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Financial participation in Europe: opportunities and risks for employees

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Policy recommendations

– Policy options for financial participation should be re-examined in the light of the recent call by the European Parliament to promote financial participation.
– Financial participation schemes should be designed so that all types of worker can benefit from them.
– These schemes should include design features to limit risk exposure and income substitution.
– Trade unions and works councils should seek active involvement in the introduction of financial participation schemes to ensure safeguards are built in and workforce objectives are achieved.

Introduction

Financial participation is the provision by companies of schemes which enable their workers to share in company profits and/or ownership. These schemes offer both opportunities and risks for workers. On the one hand, financial participation can supplement wages and salaries, thereby enabling workers to increase their income and wealth. On the other hand, the variability of profits and share prices poses risks to employees. Employees may lose as well as gain income and wealth. For this reason, financial participation is controversial and some trade unions are wary of it.

Uncommon in many European countries twenty years ago, the use of financial participation grew substantially in the early part of the twenty-first century as a result of initiatives by EU institutions and by individual countries. Many large companies in Europe now offer it to their employees, taking advantage of tax concessions and more supportive regulatory frameworks. However, its growth was adversely affected by the financial crisis in 2007-2008, after which the use of financial participation levelled-off (Eurofound 2016a).

Recently, there has been a resurgence of interest in financial participation: the European Parliament passed a resolution in 2018 calling for greater use and support for financial participation. The time is therefore ripe to review the current state of financial participation in Europe as well as the main issues arising in policy and practice.

This policy brief provides a summary of the main forms of financial participation and the issues that arise for employees and unions, drawing on the long-standing research in this area. It addresses several key questions:

– What are the main forms of financial participation?
– Who uses financial participation, and why?
– What are the implications of financial participation for other forms of employee participation and representation, exposure of employees to risk, and inequalities of wealth and income?
– What are the principles that should govern the use of financial participation?

What is financial participation?

There are two main types of financial participation: profit sharing and employee share ownership. However, the picture is complicated by the presence of sub-species and hybrid arrangements combining

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elements of both. Financial participation may also overlap with other elements of reward management such as group incentive plans and pensions.

Profit-sharing involves a variable income component, on top of the core or base wage, linked directly to profits or some other measure of enterprise results. The simplest form is *cash-based profit-sharing*, whereby employees receive a cash payment (typically one per year) based on the profits of the previous financial year. In *deferred profit-sharing* the allocated profit share is not immediately released to the employee. In some cases, the profit share may be paid into an employee savings plan or other collective investment vehicle. Changes in pensions regimes in some countries have recently encouraged employees to put profit shares into pensions savings. Gain sharing is similar to profit sharing in so far as employees benefit from reductions in costs, and hence increases in surplus. Gain sharing might therefore be seen as an alternative form of financial participation suitable for non-profit and public-sector organisations.

Employee share ownership enables employee participation in enterprise results indirectly by facilitating employee participation in company ownership. It gives access to dividend payments based on profits and to gains in the market value of share capital. There are several types of employee share ownership plan:

– Free shares for employees. Here there is an overlap with profit sharing in that profits may finance the share award.
– Share purchases, typically on advantageous terms such as a discount on market price. In some plans employers match the purchases made by employees. Since the onus is on the employee to opt into buying shares, participation in these plans tends to be lower than eligibility.
– Stock options, whereby employees are granted rights, possibly at a discount on market rates, to acquire shares in the future, typically between three and ten years. Employees benefit from growth in share value between grant and exercise. At exercise, employees may choose not to exercise, to exercise and sell, or to exercise and retain the shares acquired. These schemes are said to be free of 'downside risk'.
– Where access to share capital is not feasible, employees might be awarded 'phantom shares'. These derivatives are linked to share value to provide cash rewards but do not bring about share ownership.

Employee share ownership can be individual or collective. In the latter, shares are held collectively on employees' behalf. Alternatively, they may be held collectively at first but then distributed to individual employees over time, as in ESOPs (Employee Share Ownership Plans). Most employee share ownership plans involve only a small proportion of the firm's share capital becoming owned by employees (typically less than 5 per cent). Although employees may acquire voting rights through share ownership, they do not usually gain significant control rights in practice.

Typical tax benefits available to profit shares are exemption from income tax for employees and social security concessions for employers. In employee share ownership schemes, gains in share value may be subject to capital gains tax rather than income tax at the point of sale. There may also be other benefits such as tax exemption on discounts on the price of acquiring shares. For companies, the costs of running financial participation schemes can usually be offset against revenues, and hence company taxes.

Objectives for financial participation

There has been considerable interest within the EU in the promotion of financial participation. A series of so-called PEPPER (Promotion of Employee Participation in Profits and Enterprise Results) Reports since the early 1990s (Uvalic 1991; Poutsma 2001; Lowitzsch 2006; Lowitzsch *et al.* 2008) have identified the objectives and benefits, and charted the incidence of, financial participation. Several initiatives by EU institutions have attempted to promote legislative and regulatory reform within Member States so as to encourage companies to use financial participation (see Worker-participation 2017).

Objectives

Financial participation is believed to enhance employee involvement and identification with their companies, thereby improving company productivity and performance. Committed employees sharing in the fruits of company success will work more effectively, which will benefit the company. The potential role of employee share ownership in corporate governance has also come to the fore recently, with employee shareholders being seen as 'patient capital', as a counter-balance to short-term investors.

Principles

In a Communication from the European Commission to other EU institutions (Commission of the European Communities 2002), the following principles for financial participation were set out. They have imbued European-level initiatives ever since:

– Participation should usually be voluntary for both companies and employees
– Financial participation schemes should be open to all employees
– Financial participation should be managed in a clear and transparent way, with full information and consultation with employees and their representatives
– Financial participation should be operated according to pre-defined formula
– Schemes should comprise regular payments or invitations to employees
– Financial participation schemes should be designed to avoid unreasonable risk for employees
– Financial participation should not be a substitute for wages and salaries

There is broad agreement on these principles between European employers' organisations and many union confederations but employers emphasise the voluntary nature of these principles whereas unions often seek mandatory employee protections. Some trade unions are opposed to financial participation (especially share ownership plans) because they feel it blurs a fundamental division between labour and capital (Pendleton and Poutsma 2004).

Who uses financial participation?

There is considerable variation between European countries in the incidence of financial participation, reflecting differences in fiscal concessions and regulatory support. Profit sharing is far more common than share ownership because the set-up and administration costs are lower, and regulatory requirements are less demanding. Across Europe, profit sharing is found in 30 per cent of establishments with 10 or more employees, compared to 5 per cent for share ownership schemes (Eurofound 2016a). Profit sharing tends to be most widespread in Central and Eastern European, along with Scandinavian, countries. The United Kingdom is often seen as an exemplar for employee share ownership because of the longevity and extent of regulatory support for broad-based plans.

In terms of coverage, profit sharing is more likely to be broad-based than share ownership schemes. The European Working Conditions Survey 2015 shows that around 13 per cent of European employees receive income from some form of profit sharing and just 4 per cent from company shares (Eurofound 2016b), a slight increase since 2005 (Welz and Fernandez-Macias 2008).

Financial participation is more prevalent in larger companies and establishments (Ligthart *et al.* 2018). Share ownership schemes also tend to be primarily found amongst companies listed on stock markets, where shares can be readily traded. Financial participation tends to be most widespread in financial services and least widespread in transport and construction (Eurofound 2016a). Workplaces with a relatively high proportion of white-collar employees and with workers performing complex work tasks are more likely to use financial participation. Evidence from Finland, France, Germany, and the United Kingdom shows that levels of training are higher in workplaces and companies with financial participation (Guery and Pendleton 2015; Jones *et al.* 2012; Kraft and Long 2013; Pendleton and Robinson 2011).

Table 1 **The incidence of profit sharing and share ownership schemes in Europe 2013 (% of establishments)**

Country	Profit sharing schemes	Share ownership scheme
Austria	46	7
Belgium	20	5
Bulgaria	34	5
Croatia	19	3
Cyprus	22	6
Czechia	51	4
Denmark	35	6
Estonia	42	8
Finland	51	12
France	41	8
Germany	30	3
Greece	17	2
Hungary	16	2
Ireland	24	7
Italy	18	3
Latvia	23	1
Lithuania	53	13
Luxembourg	29	12
Malta	13	0
Netherlands	34	7
Poland	34	4
Portugal	21	3
Romania	32	2
Slovakia	53	3
Slovenia	55	8
Spain	25	5
Sweden	38	9
United Kingdom	26	9
TOTAL	30	5

Source: European Company Survey 2013 (reported in Eurofound 2016a).
Base: Private sector establishments with 10 or more employees.

Issues for employees and their representatives

Financial participation gives rise to four main issues for workers and their representatives, linked to the EU principles mentioned earlier.

Relationship to other forms of employee participation

The ETUC view is that financial participation should not substitute for other forms of employee participation, and that it is likely to be more effective when it is operated in tandem with employee involvement in company decision-making. There is a good deal of evidence to support this from the US, where studies have shown complementarity between financial participation and other forms of employee involvement (Kruse *et al.* 2010). However, a study of financial participation in Finland, France, Netherlands, and the UK found no clear association between financial participation and various forms of employee involvement (Kalmi *et al.* 2006). The claim, therefore, that financial participation is most effective for firms when operated in conjunction with other forms of employee involvement needs further examination and research (Pendleton and Robinson 2010).

Relationship to trade union representation and collective bargaining

A particular concern amongst trade unions is that financial participation may undermine collective bargaining and trade union representation. Financial participation payments might be used to substitute for negotiated pay increases. Involving employees in the ownership of the company might weaken employee attachment to unions. However, the evidence suggests that financial participation is not widely used as a strategy to weaken union representation (Pendleton 2005).

It has, however, been used alongside decentralisation of collective bargaining arrangements from national or sector to company level, especially where decentralised arrangements are aimed at aligning pay more closely with company performance. This is not necessarily a threat to employee and union representation if there are well-developed representative structures at company level, such as works councils. Profit sharing is more amenable to use in this way as it is usually paid through payroll, whereas share ownership schemes are mainly governed by securities regulations rather than employment law (though contributions may be deducted from wages and salaries).

Unions could attempt to influence financial participation to ensure that worker interests, such as protection from undue risk, are built into scheme design. On the whole, they have not sought much involvement in the introduction of share ownership schemes (the main exceptions being some occupational and white-collar unions). The introduction of financial participation is rarely required by law to be subject to collective agreement, though Belgium is a significant exception. There are myriad of reasons for the lack of involvement of unions in the introduction of financial participation, especially share ownership, schemes: these include a belief that statutory frameworks preclude the opportunity to shape scheme characteristics, a lack of expertise and resources to fully engage with them, and in some cases hostility to the principle of financial participation. Where unions and employees are involved in the design and implementation of schemes, they have a positive effect on the coverage of profit sharing and share purchase plans (Kalmi *et al.* 2006).

Exposure of employees to risk and wage substitution

Financial participation exposes employees to risk since remuneration will vary according to company and stock price performance. A particular danger arises where share ownership schemes form a significant element of employees' long-term savings. Company bankruptcy can wipe out employees' pensions as well as cause redundancies, as exemplified by Enron in the United States.

In practice, the exposure of employees to risk is very limited in most European financial participation schemes. The proportion of remuneration accounted for by profit sharing tends to be small: usually 5 per cent or less. Risk exposure may be further limited by smoothing or gearing mechanisms to limit variation in profit share payments. Employee share ownership schemes tend to limit risk exposure, especially where employees contribute to acquire shares. It is common for matching shares to be awarded, and for shares to be offered at a discount. Tax breaks may also reduce risk exposure. Thus, it may be that share price must decline considerably before employees lose any of the value of their contributions.

A critical issue is whether financial participation substitutes for core wages and salaries. The evidence suggests that it usually complements rather than substitutes for wages. Recent French studies find that establishments with financial participation have higher base and total wages (Baghdadi *et al.* 2013; Floquet *et al.* 2016). It is difficult to use share ownership schemes for wage substitution because they nearly always operate independently of wages and salaries.

Inequalities of income and wealth

Financial participation can aid employee asset formation and accumulation of wealth. It may thereby make a small contribution to reducing inequalities of wealth. Profit share payments and company shares may be rolled-over into a company savings scheme or pension plan. Profit sharing may also counter income inequalities but much depends on the mode of distribution. Profit shares are typically distributed either equally, linked to pay, or linked to tenure, and may be adjusted according to the typical hours of work. Clearly, equal profit shares have more positive re-distributional effects.

Some forms of employee financial participation, notably share purchase schemes, involve employees making contributions to acquire shares. Those with more financial resources are more likely to be able to purchase shares (Degeorge *et al.* 2004), raising the issue as to whether tax concessions are disproportionately benefiting higher earners. Financial participation also tends to be found in larger companies with better-rewarded employees, so may widen pay inequalities between primary and secondary labour markets.

Equally, the availability of workplace schemes can encourage low income employees to accumulate savings and wealth where they would not otherwise do so. British evidence gathered by the author indicates that a substantial minority of plan participants do not make any other regular savings besides their share plan contributions, and that they would spend their contributions if the share ownership plan was not available.

Conclusions

After several decades of discussion and activity within the European Union, financial participation plans can be found in companies in all Member States, though to varying degrees. This reflects the efforts of many Member States, as well as EU institutions, to promote financial participation and develop appropriate regulatory frameworks.

There are diverse views about financial participation amongst trade unions. Whatever the perspective, there are clearly issues that are relevant to unions when companies introduce financial participation plans. These include eligibility and coverage, the involvement of employees and their representatives in plan design and implementation, the relationship to other elements of remuneration and human resource practices, the links to other aspects of collective agreements, the management of risk within the plan, and the distribution of benefits.

As a general recommendation, financial participation schemes should be designed so that all types of workers may benefit from them. Second, they should include measures to limit risk and preclude income substitution. Active involvement by trade unions and works councils in plan design and governance can help insure that safeguards are built in and that workforce objectives for these plans are achieved.

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