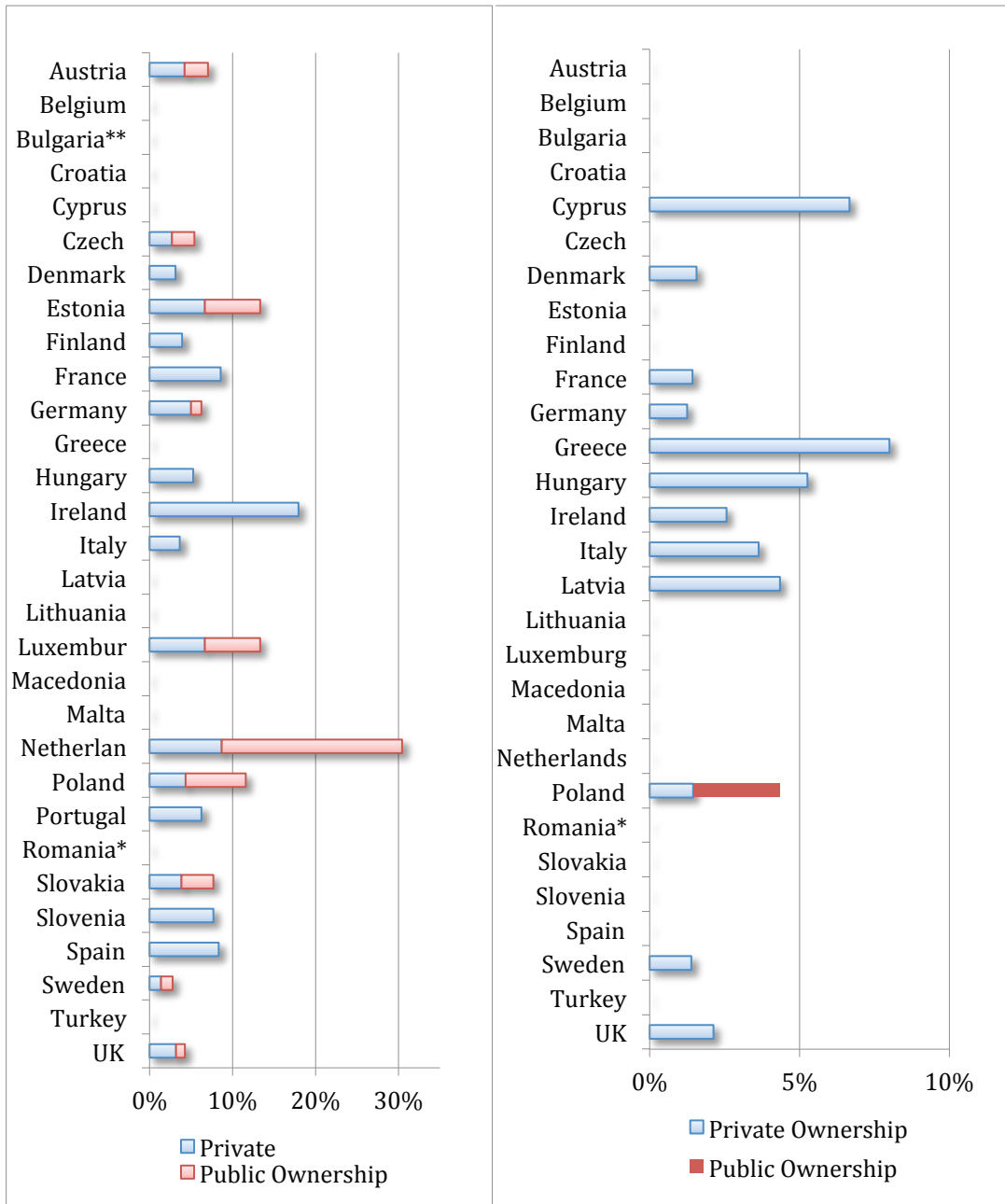
**Figure 9a and b. Percentage of companies offering broad-based PS schemes (left) and broad-based ESO schemes (right) in Health and Social Work sector in the EU-30, in both privately and publicly owned companies**



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

**NOTE:** For all countries, the absence of a bar in the diagram (or a bar of a particular colour) means that the proportion of companies (of either or both ownership types) offering PS/ESO is zero. Portugal is excluded from the data on ESO schemes (see above, footnote 24).

**Figure 10a and b. Percentage of companies offering broad-based PS schemes (left) and offering broad-based ESO (right) in Other Community and Personal Services sector in the EU-30, in both privately and publicly owned companies**



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

**NOTE:** \*In Romania, the proportion of privately owned companies offering PS/ESO is zero. There are no publicly owned companies in the sample and therefore it is not possible to give an indication of the extent of PS/ESO in publicly owned companies. \*\* In Bulgaria, the proportion of publicly owned companies offering PS/ESO is zero. There are no privately owned companies in the sample and therefore it is not possible to give an indication of the extent of PS/ESO in privately owned companies. For all other countries, the absence of a bar in the diagram (or a bar of a particular colour) means that the proportion of companies (of either or both ownership types) offering PS is zero. Portugal is excluded from the data on employee share ownership schemes (see above, footnote 24).

#### 4. Conclusions

The European Company Survey covers companies/establishments that fall within the umbrella of SGIs (or public services). Over 8,000 (out of some 30,000) establishments belong to sectors, which are largely SGIs. The precise identification of all SGI establishments is not always possible because the activity of companies is identified only at a high level of aggregation (one-digit NACE classification).

The data confirms the previous results published in PEPPER IV that EFP schemes are widespread in all economic activities across European countries. Profit sharing is more widespread than the employee share ownership. Also, the incidence of EFP schemes is generally much lower in publicly owned companies than in privately owned companies

The following conclusions can be drawn from the analysis of the ECS 2009 data:

- i. EFP schemes are in operation in public services companies and organisations (i.e., enterprises providing services of general interest) but vary widely across sectors.
- ii. Compared with non-SGI sectors, in most cases these schemes are less prevalent in SGI sectors (the exceptions are companies in utilities and transport and communication where the incidence is similar to non-SGI companies).
- iii. In publicly owned companies which provide many (in some countries, most) of the services of general interest there is less incidence of EFP. When there are EFP schemes in operation, profit sharing is the common form and there is hardly any employee share ownership scheme in operation in these companies.

Further interrogation of data is necessary in order to provide additional evidence on companies producing SGIs. This will be undertaken in the next phase of the project.

## ***II. Analysis of interviews with managers in SGLs in six EU Member States and assessment of the legal framework affecting EFP***

### **1. Four cases of EFP in French SGLs**

*Marco Caramelli*

#### ***a) Profile of the participant companies and the interviewees***

The four companies are all large French multinationals operating in four different industries: energy, transportation, telecommunications and water treatment and waste management. They are all publicly traded, and all but one are mostly owned by the French State, and are formerly fully state-owned companies, which have been partly privatised. In what follows, the four enterprises (percentage of capital owned by the employees in brackets) are called: ENERGY (1.7 per cent), TRANSPORT (10 per cent), COM (5 per cent) and WATER (2 per cent).

In comparison to the other five Member States in this study, France is an exception: According to the 1986 privatisation law, 10 per cent of privatised capital had to be first offered to employees at a discounted price leading to employee share ownership (ESO) in all large privatised firms. Furthermore, profit sharing (PS) is mandatory for companies of more than 50 employees. While in France ESO as well as PS is the rule, in the many other countries it is the exception.

*Mandatory ESO and PS in France*

The interviewees were all directly in charge of EFP schemes in their companies. In some case, EFP is directly related to the HR department, while in others, EFP is co-managed by both the HR and the financial departments.

#### ***b) Different EFP practices in France***

As most French listed companies, our interviewed companies offer the following ‘package’ to their employees: (i) gain-sharing and/or profit-sharing bonuses; (ii) free shares plans, employee stock offerings, and (iii) retirement savings plans ‘Plan d’épargne pour la retraite collectif’ (PERCO). However, none of the companies offers broad-based stock options.

There are two sorts of bonuses: gain-sharing and profit-sharing. The first is related to some ‘local’ performance indicator and is voluntarily implemented by companies, while the latter is mandatory for companies of more than 50 employees, and is based on profits. When the employees receive these bonuses, they can: (i) get them in cash—this would be taxed as other compensation—; (ii) invest them in the ‘Plan d’épargne d’entreprise’ (PEE), which

is the French employee savings plan, and take advantage of tax incentives, if they keep the money invested for at least five years.

The PEE gives the employees the choice among several funds: one is exclusively invested in the employer's stock and is usually called 'employee ownership fund', while the others are diversified funds. Apart from bonuses, the employees can decide to monthly invest part of their compensation in one or more PEE funds.

An employee stock offering is an offer by which companies give the possibility to their employees of purchasing some company's stock at a discount price and usually with a matching contribution. Some companies propose leveraged offers to limit the employee risk. The company can also decide to grant a certain number of free shares to all or some of its employees and executives, under a favourable tax treatment. Those shares are granted under certain conditions that, if fulfilled at the end of a minimum mandatory vesting period of two years minimum allow employees to become the owners of the shares, and there is another period of two years minimum during which shares cannot be sold.

#### *c) Practices in the interviewed companies*

All four firms have a gain-sharing plan, the criteria for calculating the bonus are as follows: At ENERGY, it is based on three criteria: the company's overall economic performance, the company's overall social performance, and a criteria of performance occupation-specific. At TRANSPORT company, there are six criteria: three financial and three qualitative criteria. The qualitative criteria are, for example, customer satisfaction and punctuality. Because of the crisis in the sector, the gain-sharing bonuses have represented limited amounts these last years, around €150-300 a year per employee. WATER is very decentralised: each subsidiary has its own specific criteria, in order to keep the bonus close to each specific activity. However, there is a gain-sharing agreement by plant, so that an engineer and a secretary can have a bonus based on the same performance criteria. At COM, finally, the bonus is based on two criteria of operative performance: one concerning fixed phone and multiservice, and the other concerning mobile phone.

All firms, except ENERGY, have a profit-sharing plan. In fact, ENERGY is still considered a public company, and only few public companies are allowed by ministerial order to implement a PS plan. However, TRANSPORT has not distributed any PS bonus for several years, because of its lack of profits.

All companies but TRANSPORT, implemented a free shares plan. At COM, the management does not benefit from the plan, which is limited to 'regular' employees. However, not all the subsidiaries in the world have benefited from the plan, because the board of directors in each country has to accept the plan. In all European countries, the plan has been accepted, and 133 shares were to be granted if the conditions were met. However, in other subsidiaries,

like in Africa, Middle East or Poland, the plan has not been set up, for different reasons, some being legal issues. Therefore, in those countries, the employees get cash equivalences to shares. At WATER, there are two performance criteria to decide the grant of free shares: the stock price and an index of the utilities industry. The company has to perform better than the average of the industry. Moreover, the plan is global, but there are local differences. For example, in France, the plan is 2+2 years, while in Spain and Italy, the plan is 2+3, and 4+0 for the other countries, to take into account local legislations. It is difficult to know whether those plans will be set up regularly or not, because all companies have just set up their first free shares plan.

The Retirement Savings Plan (PERCO) is complementary to the PEE, it can receive the same payments as the PEE as well as matching contributions. However, contrary to the PEE, the PERCO is conceived as a long-term savings plan, and must be diversified: funds cannot contain more than 5 per cent of the employer's stock. Finally, the funds are normally not alienable before retirement.

In terms of employee stock offerings, the situations are very different. WATER has just implemented its first global offering. At ENERGY, the goal is to implement such offerings regularly, every two years. At TRANSPORT, it seems that the management does not believe anymore in stock ownership, so no new offer is on schedule. Finally, at COM, the last offer was issued in 2007 and the management considers, as we will explain later, that the economic situation is not favourable to new offers. At WATER, there is a classic and a leveraged offer. In the classic offer, there is a discount of 20 per cent (maximum allowed by law) over the market price.

Matching contributions may concern regular payments in the plan or one-shot investments at the moment of ESO offerings. In all cases, firms use matching contributions to guide the employee investment behaviour, i.e., some limit that contribution to investment in employer stocks. For example, at COM, only the investments in the ESO fund in the PEE receive matching contributions (€310 for €780 invested by the employee). However, the matching contribution is higher in the PERCO, because the employee average age is quite high, so that the company wishes to favour retirement savings (the matching contribution in the PERCO is of €800 for €800 invested). At WATER, the matching contribution for their first ESO offering, was as follows: 1-15 purchased shares, the matching contribution was 100 per cent, and between 16 and 45, 50 per cent. This was to 'help' low-income employees. However, there are no contributions for the bonuses (profit- and gain-sharing) invested in the funds.

#### *d) Determinants of EFP*

Objectives/advantages of employee share ownership and EFP in general were given as follows:

(i) *'A driver of international social cohesion'*; according to ENERGY employee ownership is the strongest link between their subsidiaries, while WATER stressed its cohesive effects facilitating discussions and communication in general.

(ii) *'A powerful tool for cultural change'*; ESO and EFP in general, are considered a good way to change the employees' mindset in former state-owned monopolistic companies, which have had to quickly switch to private companies in a competitive environment.

(iii) *'A powerful tool for communication'*; companies use ESO to communicate to employees about corporate strategy, the creation of value and the share of this value. This is particularly important at the moment of employee stock offerings.

(iv) *'To compensate our employees'*; EFP systems are regarded very favourable for employees, compared to any other existing savings system outside the company. Moreover, it has been pointed out that in a highly competitive environment, it is important to compensate employees for their efforts by sharing with them the company's results.

(v) *'To secure the employees' loyalty and commitment to the company'*; ESO is considered to enhance employee commitment and attachment to the company. The participation rate to ESOs is considered as an indicator of the employee attitudes towards the company.

Finally, none of the interviewees has evoked neither the fact that EFP could help funding the company nor that EFP provides 'protection against takeovers'. TRANSPORT can be considered as an exception to the reported positive attitudes towards EFP as our interviewee considered that there are no clear advantages with ESO.

#### Determinants of employee stock offerings

With regards to the determinants of employee stock offerings, there is a large consensus among our interviewed companies, to say that these are implemented when things are going well, while plans may be cancelled or not renewed when the business is down. At ENERGY, for example, an ESO was scheduled for 2010, but was cancelled *'because the context in 2011, did not allow us to set up such an offer.'* At TRANSPORT, one of the reasons why they have stopped ESOs, it's because *'things are not going well'* in terms of business, and this is the same for all the industry. This was confirmed at COM, where the interviewee told us that, because the current stock market situation is not good, it is not a good period



for an ESO. Many companies that had scheduled ESOs during the last stock-market crash have finally decided to cancel it.

Our WATER interviewee told us that an employee stock offering was scheduled for September, but since the share price was continuously dropping, the CEO had started wondering whether the parameters of the offer were to be changed. Finally, the ESO manager decided to keep everything as it was planned. However, their fear was that because the crisis, the employees would not have participated in the offer. Other companies in the same situation at the same moment took different decisions. Veolia, for example, decided to stop the offer, while Technip, for example, decided to maintain it.

At COM, there is a specific reason, why new employee stock offerings are not scheduled. In fact, most employees have lost money with earlier plans. When first quoted in 1997, the share value was €27. For the 1998's ESO plan, they were at €43, and in 2000 the share value hit the €210. During that period, the employees could not sell the shares because the five-year vesting period was not completed, yet. In 2002, the share value was at €6. It has been a huge shock for most employees who had invested in shares. After another ESO offering, the stock value reached €24, and after the last stock market crisis they went down again to €12. Because of this history, the company now is abstaining from proposing a new offer, because it is afraid the employees would not participate.

While at TRANSPORT it seems that the CEO is not particularly in favour of employee stock ownership, at COM, the law provides for a limit to ESO, not allowing the state to own less than 50 per cent of the company's capital. Therefore, it was difficult to set up an ESO.

#### The disadvantages of EFP

According to our ENERGY interviewees, there are only positive sides to EFP, except for the mandatory calculation of profit sharing, which is considered to lack flexibility, with the formula being too much related to accounting rules.

*'We give low bonuses to the employees, what can even demotivate them'* is what pointed our TRANSPORT interviewee. As performance has been weak during the past years, they have distributed very low (€150-300 for gain sharing) if no bonuses at all (for profit sharing), which might have even a negative impact on the employees. As mentioned earlier, the management at TRANSPORT, has been disappointed by ESO, considering that it had not changed employee behaviour in a positive way, as usually expected.

Moreover, as previously explained, in cases like COM where the stock value dropped from €220 to €6, the effect on employees can be negative. In particular, this is the case when the employees fail

to sufficiently diversify their savings portfolio, which happens very often, because of both the matching contributions and employee preferences.

Taxation and other financial regulations are a problem for multinationals wishing to offer EFP schemes across several countries. This is what COM explained us in details. In some countries, for example, it is forbidden to provide or sell stocks to employees, while in other countries the taxes are too high. Consequently, other systems must be set up. This makes it difficult and expensive to implement a globally integrated policy.

### *e) EFP and social dialogue*

#### Trade unions

All our interviewees told us that some unions were very favourable to EFP, some quite favourable, and some were opposing. According to ENERGY, even the less favourable unions have finally had to acknowledge that—with the discount and the matching contribution—ESO provides advantages for employees. According to TRANSPORT, the unions are not interested in EFP: what they fight for is the fixed remuneration. The place of unions in collective bargaining on the introduction of EFP is partly determined by the law. For instance, according to the law, a gain-sharing agreement shall be discussed with the unions.

In the case of ESO at ENERGY, there is a first stage where the management thinks about the project, defines the parameters of the offer and validates it with the stockholders. Afterwards, the stage of social dialogue can start. At COM, one might observe less social dialogue on EFP, since only the contribution for the PERCO seems to be negotiated with the unions, the other elements being determined unilaterally by the management. Finally, at WATER, some negotiations took place on the reorganisation of the PEEs existing in each business unit, which had to be integrated with the new WATER's global PEE. The unions agreed on all propositions of the management.

Our ENERGY interviewees explained that unions tend to change things in the interest of the poorest employees. For example, they will ask for a higher discount on the first purchased shares, in order to assure better credit facilities or secured offers (e.g., leveraged offers).

#### Union, associations of employee shareholders and ESO funds' supervision councils

Beyond 'social dialogue' itself, unions might play an important role in French ESO institutions. They might participate in the fund's supervision councils and the associations of employee shareholders. The funds' supervision councils are to one half composed of members appointed by the management, to the oth-

er—plus the president—representing the employee owners. Depending on the companies, the representatives of the employee owners can either be elected out of the employee owners or be union representatives.

In our sample of companies, union representatives serve in the supervision councils. The council is in charge of supervising the management of the assets. They also exercise the voting rights regarding the employees' stock at the general assembly. In this case, union representatives fulfil a double function of representing both trade unions and stockholders, which is quite a unique situation. Associations of employee shareholders are also quite specific to the French context. In our sample of companies, only ENERGY and COM have one or more associations of employee shareholders, some being 'unionised', others not. They mainly fulfil the function of information providers towards the employee shareholders.

## 2. Analysis of three interviews conducted in Italy

*Jens Lowitzsch, Marco Cilento*

### *a) Profile of the participant companies and the interviewees*

The three companies are two large and one medium-sized Italian firms operating in three different industries: energy (80,000 employees), transport (12,600 employees) and waste management (500 employees). In what follows, let us call them: ENERGY, TRANSPORT and WASTE. ENERGY is publicly traded, as a formerly fully state-owned company, which has been privatised with the Italian state. The state is still heavily invested (biggest single shareholder with 31.24 per cent, remaining shareholders limited by PrivL to between 2-3 per cent); employees hold 1.5 per cent of the capital. The local government, i.e. municipalities, own the remaining two.

It is important to note, that according to Decree Law n°58/1998 (Consolidated Law on Financial Intermediation<sup>29</sup>), in privatisations all employees had to be offered shares. Optional preferential conditions to facilitate employee shareholding were introduced with § 381 of Law n. 266 of 23 December 2005 (Provisions for the formation of the annual and multi-year state budget—Finance Act 2006)<sup>30</sup> (for companies, in which the State has a significant ownership position. In some of the large state companies privatised on the stock exchange via trade sales and IPOs ESO—if also only to a small extent—originates in these rules.

*Italian legislation has been facilitating ESO since 1998*

<sup>29</sup> Testo unico delle disposizioni in materia di intermediazione finanziaria (Testo unico sulla finanza).

<sup>30</sup> Disposizioni per la formazione del bilancio annuale e pluriennale dello Stato (legge finanziaria 2006).

*Italian privatisation process had a very limited impact on ESO, but ESO is catching up PS*

*Implementation of the Second Council Directive on Company Law 77/91/EEC*

*Tax incentives for PS since 1992*

### ***b) Different EFP practices***

The most important form of EFP in Italy used to be profit sharing, but recently employee ownership has been catching up. The Italian privatisation process—implemented on a large scale since the 1990s—had a very limited impact on employee ownership. Tax incentives for EFP were introduced in the late 1990s. Unlike in most other countries, they regard also smaller firms, i.e., limited liability companies.

The Italian Civil Code (CC) regulates discounted employee shares in joint-stock companies with a holding period of 3-5 years. To facilitate the acquisition of shares by employees, the law permits a company to advance funds and to make and secure loans, with a view to acquisition by employees of the company, conditional that this ‘financial assistance’ is within the limits of distributable reserves (Art. 2358 CC). Furthermore, Art. 2349 and 2351 CC permit the issuing of special ‘employee shares’ in capital increases with specific rules for form, tradability and rights (see below c)). Since 1999—pursuant to Decree Law n°505/99—free shares are not considered income and exempted from personal income tax and social security contributions up to a threshold of €2,066. According to Art. 51 of the Income Tax Law (hereinafter referred to as ITL), the tax exemption is linked to a blocking period of three years.

Specific rules regarding stock option plans were introduced in 1997 under Art. 48 para. 2 g) and g-bis) ITL as amended by the Decree Law n°314/97. Decree Law n°505/99 exempted the increase in value between grant and exercise of the option from social security contributions and personal income tax. However, the latter exemption from PIT was cancelled by Decree Law n°112/2008 and Law n. 113/2008.

Rules for profit sharing are determined by collective bargaining at the firm level. Tax incentives for profit sharing were introduced by the Decree Law n°67/1997 allowing a partial tax exemption for employers’ contributions up to 1 per cent of the payroll; this percentage was subsequently increased to 3 per cent. Further, a 10 per cent ‘compulsory solidarity contribution’, substituting for the general social security contribution, was introduced. The employer benefits from a 25 per cent reduction in social security contributions. The employee is exempted from social security contributions, which the state covers in order not to reduce the initial contribution. The ceiling of the annual maximum value of the bonus rose from €3,000 to €6,000 with the income ceiling for eligibility for incentives fixed at €35,900 annually.

### ***c) Practices in the interviewed companies***

The interviewees were all directly in charge of EFP schemes in their companies. However, it is important to note that none of

them have been operating or are currently implementing broad-based EFP schemes.

In the case of TRANSPORT and WASTE, the companies are yet to be privatised. However, the interviewees regards it necessary to include constraints to private investments in order to preserve the nature of SGI with regards to contract of service and public procurement. In their opinion privatisation often lacks adequate planning and thus the public-private partnership is not well conceived; this in turn might create conditions for SGI to lose their features of universality and accessibility. Local authorities and central states are going through a severe lack of resources, among others linked to imbalances in tax income distribution from central state. Towns have no critical mass to offset cuts in public expenditure. Cities lack resources for investments in infrastructures.

#### Employee stock offerings

In the case of ENERGY, the Law stipulated that in privatisations all employees had to be offered shares, however, without providing for preferential conditions. It was not until the introduction of the Law n. 266 of 23 December 2005 that § 381 stipulated that the by-laws of companies, in which the State has a significant ownership position, may provide for special financial instruments or categories of shares to be offered free to all shareholders, or in the case of specific shareholders for the payment of compensation in order to facilitate the privatisation process. However, the employee shares were offered during privatisation in 1998 without preferential conditions and 70,000 employees took part in the offer, acquiring 1.5 per cent of the capital.

We have not found any plans to introduce employee share ownership plans. On the contrary, in ENERGY the existing narrow-based plan has been substituted by a profit-sharing scheme: 'Traditionally, from 2000 on ENERGY has provided share incentive plans for management only; until 2008-09 these were extended to broader stratum of management (initially they covered only 100 persons). Last year, a scheme was adopted to foster the internationalisation of ENERGY. This will cover around 1000 participants of a total of 75,000-80,000 employees. However, now this "long term incentive plan" is not any more share based but pays the bonuses in cash.'

#### d) General attitudes towards EFP

Objectives of ESO and EFP in general were given as follows: 'We try to create synergies with the employees'; 'Where there is a market price and competition, EFP is useful'; 'EFP should be a part of an overall system of participation'.

With regards to obstacles and disadvantages of EFP, the most poignant statement among the answers were: 'Please note that

*there are sectors like water where profitability is zero.’; ‘Complicated, especially with regards to transnational extension’; ‘Ideological and practical motives have often slowed down this process’.*

### ***e) EFP and social dialogue / trade unions***

The social partners have shown an attitude to keep together external effects (efficiency and quality of SGI), with internal processes (regulating salaries and productivity according to price development of production factors and changes in recipients’ needs, monitoring of demographic trends on the territory, evolution of the legal framework at national and local level, etc.).

#### **Associations of employee shareholders**

The recent modification of the implementation of the EU Shareholders’ Rights Directive 2007/36/EC<sup>31</sup> improved the conditions for small (employee) shareholder associations, which were introduced by Decree Law n°58/1998 (Consolidated Law on Financial Intermediation<sup>32</sup>). These associations—set up by at least 50 physical persons of which no one holding more than 0.1 per cent of the shares—above all are no longer subject to various time-consuming registration and disclosure procedures of proxy voting with the CONSOB (the Italian Securities and Exchange Commission).

In spite of this recent development, TRANSPORT expresses a sceptical view towards these associations. The only example of such an association in our three companies is ADIGE at ENERGY: Pursuant to PrivL, the 1.5 per cent share in ENERGY’s capital would theoretically have given the employee shareholders the right to nominate a candidate for the administrative council (executive board) as well as for the union representation (collegio sindacale); of course without the guarantee to be elected. ADIGE as the only association represents only 200-300 employee shareholders and thus a fraction of the 1.5 per cent share mentioned above.

#### **Unions’ attitude towards EFP**

Social dialogue seems to be important to improve work in enterprises offering SGI as a condition to have high-quality and accessible services. At national level, social partners establish macro-objectives: Main headings of public expenditure, privatisation processes, private public partnership main features and governance rules for companies providing SGI (corporate governance constraints, role of stakeholders, role of employees, etc.). Locally

<sup>31</sup> Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies, OJ L 184, 14.7.2007, pp. 17–24.

<sup>32</sup> Testo unico delle disposizioni in materia di intermediazione finanziaria (Testo unico sulla finanza).

they agree on plans for development in the territory, together with investors and local authorities may point out concrete services to be privatised, investors, return on investments, accountability, involvement of employees or enlarged civil dialogue etc. At the company level, issues are among others: condition for productivity, quality, and sustainability of the business. ENERGY reports on their (limited but positive) relationship with the unions.

#### EFP and corporate governance / employee shareholders

Our interviewee at WASTE expressed a clear vision of the role of employee shareholding with regards to corporate governance and corporate social responsibility. On the other hand, TRANSPORT gave a more sceptical view recurring to the participation of the employee rather as stakeholder than as shareholder.

#### *f) EFP and company's funding*

The interviewees stated that social dialogue (favouring private investments in SGI) indicates that social partners are confident that SGI could be run 'within the economy'. There seems to be a conviction that companies offering SGI can make profits or respect balance constraints concerning in-going and out-going financial flows. However, this depends rather on how they are run: The interviewees deem it possible—under stable market conditions (transparency, no corruption, efficient regulation)—to liberalise the SGI markets without negative effects on citizens as consumers. Despite that, private investment is not supported by sufficient rules to prevent conflicts of interest as social partners remark.

### 3. Three cases of EFP in SGI in Sweden and Finland

*Christina Sweins, Jens Lowitzsch*

#### *a) Profile of the participant companies and the interviewees*

The three companies are large firms operating in Sweden and partly also in Finland in three different industries: Energy and project development, telecommunications and construction. Hereinafter, the three enterprises are called: ENERGY, TELECOMMUNICATIONS and CONSTRUCTION. They are all publicly traded. Energy, is mostly owned by the Finnish State, and is a formerly fully state-owned company, which has been partly privatised, Telecommunications, is co-owned by the Swedish state (37 per cent) and the Finnish state (13 per cent). Construction is owned by Swedish investors (76.4 per cent) and foreign shareholders (23.6 per cent). Information on the percentage of capital owned by employees was not available.

The interviews in Sweden and Finland are discussed in this section together as the companies operate in both countries and Telecommunications is the Finnish branch of the Swedish parent

company. In comparison to Sweden, which has no particular laws on EFP and no tax incentives regarding EFP, Finland provides generous tax incentives, in particular for Personnel Funds (interestingly, these root in the Swedish model of Wage Earner Funds, now abolished). All used plans are voluntary.

The interviewees were all directly globally in charge of employee financial participation schemes in their companies.

### *b) Different EFP practices in Sweden and Finland*

*No specific system for direct promotion of EFP in Sweden*

In **Sweden**, there is no specific system for direct promotion of EFP in profits or shares. Performance-related pay is used in several companies and the collective agreements leave place for them. Performance-related pay is based both on collective and individual results. The employer may offer stock purchase programmes to the employees at a discount price, but no incentives are available. In stock-option programmes, tax is generally paid on capital income, which is lower than that on income of employment. Nevertheless, they are not considered as financial instruments and thus, taxation is not as favourable as for other options.

*Profit-sharing foundations*

Cash-based profit sharing exists, but remains unregulated by law; no incentives are available. Profit-sharing foundations are entities for the benefit of employees, to which the employer company contributes a percentage of company profit. The employees, often through union representatives, establish the foundation and determine its charter, including the provision on how the contributions are to be invested. In listed companies, the assets are often partially invested in company shares. Today, the employer pays a payroll tax of 24.26 per cent on contributions at the time they are made (Law 1996/97:21 s. 25) in lieu of a social security contribution of 31.42 per cent, which is paid on wages. No tax incentives are given to employees; they pay taxes on income attributed to employment service at the time their trust accounts are distributed. The foundation pays capital tax 1.5 per cent on its assets (§20 of the Law on Governmental Capital Tax 1997:323).

*Personnel funds are the main form of EFP in Finland*

In **Finland**, Personnel funds are the main form of financial participation.<sup>33</sup> They are deferred profit-sharing plans allowing investment in the equity of the employer company and thus involving an element of ESO. The law requires all employees to be included in the plan, whereas only senior management may be excluded. For employees, 20 per cent of the payouts from the fund are tax-free. The fund pays no taxes on its earnings. The employer company is not liable to social security contributions, and can deduct profits contributed to the fund as professional expenses from the corporate tax base. Since 1999 it is allowed that the funds can be established in civil service departments and in state-owned companies.

<sup>33</sup> In 2010, the first Personnel Fund Law was repealed and a new law was enacted 5.11.2010/934.



In lieu of profit, the government offices use measures of performance. Since 2011 it is also possible to establish personnel funds in the municipal sector, regardless of whether the activity is meant for profit-making.

Furthermore, companies may transfer shares to employees at a favourable price. The benefit is tax-free if the discount is up to 10 per cent below the current price and the majority of employees have access to the plan (§ 66 para. 1 of the Income Tax Law). 30 per cent of dividends from public companies are tax-free, and 70 per cent are taxed as capital income. The company withholds 19 per cent in tax from payments to the employees. Employees can deduct this tax from the personal income tax base.

*Tax incentives*

### *c) Practices in the interviewed companies*

The interviewed companies offer: (i) employee share ownership (CONSTRUCTION) and (ii) profit-sharing bonuses (ENERGY, TELECOMMUNICATIONS and CONSTRUCTION); they are all voluntarily implemented by the companies, and are based on profits. None of the companies offer stock offerings, broad-based stock options or a gain-sharing plan.

ENERGY uses a global short-term incentive system (STI) for all employees. STI is based on financial results of the corporation/own division and individual results. For most of the employees it means a bonus of maximum 10 per cent of the annual salary. For upper strategic experts the maximum bonus is 20 per cent, and for key position holders 30 per cent, and for management a maximum bonus is 40 per cent of the yearly salary. The plan is usually set up for one year at the time.

Additionally, for the personnel in Finland, ENERGY operates a Personnel Fund (profit-sharing system) where the employees can gain up to 3 per cent of their annual pay. The bonus is based on corporation profitability (EBIT, EVA). The goals for the system are set up annually and the bonus is paid once in a year into a trust fund. The fund is investing the capital, and the employees may take out 15 per cent of their share once a year. The corporation is paying no employer fees for the bonus payments they make to the fund, and the employees are having 20 per cent of their share tax-free. For the rest they are paying taxes as from normal wages. Upper management is excluded from this bonus system.

TELECOMMUNICATIONS use a profit-sharing bonus for the majority of the employees, and those, who are not included in the bonus system, are included in a short-term incentive programme. The plan is usually set up for one year at the time. The profit-sharing bonus is based on financial results of the company, which can vary from year to year. In 2012, a coupling to individual and team-based outcomes was added to the system. The STI is also based on financial results and individual outcomes. The targets are set a

year in advance. The long-term plan is to further develop the profit-sharing system towards a share ownership plan.

CONSTRUCTION offers an ESO programme to their employees. The employees are included in a 'saving' programme, where they can save up to 5 per cent from net wages; for key employees it is 7.5 per cent and for top employees 10 per cent. The savings are invested in company shares. If the employees still are employed in the company after 3 years (vesting period) they get a bonus share (matching contribution) for each four shares previously acquired. Additionally, the employee can get up to three more shares depending on the unit performance. The plan is 3+3 years; its lifetime is 2011-16. The ESOP programme is related to the 'local' performance indicator and is voluntarily implemented by the company and it is based on profits. The employees can join the programme three times a year and leave the programme whenever they want to. After three years membership, they can: (i) sell the shares—which would be taxed as other compensation—; (ii) or continue to keep the shares and stay in the programme.

CONSTRUCTION offers an additional profit sharing plan but it difficult to know whether the plan will be set up regularly or not, because for instance company has just set up their second plan.

#### **d) General attitudes towards EFP**

All interviewees agreed that EFP is a motivational tool that enhances company performance. Objectives and advantages of employee share ownership and EFP in general were given as follows: *'An organisation with higher performance'*; *'a share in the success'*; *'EFP enhances engagement'*. The respondents stated that EFP is a way of providing employees with a more direct way to share in the economic success of the company. An important issue mentioned in the interviews was the motivational effects it has on employee behaviour. By coupling performance with EFP, they believe, it is easier to positively influence employees' behaviour.

Concerning ESO in particular, the interviewed companies stated that ESO is implemented to commit the personnel to the company so that the business would go better enhancing *'alignment with company goals'*. With regards to attracting key-personnel and recruiting, all interviewees mentioned EFP as an important tool. As attitudes of employees are concerned, the interviewees, in particular ENERGY, find that there is a positive attitude towards EFP. None of the companies found that EFP is a tool for helping funding the company. In general, the interviewees find that there are only minor disadvantages with EFP.

#### **e) EFP and social dialogue / trade unions**

The place of unions in the EFP negotiations is partly determined by the law. The plans must be discussed with the Unions by the law, but the companies are voluntarily implementing the EFP

plans. The interviewees find that unions are not very interested in EFP. The reason for this seems to be that they focus on fixed remuneration. However, in TELECOMMUNICATIONS it is reported that unions would prefer EFP to be negotiable, which it currently is not. As with regards to EFP ad EU works councils in Sweden and Finland the role of the social dialogue seems to be quite small. Discussions, if they occur, tend to be concerned about the questions whether the same financial participation scheme applies in all countries where the company is operating.

#### 4. Analysis of two interviews conducted in Spain

*Izaskun Alzola and Jens Lowitzsch*

##### *a) Profile of the participant companies and the interviewees*

The two companies are both large Spanish public companies operating in two different industries: Telecommunications and water treatment and waste management. Both of them are run by public administration and are fully state-owned companies, which excludes any form of share ownership. The interviews were carried out to know if there were any profit sharing or performance related pay schemes and, if not, the reasons for not having any such scheme. Hereinafter, the two enterprises are called: TELECOMMUNICATIONS and WATER.

##### *b) Different EFP practices*

There is no special regulation pertaining to profit sharing, no tax incentives are granted. Both cash-based and share-based profit-sharing plans are found, but cash-based profit sharing prevails. In many cases, profit-sharing plans contain financial indicators as well as performance-related indicators, so that they cannot be considered as genuine profit-sharing plans. Certain share-based plans ('performance shares') are linked to financial indicators, such as BPA, RTA, etc. Stock appreciation rights, i.e., payment in cash or transfer of shares connected to the increase in the share value at the end of a determined period, are sometimes granted, but rarely.

*No special regulation pertaining to profit sharing, no tax incentives are granted*

Employee share ownership<sup>34</sup> and stock option plans are relatively few, they are mostly found in large multinational companies and are generally limited to executives. However, share purchase plans have enjoyed tax incentives under certain conditions since 1996, which were specified in Law RD 214/1999, extended in 2003 and are now stipulated in the Personal Income Tax Law (Law 35/2006). Company shares or shares from a group of companies given to employees for free or at a discounted price are ex-

*Tax incentives for share purchase plans*

<sup>34</sup> In the sector of small and very small enterprises, EFP typically takes the form of 'worker-owned companies' (sociedades laborales) and worker co-operatives.

*Tax incentives for stock option plans*

cluded from income tax assessment under the following conditions: (i) the market value of the benefit at the time of acquisition does not exceed Euro 12,000 p.a., (ii) shares are offered within the framework of a regular compensation plan (but not necessarily of a broad-based plan), (iii) each employee and his family members own not more than 5 per cent of the equity capital and (iv) the sale of the shares is blocked for three years.

Stock option plans are also linked to tax incentives as of 2003. If the vesting period does not exceed two years and options are not granted annually, a 40 per cent personal income tax allowance (limited by the annual medium wage determined by law multiplied by the number of years before vesting) applies. If the shares cannot be sold within three years after the option grant and the plan includes all employees on equal terms, the amount of the tax allowance and the ceiling are doubled.

*c) Practices in the interviewed companies*

One of our interviewed companies, TELECOMMUNICATIONS, offered a gain sharing plan from 2003 to 2009/10: In 2003, the management negotiated with the works committees (one work committee for each company of the group) a scheme called 'Professional Development System'. The aim of this system was to analyse the skills and competences of each employee, and to establish a plan to improve the work developed by them in order to help them to reach the objectives previously agreed in the team. The process involved setting annual goals for the different groups of employees, business units and working teams. In addition, skills/competences/abilities of each employee and—where appropriate—the training needs that would enable them to reach their objectives were analysed. At the end of the period, the company evaluated the achievement of goals and—depending on the results—a percentage of the variable compensation (in their salary) was established. All this was included in the collective bargaining, and each year the system was updated and adapted. Finally, as afore mentioned, in 2009/10 the scheme was discontinued.

WATER has no EFP schemes. On the one hand, the nature of the organisation as a state-owned enterprise impedes a share ownership scheme (interestingly, this also applies to its subsidiary, a 100 per cent daughter whose legal form is a joint-stock company). On the other hand—according to the interviewee—the current economic situation is the main obstacle to profit sharing. In the past, consulting firms analysing the salary system have proposed introducing incentives based on the revenue of the organisation or the productivity of employees in order to increase their motivation. However, the management did not follow these recommendations as they believed the current economic situation to be prohibitive.

#### **d) General attitudes towards EFP**

The objectives / advantages of EFP

*\* 'Increase staff / employees motivation'*

The interviewee at TELECOMMUNICATIONS stressed that EFP is a tool that enhances company performance. An important issue mentioned in this context was the motivational effects it has on employee behaviour.

*'One reason for implementing the system was the need to increase staff / employees motivation and their integration into the business plan, aligning them with the goals of the company, while improving their relationship with the team leaders'* TELECOMMUNICATIONS

*\* 'Improving their relationship with the team leaders'*

As a result, in particular employee's goals with those of the company, while improving their relationship with the team leaders was reported to have improved.

*'All these items improved as the system "forced" each manager to hold a meeting with their team, to set out the general objectives of the year, to settle the objectives of the team (the team had to reach a consensus), to monitor and, finally, to evaluate (also by consensus).'* TELECOMMUNICATIONS

Outlook on future plans

The respondent at TELECOMMUNICATIONS was uncertain about EFP as an option in the future, but thought this to be rather improbable given the nature of the organisation.

*'Well, we still maintain the system but not as an incentive that increases the amount of the salary of the employees; only for the establishment of the objectives, the evaluation and others. I do not know if in the future a financial participation plan (for example, an employee share ownership plan) will be implemented. Remember that EITB is part of the Basque Government and in this kind of entities (Administration) there are not this kind of schemes.'* TELECOMMUNICATIONS

Disadvantages of EFP

In TELECOMMUNICATIONS, one of the main reasons to discontinue the plan were budget constraints of the regional government.

*'Economically it was not possible to maintain the system (the Basque Government had already begun with the cuts), so the company was forced to remove the plan.'* TELECOMMUNICATIONS

#### **e) EFP and social dialogue / trade unions**

The interviewee at TELECOMMUNICATIONS finds that unions are not very interested in EFP.

\* *'Unions are not very interested in EFP'*

*'The Works Committees did not accept the proposal of TELECOMMUNICATIONS of changing the collective plan for an individual plan. This is an issue that emerged at the beginning (when the system was implemented) and the plan was always collective: from the beginning the incentive was paid to the team, so all the participants of one team earned the same. But each team earned a different amount of money for the incentive, because each team had its own goals. The achievement of the goals was evaluated at team level, so there could be differences between teams (though not significant because the variable was designed in order not to create significant differences between different teams).'*

TELECOMMUNICATIONS

\* *'They did not believe in the system'*

When the gain sharing plan was discontinued at TELECOMMUNICATIONS, the Works Committees did not put up much resistance.

*'Works Committees did not put up much resistance as they did not believe in the system. It should be noted that the objectives of the previous years had failed to pay the maximum compensation, so it was not so traumatic when the system was removed.'*

TELECOMMUNICATIONS

## 5. Analysis of two interviews conducted in the UK

*Iraj Hashi and Jens Lowitzsch*

### ***a) Profile of the participant organisations and the interviewees***

The interviews in the UK focussed on the public administration as no other interview partners, e.g., from privately owned SGLs were available. Obviously, as mentioned earlier in the introduction, this limits the range of possible EFP schemes to forms like profit-related pay or profit sharing. The legal framework in the UK in contrast is strongly oriented towards share ownership schemes as described below.

The first interview was conducted with the Chief Executive of a District Council, a unit of local government (District Level) responsible for the provision of certain services (public leisure facilities, fire service, education, and some social services). The second interview is with an executive at the Office of Public Management, a consultancy company engaged in advising the Central Government on transferring some of the public services currently provided in public organisations to organisations, which are either in the private sector or joint-ownership sector.

### *b) Different EFP practices in the UK*

Although the organisations interviewed in the UK do not have any EFP schemes, a wide range of employee participation schemes are available in this country. All employee financial participation plans fall into one of two categories: approved by the Inland Revenue or not approved. The former plans enjoy substantial exemptions on tax and national insurance contributions. Under current legislation, all approved plans (and typical unapproved ones as well) are employee share ownership plans. Unapproved plans are used for granting shares, options or cash equivalents that exceed legal maximums to individual employees or to employees, who are not UK tax subjects. Under current legislation there are four approved plans, one share ownership plan with several modifications, the *Share Incentive Plan* (SIP) and three stock option plans, the *Savings-Related Share Option Scheme* (SRSO), the *Company Share Ownership Plan* (CSOP) and the *Enterprise Management Incentives* (EMI). SIP and SRSO are broad-based, while CSOP and EMI may be restricted. Although not regulated, some forms of unapproved schemes are quite widespread: Long-Term Incentive Plans (LTIP), restricted Shares Plans and Unapproved Option Plans.

#### Inland Revenue Approved Share Ownership Plans:

The *Share Incentive Plan* (SIP) was introduced under the Finance Act of 2000 to replace the PRP on which it is partially modelled. The employer company sets up a trust to serve as an intermediary in allocating shares to employees. The share may be allocated without cost ('free shares'), at a discount, or at full price ('partnership shares'); also the employer may match the employee's partnership shares ('matching shares'). Tax exemptions are valid for all versions of the plan after the shares have been held for five years, or earlier if the employee terminates his employment on account of injury, disability, redundancy, retirement or death. Shares sold immediately after withdrawal are exempt from a capital gains tax.

#### Inland Revenue Approved Stock Option Plans:

*Savings-Related Share Option Scheme* (SRSO) or *Sharesave* or *SAYE Scheme*, introduced by the Finance Act 1980, is currently the most popular plan judged by the number of participants. It must apply to all employees, except possibly those with relatively short service. The basic structure of the plan is as follows: the employee enters into a Save-as-you-earn (SAYE) contract with a designated bank or building society, agreeing to save a specified monthly amount (£5-250) by deduction from after-tax remuneration for 3, 5 or 7 years and the employer company grants him share options for the maximum number of shares he will be able to purchase at the exercise price with his SAYE savings. The SAYE contract al-

*Two categories of EFP plans: approved by the Inland Revenue or not approved*

*Under current legislation there are four approved plans: one share ownership plan with several modifications, the Share Incentive Plan (SIP) and three stock option plans*

*Currently the most popular plan judged by the number of participants: SRSO or Sharesave or SAYE Scheme*

ways includes a tax-free bonus added to savings on completion, the amount depending on the term of the contract and the rates are set by the Treasury. The share exercise price can be up to 20 per cent under the market value of the underlying shares at the time of the grant. At maturity of the SAYE contract, the employee is entitled to choose whether to exercise the option and retain or sell the shares or take the savings and bonus in cash. These requirements fulfilled, the employee is not liable for personal income tax at grant or exercise. However, he must pay capital gains tax on the sale of shares.

*Discretionary plan, which is often limited to the executives, but can also be broad-based: CSOP*

*Company Share Ownership Plan (CSOP)* was introduced in 1984 as Discretionary Share Option Scheme (DSOP) and re-launched in 1996 under the current name with amended requirements. It is a discretionary plan, which is often limited to the executives but can also be broad-based. It is often connected to performance results, i.e., a certain goal must be reached before the option can be exercised. The following requirements also apply: the value of outstanding options per employee must not exceed £30,000 at grant; the exercise price may not be less than market value at grant; the exercise period may not be shorter than three nor longer than ten years after grant. These requirements fulfilled, the employee is not liable for personal income tax at grant or exercise.

*In order to help small (gross assets less than £30m), higher-risk companies to recruit and retain highly qualified employees: EMI*

*Enterprise Management Incentives (EMI)* was introduced by the Finance Act 2000 in order to help small, higher-risk companies to recruit and retain highly qualified employees. It applies to companies with gross assets of less than £30m. The plan can be selective. Approval of the Inland Revenue is not required, but it must be notified of each stock option grant under EMI within 92 days. Options granted must not exceed a total market value of £120,000 per employee or £3m for the company. These requirements fulfilled, neither employees nor the employer company are subject to personal income tax or national insurance contributions at grant or exercise. However, they must pay capital gains tax at the sale of shares.

#### Profit-sharing plans

At present there are no approved financial participation plans in the form of profit-sharing plans. However, a few unapproved bonus schemes might be both broad-based and profit-connected; if so, they could be considered as cash-based profit-sharing plans. An exceedingly popular approved profit-sharing plan—Profit-Related Pay (PRP) or Approved Profit-Sharing (APS)—was in operation until it was terminated in 2003.

*No approved profit-sharing plans*

### *c) Practices in the interviewed organisations*

#### District Council

The District Council is a local government organisation and, as such, is not in a position to offer its employees any ‘shares’. More-



over as it operates within a budget (made up of a grant from the Central Government supplemented by local taxes), all of which is spent on its activities. It does not generate profits and therefore it is not able to offer its employees any profit-sharing schemes either. Indeed, as the interviewee pointed out, there is no share ownership or profit-sharing scheme in any local government organisation in the UK

The only form of employee financial participation used in the District Council has been 'performance related pay (PRP)'. The motivation for this scheme, which was introduced in April 2006, after the present Chief Executive took charge of the Council, was to provide an incentive scheme for employees, clarify the responsibility of employees (especially those at managerial level), establish the principle of accountability, and to encourage staff to perform their jobs well. This scheme was particularly important at the time it was introduced: in the previous regime, staff had become very lax and the incentive to work hard had been weakened. All staff used to receive one incremental point on the salary band of their scale automatically. There was little difference between those who worked hard and those who did not.

The purpose of introducing PRP was to develop a system, in which progression (and salary increase) is earned by employees on the basis of their performance.<sup>35</sup> The variable element of the salary depended on: the performance of the work group (with a weighting of 60 per cent), performance of the Council as a whole (with a weighting of 20 per cent) and attendance (with a weighting of 20 per cent). Annual targets would be set for individual work groups (in some cases for individual employees) by the Head of the relevant Department (or Service) and the employees will be appraised annually. Those achieving 65 per cent or over will be able to progress 1 increment on their salary scale. For a person at the top of the salary scale (with no possibility of receiving an increment), good performance will result in a lump sum bonus equivalent to an additional point on the salary scale.

The new system did improve the performance of employees. It made them conscious of their responsibilities and the importance of providing good service to the residents. There was general satisfaction with the scheme. The unions and staff representatives had agreed with the new system and co-operated in its implementation.

However, after some time, the system became too bureaucratic and some employees became too focused on meeting the target (rather than providing good quality service). There was also in-

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<sup>35</sup> There was an additional reason for the introduction of PRP in this Council: the unification of pay scale for all groups of employees. Previously different groups of employees had different contracts (with some staff receiving low basic wages and large bonuses while others received fixed salaries with automatic annual progression).

creasing use of the appeals process (in particular on the issue of absence due to illness which counted against the employees). This was very time consuming. Eventually, the Council decided to abandon the PRP system in 2010. The change of Government in the UK and the start of the austerity measures from May 2010 (budget cuts) put additional financial pressure on local government institutions and contributed to the abandoning of PRP. The Council decided to focus on improving the employees' conditions of work instead of being concerned with the pay scale and PRP arrangements.

At present only the Chief Executive and a few Head of Services are subject to annual reviews and pay increases.

It is possible to develop a bonus system for some staff of the Council whose work involves bringing additional business to the Council (for example the employees of fitness centres who are competing with private fitness centres, or the department working on bringing new companies to the area). In these cases, there is a clear stream of income, which is additional to the normal Council budget, and therefore it is possible to allocate some of it to the employees who generate this income. But so far, no such system has been developed in this District.

#### Office of Public Management (OPM)

OPM is a 'development centre' specialising in improving public services. It has been appointed by the Cabinet Office as an expert mentor on its 'mutual pathfinders' programme. This involves advising local governments in transferring one or more of their public services to another organisation owned by the community, employees or jointly owned by the local government.

The interview focused on the interviewee's experience of working with different public sector organisations in the past seven years, in particular his knowledge of the ways, in which some public service have been transformed into other types of companies (principally shared ownership companies, in which employees have an ownership interest).

The Cabinet Office has developed a programme called 'mutual pathfinders' encouraging the formation of 'mutual companies' (or mutuals) to take over the provision and delivery of some public services. A number of these companies have been established in the last few years; OPM has been acting as 'mentor' to some of them at the behest of the Cabinet Office. These cases include transfer of leisure services, recycling, healthcare, education (among others) in different parts of the country into 'shared ownership' arrangements.

The fundamental reason for the development of this type of organisation has been the government's austerity measures whereby the local authority budgets have been reduced significantly and

continuously since 2010 and are likely to be reduced in the next two or three years. This has forced the local authorities to explore alternative ways of funding some of their services (including some statutory service). The new organisations (shared ownership companies) set up to provide the service in question are either wholly owned by the employees (in the form of a 'co-operative' or 'mutual') or are jointly owned by the employees and the local Council (usually the Council owning some of the assets such as leisure facilities. In another case, a local Health Authority has transferred healthcare provisions in a particular area to a GP-owned company while the support staff remain the employees of the local Healthcare Trust.

An unintended consequence of these developments has been the positive outcomes of these transfers. The shared ownership companies have been generally successful, showing a growth in their turnover and—equally importantly—an improvement in the relationship between employees and the company. In many cases sickness rates have dropped and the culture of the organisations have changed. These are outcomes usually associated with EFP schemes. So, with increasing pressure on public resources and the continued austerity programme, this type of spin-outs is likely to expand. The success of previous shared ownership organisations will be an incentive for employees to accept the change.

On the question of Performance Related Pay (PRP) as a mechanism of motivating employees, the practice in the public sector (providing public services) is rather rare. Our interviewee does not know of any example of PRP in public services.

## Chapter 3. EFP in the public administration in Germany, United Kingdom and Sweden

Anja Bork and Jens Lowitzsch

### ***1. Introduction: Performance-related pay in public administration***

*PRP is existing practice in most European countries; EFP is generally underrepresented in public services*

As shown in the 2009 European Company Survey data (see above Chapter 3), EFP is mainly used in non-SGI sectors, whereas the public services are underrepresented. This is even more the case with regards to public administration for the structural reasons already discussed in the introductory chapter. However, similar models in this subcategory of organisations that provide SGI are operated. An already existing practice in most European countries (e.g., Germany, Great Britain, Denmark, Sweden and France) is performance-related pay (PRP), which among other possible benefits is expected to increase commitment and motivation among employees to achieve a higher productivity. Furthermore, the main reason for establishing this reform is to enhance the performance of public employees.

#### **1. Research on PRP remains unsatisfactory**

*Lack of evaluations and systematic analysis of the impact of PRP on public administration*

Although performance-related pay schemes are implemented in most EU Member States, empirical studies about its successes and failures are still scarce (Demmke, 2009, p. 53). Even in the case of longer running schemes, there is a lack of evaluations and systematic analysis of their impact on public administration.<sup>36</sup> It is conspicuous that there are only a few international, comparative and empirical studies (e.g., OECD 2005), which can make concrete statements concerning existing experiences with performance-related pay as well as the performance appraisal practice in public administrations in the European Union.

*No uniform payment schemes within national public services, which are applicable in the whole civil service*

Furthermore, it is interesting to note that this unsatisfactory research situation within the European Union roots not only in different concepts of performance-related pay in general, but also in country-specific key terms such as for instance 'pay for performance' or regular 'performance appraisal (schemes)'. This leads to the following conclusion: Due to those wide-ranging country-specific differences and because of decentralising tendencies in most payment systems (e.g., in Germany, Belgium and Spain),

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<sup>36</sup> Until now, a plenitude of studies have been published on the subject, but in most of the cases they are just reflections on the individual motivation among employees, which are only practical guides for HR managers.

there do not exist uniform payment schemes within national public services, which are applicable in the whole civil service (e.g., in Germany there are different payment systems for civil servants and public employees from the Federal and State level). Moreover, in most countries the remuneration competences differ enormously amongst the different national pay systems. For instance, in Sweden the human resources responsibilities (including remuneration competences) are decentralised to human resources units within individual ministries and agencies.

## 2. Overview of the questions investigated

PRP may be qualified as profit sharing (if related to unit or group performance) or gain sharing (if related to individual performance) when productivity can be measured and performance assessed.<sup>37</sup> Employee share ownership cannot be viewed as possibility for employee financial participation in public administrations as employees do not have the option to acquire a share in the equity. However, this chapter covers models of EFP in types of services of general interest (e.g., social, health services; education; housing; children's centres and childcare) that sometimes generate high returns and where employees may benefit of some alternative models of ownership.

We inquire about the reasons, why the implementation of performance-related pay is not effected in all fields of public services. For this purpose, the following sections analyse existing performance-related pay systems in Germany's, Great Britain's and Sweden's public services. We conclude with a presentation of recently developed alternative models of participation where employees can benefit of participation in ownership when externalising services once belonging to public administration. These 'exotic' schemes help to investigate to which extend the use of employee ownership schemes as opposed to the 'classical' schemes practised in public administration might be feasible in the future.

### II. EFP in public services in Germany

In general, PRP is not a new approach for human resource management in the German public administration. The initial reasons for implementing PRP are seen in the necessity to directly reward top performers (with a bonus). But in Germany, personal circumstances of an employee (e.g., family status, age and seniority) are more a decisive factor within the pay system than the actual performance. Moreover, the public service pay system is character-

*PRP is not a new approach, but personal circumstances are more a decisive factor within the pay system than performance*

<sup>37</sup> Interestingly, performance-related pay schemes have spread in parts of the public services other than in public administration or state enterprises, namely in employee-owned organisations such as health organisations.

ised by the element of promotion within a given class of service where each class is again subdivided into salary grades.<sup>38</sup> In the past, the instrument of a performance bonus was only applicable if the relevant posts for promotion were available. Otherwise, the top performer could not reach a higher grade. As a result, staff members who were not among the top performers were also promoted if the relevant posts were available and no better candidates were found (OECD, 2005, p. 120). Payment was determined less by motivation and willingness to perform than by the tasks of the employees. Consequently, the Federal and State Governments created through the *Act to Amend the Public Service Law (1997; Gesetz zur Reform des öffentlichen Dienstrechts)* and the *Act Governing the Structure of Remuneration (2002; Besoldungsstrukturgesetz)* an opportunity to award performance steps, bonuses and allowances in a more flexible manner.

### 1. Pay flexibility in the public administration - an overview

*Wage agreement for the public sector offers the possibility to honour performance and motivation beyond the fixed charge table*

The situation in Germany seems to be particularly interesting not only with a view of the remuneration competences between Federal and State governments (in the course of the federalism reform), but also the differentiated status groups. As an employee, the salary is based on the wage agreement for the public sector (*Tarifvertrag für den öffentlichen Dienst, TVöD*), which offers in §18 TVöD the possibility to honour performance and motivation beyond the fixed charge table. Linking the pay system in public services more closely to performance with the consistent pursuit to achieve a higher productivity and to ensure optimum customer satisfaction represents an absolute novelty. The wage agreement sets, of course, some framework conditions for introducing PRP.

*Performance bonus is paid as a bonus or as a merit bonus for individual performance or teamwork assessed on the basis of target agreements or systematic performance evaluations*

The performance bonus as a one-off payment will be paid as a bonus or as a merit bonus, an allowance for individual performance or teamwork. It is paid monthly amounting to 1-8 per cent (monthly fee of the previous year), which is not regarded as a component of pay but rather constitutes a flexible remuneration element (Kuner, 2007, p. 110). Beyond this, there are two methods to assess performance.<sup>39</sup> The first one is based on concrete—voluntarily—target agreements (targets, duties and individual expectations) employees' performance can be analysed according to reward the staff in the appropriate amount. Secondly, systematic performance evaluations are utilised for the unambiguous measurability for performance standards (expenditure of time, quantities, etc.) (Litschen et al., 2007, p. 115-134).

<sup>38</sup> The characteristic feature of the German system is the differentiation into four classes of services / professional categories where all offices of the same field of study are included: (i) 'Lower Service', (ii) 'Intermediate Service', (iii) 'Upper Intermediate Service', (iv) 'Higher Service' or 'Senior Civil Service'. The German civil service is a career system in which promotion depends on obtaining higher qualifications.

<sup>39</sup> See § 18 (5) TVöD.

Thus, the performance allowance depends on a positive performance evaluation and follows performance criteria, which are developed by the Federal Ministry of the Interior (performance appraisal guidelines). Within a rating scheme<sup>40</sup>, staff members are evaluated in their work results, expert knowledge, working methods, social skills as well as in their leadership and delegation (managers and executives).

Regarding to the implementation, it must be recognised that PRP is not applied uniformly by the administrations of the *Länder*. As already mentioned, there are different remuneration competences between Federal and State governments regarding, inter alia, employees' payment. The procedures and methods for the implementation of PRP are to be regulated in a decentralised manner on their own responsibility. Therefore, there are hardly reliable data concerning the implementation of PRP. Nevertheless there are some statistic data about the granting of PRP in 2003 when over €50 million were spent in Germany (OECD, 2005, p. 124).

*Different PRP practice due to different remuneration competences between Federal and Länder governments*

## 2. Critique and challenges for further development

In the last few years, the role of flexible remuneration and incentive structures was widely discussed. The discussion mainly focused on the question how incentives could be granted with respect to general principles (in particular fairness and efficiency). A couple of literature sources deal with avoiding the principle of indiscriminate all-round distribution (Hock et al., 2006). For example, in order to keep bonuses from becoming routine, there are restrictions, e.g., in the *Civil Servants Remuneration Act (Bundesbezahlungsgesetz)*.

*Avoiding the principle of indiscriminate all-round distribution*

In view of diverse reform initiatives the following features have been suggested for successful performance-related payment systems:

- i. Performance Management: Low-performing employees should not benefit from top performers. Otherwise, PRP will be seen as being unfair (problematic in large units). Leadership training must be carried out in order to handle poor- performance, too.
- ii. Transparency and Benchmarking: Guarantee of measurability for qualitative objectives, operationalization of objectives in the form of target agreements or systematic performance evaluations (for the awarding procedure).
- iii. Integrated incentive and remuneration systems: It is doubtful whether, e.g., 1 per cent of the variable (perfor-

<sup>40</sup> 9 points means the employee „surpasses the requirements by constantly outstanding performance“ to 1 point where the staff “does not meet the requirements at all” (see OECD, 2005, p. 122 f.).

mance-related) compensation components can boost the productivity and attractiveness of public administrations. A generous performance bonus is seen conditional for adequate employee participation.<sup>41</sup>

*German concept of PRP is gain sharing related to individual performance, not a collective profit-sharing scheme related to the result of the group and measured by some indicator*

In summary, the German concept of PRP can be qualified as a gain-sharing scheme related to the individual performance of an employee aiming to reward those who perform well and do a good job but not those who perform poorly. Thus, it is not a collective scheme related to the result of the group and measured by some indicator of unit/company output/profits as a genuine profit-sharing scheme. On the whole, Germany continues timidly to implement performance-related pay systems. In the short-run the German case is not expected to change dramatically. Different provisions on the Federal and the State level as well as even among the 16 Federal States (*Länder*), where not in all of them PRP schemes have been implemented, are quite problematic.

### III. Case study: PRP in Great Britain

*In no other European country effects and outcomes of the reform of the remuneration systems were assessed more in depth than in the UK*

In the 1980s, the civil service has been radically reformed under Margaret Thatcher and—as in the case of Germany—centralised administrations have been gradually abolished in Great Britain, too. In no other European country effects and outcomes of the reform of the remuneration systems were assessed more in depth than in Great Britain. Studies conducted by Marsden (London School of Economics and Political Sciences, Centre for Economic Performance (CEP), chair in industrial relations) provide information about positive effects and problems of the British system (Marsden, 1993).

*Labour law applies for private employees as well as for employees in the public sector*

It should be stressed that the development of the civil service is at British Crown's discretion. Therefore, there is no legislative structure, which can be compared with the German Civil Service Law (Johnson, 2003, 10). For this reason, labour law applies for private employees as well as for employees in the public sector, who, however, have special legal provisions (e.g., in the police service).

#### 1. Description of the national system: Instruments and effects

*Remuneration is oriented to performance-related and position-related features, contrary to the German case, which is based on a career system*

The British PRP policy applies to all categories of staff at the individual and collective level. Remuneration is oriented to performance-related and position-related features, contrary to the German case, which is based on a career system. Within the British position-based administration system (comparable to the systems of Finland, Denmark and Latvia), administrations have developed very different practices of remuneration schemes. The explana-

<sup>41</sup> Besides that, experts question financial incentives claiming that they only give short-term gains or even reduce performance as money is not the main incentive for increased productivity (Demmke, 2009, p. 58); see also below case study Great Britain.



tion is that civil servants remuneration has been centralised in free-standing departments and 'executive agencies' since 1988. Although the Civil Service Management Code (CSMC) provides a framework regarding the pay and working conditions of public employees, the responsibility for the actual amount of pay lies with the agencies.

There are around 65 executive agencies ("Civil Service," n.d.). Each agency is part of a government department, but has its own management and budget. In 1996, departments and agencies received full delegation to develop terms and conditions for their staff (below the senior civil service) (OECD, 2005, p. 165). All departments have to review their pay and performance structures in order to ensure that the system is best suited to their business needs as well as their reward strategies are in line with their own business objectives (and with market pressures). Hence, current pay systems vary across organisations and typically involve a pay range set by grades (the same in Germany), target rates and non-consolidated bonuses (OECD, 2005, p. 168). For instance, employees of the Finance Ministry are assigned to five wage categories based on a central 'Job Evaluation System'. Employee's performance is appraised compared with other employees. So the best 5 per cent of performers will be paid out a fixed amount or 3.5 per cent of the basic pay, the next best 30-35 per cent receive 3.2 per cent of the basic pay and further 55-60 per cent get a 2.9 per cent increased pay (Köllner, 2006, p. 18). It seems doubtful why poor performers still receive a 1 per cent bonus on top of their regular remuneration although they do not make a significant contribution to the organisation's success.

Interestingly, the senior civil service (SCS) pay and performance management system is centrally organised by the Cabinet Office (Köllner, 2006, p. 16). A 'Senior Salary Review Body' ensures the further introduction of PRP and recommends the range of available bonuses to the government. Senior civil servants have a specified minimum pay level, which corresponds with their position. Achieving progressively higher remuneration depends on a better performance and the following distinction into three performance groups—Group 1: The best 25 per cent of performers can achieve a wage increase up to 5-20 per cent; Group 2: the middle range 50-65 per cent and Group 3: employees performing lower 10 per cent which have to face to pay cuts (Köllner, 2006, p. 17). Additionally, the pay system for senior civil servants introduces a mixture of both consolidated base pay awards and non-consolidated bonuses, which have to be re-earned each year, judged against public service agreements, business plans and up to four individual key objectives which are derived from overall objectives. In 2003/04, senior civil servants (approximately 1 per cent of the public employees work in SCS) have earned an average of 3,5 per cent more compared to the previous year.

*Current pay systems vary across executive agencies and typically involve a pay range set by grades, target rates and non-consolidated bonuses*

*PRP makes a significant part of the employee's payment*

All in all, Great Britain is one of few examples where PRP makes a significant part of the employee's payment. Similar to Denmark (PRP part: max. 20 per cent) or Finland (PRP part: max. 15 per cent), the financial participation in monetary terms or tangible goods is higher than in Germany's public sector. The British 'Total Reward Approach' implies not only a performance-related part of at least 5 per cent of the basic pay but also other incentives like child care facilities, advanced vocational training or a good work-life balance, which are seen as essential motivating elements, too.<sup>42</sup> Reasons why this approach is followed could be seen in the variable and limited budget of the agencies and in the varying target rates whose amount depends on the market pressure. Concerning the first aspect, differences in the agencies' budget lead to varying bonus levels in different organisations and agencies and therefore PRP can be substantial in some cases and in others not.

## 2. Critique and challenges

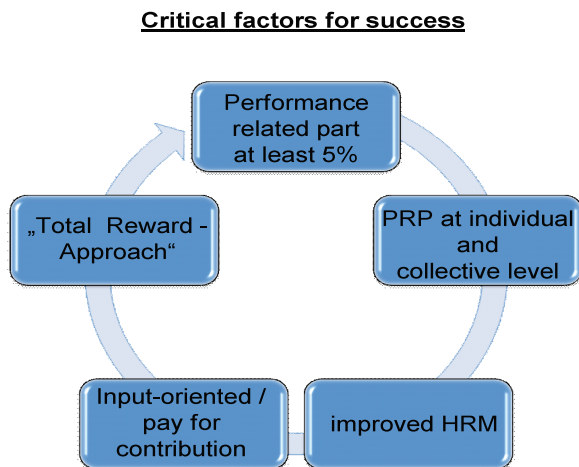
*According to recent research, fundamental for an effective performance-management framework is a minimum proportion of 5 per cent performance-related pay as well as non-monetary incentives*

In several studies David Marsden et al. (1993; see also Marsden and Richardson 1993; Makinson, 2000) have given recommendations for PRP and incentive systems. According to Marsden and Köllner (see figure 17), critical factors for a successful PRP system are, e.g., that the minimum proportion of performance-related pay should be 5 per cent. Moreover, they claim that fundamental for an effective performance-management framework is measuring performance, giving feedback of achievement and updating payment schemes through to dealing effectively with poor performance. They positively evaluate the British pay system, which is trying out a new 'Total Reward Approach' as several studies emphasised the importance of non-monetary incentives for increasing motivation and productivity.

*Input-oriented vs. output-oriented system*

Like in profit-sharing schemes, PRP at the collective level (teams or units) offers an opportunity to reduce envy among the staff and support their social cohesion. Finally, there is a debate about how far an input-oriented system (pay for contribution: skills and competences will be assessed) is preferable as an output-oriented system. As already mentioned, it is quite difficult to measure performance, results and productivity. Thus, the input-oriented system is mainly used in sectors where results are hardly measurable, e.g., compared assessments of schools, hospitals or police performances. PRP depends frequently on quantity instead of quality determining for instance by customers satisfaction.

<sup>42</sup> A detailed overview on different incentives can be found at Köllner, 2006, p. 21.

**Figure 11. Factors for success (according to Marsden/ Köllner)**

Source: compiled by the author; content of Marsden (1993, p.33) and Köllner (p.19)

Summarising the British PRP system it can be stated that due to decentralisation of civil servant's remuneration to departments and agencies, the scope for performance-related incentives are dependent on the budget. Interest in PRP schemes has spread over a wide range of public services, such as school systems, national health services, universities or police. Due to individual payment arrangements in all agencies, it is impossible to give details about the exact percentage of PRP. However, it is reported that British employees—similar as in Denmark and Finland—accept PRP (Demmke, 2009, p. 56).

#### **IV. Case study: PRP in Sweden**

Characterised by a previous rigid pay and grading structure, which was highly centralised until the late 1980s, the Swedish government devolved employer responsibilities to executive agencies in 1994. A system for individually differentiated pay at agency level replaced the existing universal grade system and is today well established. Overall, the PRP schemes in Sweden resemble more the British system than the German one because of the almost completely autonomy of the agencies in matters related to employer policy (each agency decides pay, promotion, hiring and firing, etc.).

*A system for individually differentiated pay at agency level replaced the existing universal grade system and is today well established*

##### **1. Description of the national system: Instruments and effects**

“The system of performance-related pay in the Swedish administration is more a system to evaluate and reward each employee's contribution to the agency mission and tasks than a tradition-

*Main objective is the creation of well functioning links between individual and organisational performance*

al pay for performance system (Dente, 2003, p. 10).’ This quote from Dente provides the main objective of the Swedish PRP system namely to accomplish primarily the agencies’ outcomes, results and efficiency. It is not so much a question of employee participation in terms of rewarding employees by merit increments or bonus distributions but more of creating well functioning links between individual and organisational performance (management by objectives) (OECD, 2005, p. 156).

*No uniform system of PRP: wages and other terms of employment are regulated by collective agreements with the unions*

And again, in the Swedish case, there is no uniform system of PRP. Most employees of the Swedish Government are under individual pay systems. Excluded are, however, senior government officials (notably university professors and directors-general) whose salaries are set on an individual basis either by a review board or directly by the government (OECD, 1993, p. 111). It is interesting to know that wages and other terms of employment are regulated by collective agreements with the unions, which are well organised and have a large membership (Ibid.). Benefits from performance reward systems can be derived as part of the local collective agreements (exceptions are among the police, armed forces and judges alike—as mentioned above—university professors and directors-general). The Swedish Agency for Government Employers (SAGE) represents government agencies in collective bargaining.<sup>43</sup> So the ‘basic agreement’ and the ‘general agreement’—as two types of agreements, which are negotiated at the central level between SAGE and the central unions—deal with the whole negotiation procedure, are valid over time and cover overall salary levels and other general conditions. In contrast, there are ‘local agreements’, which determine employees’ individual pay and local conditions and are seen by most staff as the most important agreement of course.

*Each department and agency establishes its own payment policy—including performance appraisal scheme—in negotiation with the unions*

In practice, each department and agency establishes its own payment policy in negotiation with the unions, which in turn participates in deciding what kind of performance appraisal scheme for individual merit or bonus payments will be used in each department. Different departments have developed their own performance appraisal schemes, which lead to an unstandardised and not uniform evaluation system in Sweden. However, individual salary increases are based on, e.g., merit ratings, typically based on tasks undertaken and job outcomes and furthermore on job level. Reasons and basic criteria for salary differentiations are the level of difficulty of work and responsibility as well as the requirements and demands of the work and of course the level of performance.

<sup>43</sup> For more details about SAGE, [http://www.arbetsgivarverket.se/t/Page\\_121.aspx](http://www.arbetsgivarverket.se/t/Page_121.aspx) (Accessed 2 December 2011).

## 2. Critique and challenges

The centrally negotiated and individual pay system is today well established throughout the civil service. Since 1990 the public sector has been using this system when recruiting as well as when deciding pay increases for employees.

Meanwhile, it is commonly agreed that pay should be individually determined (more than 90 per cent of the employees are on individually differentiated salaries). On the basis of three main factors (responsibilities within the job tasks, performance of the employee and the market situation), the Swedish PRP model shows on the one hand a strong relation to the employees' performance related to the achievement of agency objectives and cost savings. The government in turn monitors agencies' employment policies concerning competences, salary level and development, gender distribution, age structure and staff turnover as well as new objectives and areas for development (OECD, 2005, p. 154). On the other hand, the Swedish systems set a high value on the market situation. When determining individual payments, the market value of this particular job is crucial, too. The local agencies categorise different job positions on the basis of pay surveys and market analyses.

Summarising, the Swedish model is much closer to the British system than to the German one, which shows big differences in the compensation for public and private employees (for the same services). But similarly to all previous case studies, the compensation for employees is made up of the base (negotiated) payment as the largest part and the compensation for top performances as a minor part (among others like holiday pay or overtime premium). Hereby, supervisors in collaboration with the agencies maintain yearly dialogues with each employee (360 degree feedback system where both sides—employee and manager—give a feedback). The amount for PRP in Sweden ranges from 0 to over 30 per cent of the base payment and therefore the Swedish PRP model is highly classified. As is pointed out with regards to the Danish system: 'It is important [...] that the PRP makes up a reasonable part of the total pay. If the part is too small, why use [the] system at all (Dente, 2003, p. 24)?' The implementation of this system is reported to result in better recruitment and retention of good managers (OECD, 1993, p. 113). At last, it should be mentioned that team-based rewards are less regarded than in, for instance, Great Britain. Therefore,—although closer to the British system—the Swedish model in essence remains a gain-sharing scheme.

*90 per cent of the employees receive individually differentiated salaries*

*The amount for performance-related pay in Sweden ranges from 0 to over 30 per cent of the base payment and therefore the Swedish PRP model is highly classified*

## V. Alternative forms of participation

*Taking a different approach to ownership of organisations may bring significant rewards in terms of organisational performance, staff and user satisfaction as well as benefiting society*

Given the described problems in implementing PRP schemes, recently, initiatives to overcome its systemic limitations have been launched above all in the UK. As mentioned in the introductory remarks, employees may benefit of alternative models of ownership for instance in employee or user-owned (or employee plus other stakeholder-owned) organisations in public services: (i) employee-owned, (ii) co-owned, (iii) co-operatives, (iv) mutuals, (v) community trusts, (vi) social enterprises, (vii) public-interest companies and (viii) civic companies (OPM, 2010, pp. 29-32). All these refer to the same idea: taking a different approach to ownership of organisations may bring significant rewards in terms of organisational performance, staff and user satisfaction as well as benefiting society (OPM, 2010, p. 7).

### 1. Share ownership in the UK as a result of 'spin-outs'

*'New ownership forms' can result from existing public services*

Shared ownership models, which have a long heritage in the UK, were established in the middle of the 19<sup>th</sup> century. Co-owned organisations and mutuals represent nowadays a significant part in the UK economy (OPM, 2010, p. 7): The annual revenues exceed £95 billion a year. There are over 4,990 co-operatives in the UK, which are owned by circa 12.8 million members.<sup>44</sup> In the following, a few examples of alternative forms of ownership show how 'new ownership forms' can result from existing public services. They are implemented mostly in the context of 'spin-outs'.

#### a) Central Surrey Health (CSH)

*First employee-owned health service organisation*

In recent years, increased flexibility was introduced within the National Health Service (NHS) in order to react to operational necessities and matching pay to local labour markets and—increasingly—to performance (Glascott and Bowden, 1993, pp. 163-185). Established in 2006 as a spin-out, 'Central Surrey Health (CSH)' is the first employee-owned health service organisation. In 2010, they received the Philip Baxendale Awards, which recognised excellence in achieving successful employee ownership.<sup>45</sup> CSH provides therapy and community nursing services and is owned by circa 750 nurses and therapists it employs. Every co-owner who is joining CSH receives a 1p share in the business and those employees who will leave the company will give their 1p share back.<sup>46</sup> Interestingly, the co-owners will not receive dividends because the profit will be re-invested into the high quality of patient care. Furthermore, some elected co-owners are members in a representative body, which is called 'The Voice' who de-

<sup>44</sup> <http://www.uk.coop/economy/figures> (Accessed: 18.11.2011).

<sup>45</sup> <http://csh.dm-test.co.uk/image/csh/22c09fae-5bda-4b3a-9b9b-06b72cad8987.pdf>. (Accessed: 18.11.2011).

<sup>46</sup> [http://www.centralsurreyhealth.nhs.uk/page/social\\_enterprise](http://www.centralsurreyhealth.nhs.uk/page/social_enterprise) (Accessed: 22.11.2011).

bates in collaboration with the board on future strategies and current performances.

### *b) My Civil Service Pension Ltd based on the John Lewis model*

Another example is the case of 'MyCSP': 'My Civil Service Pension Ltd (MyCSP)' is the first joint-venture mutual, partly owned by employees collaborating with a private sector provider.<sup>47</sup> The company's ownership is divided into three parts. At first, one third is retained by the government, another third is owned by the joint-venture partner, and the employees own the last third. Employees will receive a share on joining the company and forfeit it on leaving. They will not be able to buy and sell their shares. Instead, the shares will be held in trust by an employee benefit trust (EBT), based on the John Lewis<sup>48</sup> model<sup>49</sup>: staff will receive dividends on their shares each year, with their value dependant on the company's performance. Thus, if the employee leaves the company, his/her share will be lost.<sup>50</sup>

*First joint-venture mutual, partly owned by employees collaborating with a private sector provider*

A professional director selected by the company will chair the EBT. Meanwhile, the staff will elect representatives to an employee-partnership council, and two members of that council will join the board of the EBT alongside the director. A representative from the employee-partnership council will sit on the company's executive board. But on the main shareholder board—the new company's key strategy-setting body—the employees will be represented by the appointed director from the EBT, acting as a non-executive director.

## 2. Co-operatives in Sweden

Sweden is a typical welfare state, and especially the health and social service sector is very important for employment and also in terms of financing. A CEEP study reported that 16.1 per cent are employed in the health sector followed by 11.1 per cent in the sector of education.<sup>51</sup> Meanwhile, in this sector, most SGI in the Scandinavian countries are provided by local public communities, and

*In health and social services sector, most SGI in the Scandinavian countries are provided by local public communities*

<sup>47</sup> In mid-2011, Francis Maude, the cabinet office minister, announced handing My Civil Service Pension (MyCSP) to a mutual (It's our business, 2011).

<sup>48</sup> The John Lewis Partnership operates 29 shops across the UK (28 department stores and one John Lewis at home), <http://johnlewis.com>, and 227 Waitrose supermarkets. The business has an annual turnover of over £7.4bn. It is the UK's largest example of employee financial participation where all 70,000 staff are partners in the business.

<sup>49</sup> Whereas John Lewis leads the world in employee motivation, it is not technically a true employee share ownership scheme: It is controlled by a trust that owns virtually all of the shares in the partnership. It does not operate employee share schemes and pays all annual bonuses to employees in cash and not equity.

<sup>50</sup> [http://network.civilservicelive.com/pg/interviews/csl\\_cronadmin/read/609750/](http://network.civilservicelive.com/pg/interviews/csl_cronadmin/read/609750/) interview-phil-bartlett (Accessed: 19.11.2011)

<sup>51</sup> CEEP Mapping Report (CEEP, 2010, p. 25).

in almost all areas of SGI there are today both public and private actors.

*Co-operatives in public services, such as childcare, are successful in Sweden, and some parents have established co-operative nurseries and schools*

The Swedish government created a supportive environment, provided workers with appropriate business support and knowledge for more co-operatives as well as invested in a national framework of co-operative business advice (Birchall, 2009, p. 2). Co-operatives in public services, such as childcare, are successful in Sweden, and some parents have established co-operative nurseries (and schools), which enhance choice and high-quality childcare services (Bland, 2011, p. 15). For example, 1,200 childcare co-operatives provide pre-school care for around 30,000 children; however, the majority of day care is still done directly by local authorities (80 per cent) (Bland, 2011, p. 15).

*Worker co-operatives and consumer/parent co-operatives benefit from the funding they receive from the municipalities*

Generally, Swedish childcare co-operatives are run as one of two different models of economic association: (i) worker co-operatives, which are owned and run by the staff/teachers, or (ii) consumer/parent co-operatives, which are owned and run by the parents. Both types benefit from the funding they receive from the municipalities, which cover only a portion of the costs (and parents' monthly fees, of course). In Sweden, municipalities have the authority to outsource pre-school services to non-municipal organisations, such as parent and worker co-operatives, voluntary organisations and private corporations. In the following, a few examples of childcare co-operatives are given as representative of the multitude of innovated activities:

- “Freneitskolan Kastanjen” (a multicultural co-operative school and pre-school),
- “Mångården” (a parents co-operative catering to Islamic children) and
- “Maria Gamla Stans Flyktingförskola” (a refugee pre-school which is funded by Sweden’s Department of Immigration).

*Co-operative childcare organisations meet many of the key socio-economic, cultural and religious-based needs of diverse groups*

Those pre-schools offer full-time care and education for children who are taught to understand and accept the diversity through learning about the different cultures and languages. The professional staff has the incentive to put new ideas into practice more easily than in a local authority run nursery. They also have the choice of how to use any profits they make, which in a public-run nursery would go back to the municipality (Bland, 2011, p. 16). In addition, all staff members have opportunities to make substantive contributions to decision-making processes at all levels within the pre-school. Employees are offered the possibility of assuming ownership of the organisation and its activities (Pedwell, 2003, p. 25). All in all, co-operative childcare organisations have succeeded in meeting many of the key socio-economic, cultural and religious-based needs of diverse (immigrant) groups.



Another potential role of co-operatives in the reform of social care lies in the domain of housing co-operatives, e.g., the Stockholm Co-operative for Independent Living (STIL).

## Chapter 4. Assessment of the specific factors affecting the development of EFP in the new Member States

*Denis Suarsana and Jens Lowitzsch*

### *I. Introduction*

Spontaneously, one could suppose that employee financial participation and especially employee share ownership must be widespread in the countries of Central and Eastern Europe. During the times of Communist rule in the region, all means of production were in state-ownership while the state was comprised—at least according to the official ideology—of the working class. Consequently, it could easily be expected that the transformation process would try to continue this tradition and broadly support workers to become company owners.

However, considering the respective current situation in the region, employee financial participation is only poorly spread in the countries' economies. This fact is even more surprising, if one notices that employee share ownership indeed has been a major form of privatisation in the early 1990s. But, since that height of employee financial participation in Central and Eastern Europe, this type of ownership has declined all over the region.

### *II. The role of EFP during transformation and thereafter*

The economic liberalisation process in Central and Eastern Europe required the introduction of broad private property ownership into the legal framework of the economies. Formerly state-owned enterprises had to be transferred into private property. Hence, the process of privatisation became one core element of the transformation in the region. As, until that time, the societies of Central and Eastern Europe had been comprised of non-owners—at least in terms of the means of production—the right to own property gained a rather new dimension in this context. Private property did not only mean controlling the means of production, but it also—and most notably—had to fulfil the function of 'social integration as an element of social stability, democracy, and economic justice' (Roggemann and Lowitzsch, 2009, p. 73). It is clear that in a society of previously non-owners the initial distribution of private property could not be a result of entrepreneurship or individual economic performance, but is rather the outcome of a planned distribution of this property among the population. Therefore, privatisation did not only have an economic dimension, but a crucial social and political function, too.

### 1. Employee share ownership became a major form of privatisation

In this context, employee share ownership became one major form of privatisation in Central and Eastern Europe. Politically this was considered necessary to secure the population's support for the transformation process in general and specifically for the process of privatisation (Uvalić, 2006, p. 58). However, it was also an imperative in economic terms, as it was used to compensate for the lack of domestic and foreign capital investment (Vaughan-Whitehead, 2006, p. 77). Hence, the implementation of employee financial participation schemes was entirely driven by practical considerations. This type of privatisation was simply the fastest and easiest one. But a political belief that employee financial participation should become a long-term principle of the economy could not be observed in any of the countries. Therefore, political measures to support employee financial participation in the long run are almost non-existing in Central and Eastern Europe. In consequence, this type of company share ownership declined rapidly soon after a temporary height during the first years of the privatisation process<sup>52</sup>.

At the beginning of the transformation process, in almost all states of the region employees enjoyed a privileged position in terms of the privatisation of state enterprises. Workers were able to obtain shares of their companies through discounts, leased buyouts, ESOPs or even for free. Only the Czech and Slovak Republic opted for a programme of mass privatisation through vouchers, which did not necessarily have to be used on shares of the worker's own company. As a consequence of this policy, insider-owned firms (by employees and managers) became very common in the region. However, until the mid-1990s, in almost all countries of the region, new privatisation legislation put an end to the preferential treatment of employees in this respect until. Consequently, the second half of the 1990s witnessed a rapid decline in employee ownership as many workers sold their shares, most frequently to their managers, but also to external investors and owners (Lowitzsch et al. 2006, p. 20 ff.).

### 2. Other types of EFP are rarely spread in the region

However, apart from employee share ownership other types of workers' financial participation are rarely spread in the region as well. Profit sharing has been in existence to some extent during Communist times, granting bonuses or other indirect compensations to individual workers. However, those schemes were fre-

<sup>52</sup> Once again, Slovenia must be named as the exception in this respect. Slovenia is home to a long tradition of workers' self-management. Hence, employee financial participation has not only been an issue during the early privatisation period. In Slovenia, this type of ownership is playing a major role in the economy until today (Lowitzsch et al., 2006, p. 19).

quently misused. Today both employers and unions are rather opposing these schemes. Especially trade unions opt for higher wages instead of flexible profit sharing (Lowitzsch et al., 2006, p. 27). Employers would only welcome the introduction of profit-sharing schemes as a way to reduce wage costs and hence downward the flexibility of wages (Eurofound, 2010, p. 41).

In co-operatives, workers participate in both company results as well as decision-making. This type of enterprise organisation also has a tradition in Central and Eastern Europe that reaches back into the times of Communist rules. However, this tradition turned out to be the co-operatives' main weakness. Although new laws on the issue were passed in most of the states of the region, co-operatives are rather rare. People associate those co-operatives with the old Communist regimes and therefore this type of employee participation is only poorly accepted in the region (Lowitzsch et al., 2006, p. 24).

### 3. Reasons for the decline in employee ownership

Interestingly, the decline in employee ownership cannot mainly be explained by a weak economic performance of those companies, which were mainly in the hands of the workers. There is no evidence that employee-owned enterprises were doing worse than other companies in Central and Eastern Europe. It can only be stated that employee-owned firms in general showed a slower implementation of employment adjustments. Lay-offs have been rarer than in externally owned companies as there has been a greater interest to find alternative adjustment measures. Hence, flexibility in terms of working time and wages was more common in employee owned companies, because workers were more willing to accept such measures in order to secure the profitability of the firm and to avoid massive lay-offs. The only real economic disadvantage of those employee-owned companies has been the fact, that they suffered from a lack of capital as they were facing major difficulties in getting access to credit and investment (Vaughan-Whitehead, 2006, p. 80 ff.).

Instead, two different political aspects can mainly explain the decline in employee share ownership. Firstly, the support from political decision-makers for employee financial participation has been low. No government tried to prevent workers from selling their shares to managers or external owners. The main explanation for the massive sale of employee-owned shares is the low level of wages in the economy. However, the governments did not introduce any measures—such as social support for workers or limitations for the selling of shares—to encourage workers to keep their obtained shares (Vaughan-Whitehead, 2006, p. 78). Further, in many countries of the region employee financial participation is

not even on the agenda of most political actors. Hence, there is no policy strategy in existence that would support the long-term implementation and sustainability of employee financial participation. Legislative support in the form of easy access to credit or tax incentives in combination with the application of such schemes cannot be found in the region, either (Lowitzsch et al., 2006, p. 28).

Secondly, employee financial participation is lacking any serious support from trade unions in the region. While profit sharing has been neglected entirely, employee ownership has at least been an issue on the unions' agenda temporarily. During the early years of privatisation, the trade unions have supported employee share ownership as an alternative to the transformation of state-owned companies into property of private foreign capital or to mass privatisation programmes. By this, the unions hoped to avoid external ownership and mass lay-offs, which were feared to be conducted during economic transformation. However, in addition to this initial support, the trade unions of the region did very little to secure the important role of employee share ownership in the economy. Neither did they support and inform workers to prevent them from selling their shares, nor did they promote the creation of any institutional framework to secure employee financial participation in the long run (Lowitzsch et al., 2006, p. 25)<sup>53</sup>.

Consequently, taking into account those two major factors, it is no surprise that employee financial participation in Central and Eastern Europe has turned from being a core element of the privatisation process into a declining phenomenon.

#### 4. Comparison to the West European countries

Interestingly, although employee ownership rooting in privatisation is in decline in most countries of the region, an East-West divide does not exist concerning share ownership schemes (Lowitzsch et al., 2009, p. 6)<sup>54</sup>. It seems that the variations within the different regions is much larger than between them (Hashi and Woodward, 2009, p. 35). In fact, according to CRANET data, between 1999 and 2005 the percentage of companies offering broad-based share ownership schemes increased in the old EU-15 from an average of 13 per cent to 17 per cent and in the new EU-12 from an average of 10 per cent to 23 per cent. We observe a

<sup>53</sup> The reason behind the trade unions' refusal or scepticism towards employee financial participation (not only in Central and Eastern Europe, but in all industrialised countries) can be found in a misunderstanding about the changing structure of the production process. Trade unions believe, 'that labour work is the only way to participate in production and earn income and [...] that capital mystically amplifies the "productivity" of workers who own no interest in it' (Kelso and Kelso, 1991, p. 153). By misbelieving that labour not capital productivity is on the rise, they remain simply demanding higher wages instead of financial participation in non-labour assets.

<sup>54</sup> However, there is—unsurprisingly—a large divide with regard to profit-sharing schemes, which are very rarely applied in Central and Eastern Europe (Lowitzsch et al., 2009, p. 6).

slightly different picture for the percentage of companies offering profit-sharing schemes, which increased in the old EU-15 from 29 per cent to 36 per cent and in the new EU-12 from an average of 19 per cent to 26 per cent (all weighted country averages).

However, this is not very surprising considering the important role that employee share ownership played especially during the early stage of the privatisation process. Since then, the number of such schemes has declined in Central and Eastern Europe to a similar level that can be found in the EU-15 states. This development indicates, that—without further political support—share-ownership schemes might soon fall below the level in Western Europe.

### *III. The role of EFP in Central and Eastern Europe CEE*

In Central and Eastern Europe, employee financial participation has almost exclusively been an instrument to facilitate privatisation of state-owned enterprises and to secure the population's acceptance of the transformation process. Thus, this concept has never been considered as a crucial element in the long-term process of shaping the region's economic systems. It is therefore not surprising that the potential and the advantages of employee financial participation—for both labour markets in special and the overall economic situation in general—have hardly been a subject in public and political debate.

The European Commission has suggested to transfer the positive effects of employee financial participation schemes in the EU-15 (as reported in the literature review; see Chapter 5 below) to Central and Eastern Europe promoting information dissemination on best practice. In this region, the prospect to financially participate in their own company's economic performance—either through share ownership or profit sharing—could raise workers' motivation and consequently increase labour productivity. As average wages in the region are relatively low, such an additional income could act as a relevant incentive for workers.

## Chapter 5. Literature review: Key features and implications of EFP

*Iraj Hashi, Jens Lowitzsch and Edvard Orlić*

### ***1. Review of the Literature on EFP***

The issue of employees participating in the financial results of their enterprises has become increasingly important across the European Union for at least the last two decades. This chapter aims to provide the reader with a review of the rich body of theoretical and empirical literature on EFP, especially the contributions in the last two decades. The research has been mainly concerned with the impact of EFP on the performance of companies and the particular mechanism linking the two. However, it should be emphasised that the bulk of this literature relates to privately owned companies, and therefore excludes most of the enterprises providing SGIs, which are fully or partially publicly owned. There has been very little research on enterprises providing SGIs and consequently this literature review is supplemented by an analysis of the available empirical data as well as the interviews conducted in SGIs in Chapter 2 of this Report.

The impact of EFP may vary widely in different enterprises because of the heterogeneity of enterprises in terms of the level of EFP, the extent of employees involvement in different forms of financial participation, the quality of employee involvement, and the broad culture of the enterprise in terms of employees' involvement in the decision making process.

The review is organised on the basis of the main areas in which EFP may be expected to influence the operation and performance of enterprises.

#### **1. Improved enterprise efficiency, labour productivity and competitiveness**

The most cited benefit of EFP in the theoretical literature is that it provides a mechanism for employees to be more involved in their firms. By giving employees a stake in the success of their firm, higher levels of effort, more positive attitudes and a co-operative behaviour will be induced. These will also result in higher labour productivity and improved overall enterprise efficiency, which—in turn—make the company more competitive (Blasi et al., 2003 and Freeman, 2007).<sup>55</sup>

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<sup>55</sup> Blasi et al. (2003) reviewed seventy empirical studies on the effects of employee stock ownership, broad-based stock options, profit sharing, and employee participation and found that the adoption of any of the scheme led to an average rise in productivity by 4 per cent, ROE by 14 per cent, ROA by 12 per cent and profit margins by 11 per cent.

EFP is also expected to enhance the employees' commitment to the firm and identification with its goals. (Perotin and Robinson, 2003). While share ownership is expected to generate greater long-term identification with, and loyalty to the company, profit sharing (especially cash-based) is likely to provide incentive for greater short-term effort by employees as some employees are likely to be risk averse and to value cash more than shares.

On the other hand, some theoretical literature have argued that employee ownership can have adverse effects on the performance of enterprises for a variety of reasons. Jensen and Meckling (1979) highlight the impact of the involvement of ill-informed employees in decision-making and their interference in the work of management. Hansmann (1990 and 1993) has drawn attention to the cost of 'collective governance'<sup>56</sup> and the impact of the conflict between heterogeneous groups of employees (young and old, skilled and unskilled, etc.) with different interests and objectives on the decision making process.

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

#### *a) Recruiting and retaining employees, especially in SMEs*

Financial participation can help the recruitment and retention of qualified employees, especially in SMEs, which find attracting and retaining such personnel problematic (Pendleton, Blasi, Kruse, Poutsma and Sesil, 2002). SMEs typically lack a well developed and extensive internal labour market found in many large firms, thus promotional opportunities are very limited. The challenge for SMEs is to attract experienced managers and other personnel, and retain them once they have been recruited.

#### *b) Reduced absenteeism and labour turnover*

Another benefit arising from EFP is reduced absenteeism and labour turnover (Robinson and Zhang, 2005). The change from a system of guaranteed wages, in which rewards are independent of efforts, to a system that provides employees with an income more directly linked to enterprise performance is expected to lead to greater employee commitment, lower absenteeism and labour turnover, and reduced conflict within the company.

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These findings are corroborated by Freeman (2007) who found that most research on employee owned firms showed that they are more productive and profitable, survive longer, and result in better shareholder returns.

<sup>56</sup> The experience of the last decade of decision making in enterprises in former Yugoslavia also provides a poor example of employee participation in decision-making, particularly in terms of the speed of decision-making and the excessive time spend in reaching agreements (Pendleton, 2001).



## 2. Information sharing

EFP offers the opportunity for information sharing between employees and their firm, which is of crucial importance to the managers and which would enrich the company's decision-making process. Information sharing enables the management to draw on the employees' knowledge of the company's operations and how they can be improved. Employees will be more willing to share such information when they feel this would benefit the company (Pendleton and Robinson, 2010).

## 3. EFP and the free-rider problem

Any group-incentive system is perceived to be subject to free riding. In EFP schemes each worker will receive only a small fraction of any additional income resulting from her own effort, but will gain the benefits of the collective effort of others when they are in a collective benefit scheme (such as, e.g., in profit sharing). Therefore, there is a temptation for free-riding, shirking and on-the-job leisure. As EFP schemes can foster greater trust, co-operation, and identification with the firm, they can also reduce the extent of free riding. Furthermore, EFP schemes may generate an environment, in which employees engage in 'peer monitoring' or 'mutual monitoring' and in which shirking is deterred (Kruse et al., 2004; Blasi et al., 2006; Fitzroy and Kraft, 1986).

## 4. Increased flexibility – EFP as a shock absorber during recessions

EFP schemes can introduce greater flexibility in the employees' remuneration package (Weitzman, 1984; Kruse et al., 2010). The significance of the flexibility of remuneration becomes clear especially during times of recessions or when the company is forced into restructuring. When there are unanticipated aggregate demand or aggregate supply shocks, compensation would adjust more quickly under profit sharing than under a fixed wage system, in which wages are set by long-term contracts. A profit-sharing firm would exhibit less employment variability than a firm with fixed wages (Weitzman, 1984).

The flexibility of the remuneration package is also of great importance to employees. In hard times, the employees' share of profit as a component of remuneration may decline but, in return, employees are more likely to retain their jobs.<sup>57</sup>

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<sup>57</sup> One recent example where employees agreed to pay cuts in exchange for shares is the case of pilots in British Airways who agreed to a pay cut of 2.6 per cent and the reduction of 20 per cent in some allowances (Daily Mail, 14 July 2009).

### 5. EFP as a tool for overcoming restructuring difficulties

In the times when restructuring is needed, changes to employment and working practices aimed at cutting costs and maintaining the level of productivity, become necessary for the firm to survive. EFP schemes provide a guarantee that employees, who have to make sacrifices for the good of the firm in difficulty, will benefit from successful restructuring. Furthermore, if EFP schemes are supplemented with involvement in decision-making, the effects should be even stronger (Jones, 2004).

### 6. EFP and SMEs

EFP may have specific benefits for SMEs, over and above the potential benefits available to all firms.<sup>58</sup> In high-technology sectors with highly skilled employees, it may facilitate the provision of start-up finance for new enterprises by attracting risk capital. It also provides a viable option for solving succession problems. EFP can promote an ‘entrepreneurial spirit’ in the workforce of SMEs and enable them to attract and retain key personnel (Pendleton, Blasi, Kruse, Poutsma and Sesil, 2002).

However, it should be recognised that introducing EFP in SMEs is quite difficult because the set costs of EFP schemes may be considerable in small companies. Also financing constraints may make pay-outs to employees in addition to wages very difficult.

### 7. Risk for employees

It is important to note that both profit sharing and share ownership involve certain amount of risk for employees. Profit is determined not only by employees’ efforts, but also by management decisions and external factors, which are outside employees’ control. The problem is potentially more serious with employee share ownership schemes as poor performance of the firm can result in lower share prices and losses for employees.

One of the oldest commonly referred to drawbacks of employee ownership is that—from the employees’ stand point—holding shares of their own company is a poor portfolio decision, involving a ‘double risk’ of becoming unemployed and losing their savings (invested in the company), if the company gets into financial difficulties. In reality, of course, shares of the company form only a small part of an employee’s savings and EFP schemes do not prevent employees from holding other forms of savings. There is also little empirical evidence for this assertion while employees them-

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<sup>58</sup> On a Framework for the Promotion of Employee Financial Participation. Brussels: European Commission, COM (2002) 364 Final.

selves seem to be less concerned with the issue (Kruse, Blasi and Park, 2008).<sup>59</sup>

## *II. Conclusions*

The main conclusion is that EFP is a policy, which has the potential to lead to improvements in the performance of enterprises as well as in the atmosphere, in which employees work. However, because of the diversity of the available schemes, it is not possible to generalise this potential. The success (or otherwise) of schemes will depend on the implementation methods, the role of participants, the specific EFP scheme applied and—in the case of ESO—also on whether employees have a majority share holding or a minority ownership.

The bulk of empirical evidence on EFP confirms the positive impact on various aspects of enterprise performance in private companies. EFP schemes are often seen as a solution to some of the problems of industrial societies: dissatisfaction of employees, poor quality of working life and declining productivity. It is argued that EFP schemes are likely to lead to lower absenteeism and labour turnover, greater investments in company-specific human capital and reduced conflicts within the company.

In terms of public services, EFP schemes—particularly those involving share ownership—cannot be applied in those public services, which are provided fully or jointly by government departments or institutions. Therefore, EFP in these services have to take different forms.

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<sup>59</sup> A recent large-scale study of employees' attitudes to EFP, covering over 35,000 employees in the US, shows that this issue (and more broadly speaking the issue of risk aversion) is not a barrier to EFP (Kruse, Blasi and Park, 2008).

## Chapter 6. Conclusions

EFP has been the subject of discussion at academic and policy level for several decades. But the interest in EFP has been revived in the last decade. However, most of the discussion on EFP has been in the context of enterprises that do not provide SGIs and little research has been done on enterprises providing these services. This report, therefore, provides the first study focusing on EFP in SGI enterprises.

### **There is a lack of research on enterprises providing SGIs**

There is a large body of theoretical and empirical literature on EFP. The large majority of these studies maintain that EFP schemes lead to improvements in labour relations, information sharing and co-operation, and reduced absenteeism and industrial strife, leading to increase in labour productivity and competitiveness of firms. There are also studies, which argue that EFP schemes blur the difference between employees and owners, free rider problem and increased shirking and an increased risk for employees. The bulk of the available empirical evidence, including large meta-studies, support the view that EFP schemes lead to improved enterprise performance. However, most of these studies refer to non-SGIs.

### **The incidence of EFP in SGIs is much less than in non-SGIs**

Different forms of EFP in private sector companies are already widespread in the EU and the United States, and they have been expanding the last decade. The number of companies offering EFP schemes, the proportion of employees covered by such schemes and the proportion of employees engaged in EFP schemes have all been growing in the last decade, despite the financial crisis of 2008/09. The European Company Survey 2009 is the only EU-wide database with information on EFP schemes adopted by enterprises in all sectors of the economy. The survey results show that EFP schemes are more prevalent in non-SGI enterprises than SGI enterprises. Within the SGI sector, there is also wide variation in the availability of EFP schemes. Some sectors, especially utilities, as Electricity and Water Supplies, have a much higher level of EFP than sectors such as Public Administration, Health, Education, etc.

**In a supportive environment, firms adopt EFP more actively**

Countries such as France, UK, Denmark, Slovenia and Ireland have adopted EFP schemes on a wider scale and supported them through legislation, fiscal incentives and a more friendly environment. In other countries such as Malta, Cyprus, Estonia, Latvia and Luxemburg, there has been less legislative and fiscal support and the enterprises have shown less interest in adopting these schemes. The case studies of this project—especially the analysis of the current legal framework—have, on the whole, supported the broad overview of the development of EFP schemes in EU countries. However, the specific situation of SGIs has a strong impact on the incidence: While in France the compulsory profit-sharing system with generous tax incentives for all EFP schemes has led to a relatively widespread incidence, in the UK with its focus on share ownership despite generous tax incentives the incidence in SGIs is much less.



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