Guest editorial: Introduction to the special issue "The development of employee share ownership and profit sharing, across the EU-27, the United Kingdom and the United States of America as of 2024"

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1. Structure of the special issue

This Special Issue contains six papers which provide an overview of the development of employee financial participation (EFP), i.e. employee share ownership (ESO) and profit sharing (PS), across the EU-27, the United Kingdom (UK) and the United States of America (USA) as of January 2024. The work presented stems from and refers to the most recent Promotion of Employee Participation in Profits and Enterprise Results (PEPPER) V Report published in May 2024 (Lowitzsch and Hashi, 2024).

(1) The first paper by Jens Lowitzsch and Jasper Lüke gives an introduction against the background of the policy development of the past 35 years. It highlights the growth of financial participation over the last decade, referring to the most recent cross-country data available, i.e. the 2021 CRANET Survey, the 2019 European Company Survey and the 2015 European Working Conditions Survey, which also show its potential positive impact on employment and productivity. The overview table at the very end summarises the 29 country profiles of the PEPPER V Report.

(2) The following paper by the two editors of the PEPPER V Report, Iraj Hashi and Jens Lowitzsch, provides a comparative assessment of EFP in the EU Member States and the UK, showing how the regulatory framework and the political support have evolved between 2014 and 2024. It proposes a framework for the ranking countries based on regulatory density and support measures and provides an assessment of this ranking in the light of empirical data on the incidence of EFP. The countries are ranked using three indicators, i.e. (1) legal framework, (2) fiscal incentives and (3) political support/social dialogue.

(3) Joseph Blasi and Douglas Kruse show in Paper 3 that positive distributive effects in the EU and the USA are called into question by the concentration of capital ownership and capital income at the top in the two regions.

(4) Paper 4 by Denis Suarsana and Jens Lowitzsch focusses on ESO in different types of small and medium-sized enterprises (SMEs), i.e. start-ups, conventional firms and social enterprises. It argues that tax and fiscal incentives should be extended to all enterprises including those from the social economy.

All articles submitted in this Special Issue are based on work from the PEPPER project, a series of reports since the 1990s, with the latest work being co-funded by the European Commission DG MARKT (No: MARKT/2013/0191F2/ST/OP) (both the collection of the country data of the 29 Country Profiles and the online dissemination tool "Virtual Centre for Employee Financial Participation", see https://kelso-institute-europe.de/tools/compare-countries/) and by the Kelso Institute Europe (editing and updating all 29 Country Profiles in 2024).

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(5) Paper 5 by Jens Lowitzsch, John D. Menke, Denis Suarsana, Graeme Nuttall, Tej Gonza and Thibault Mirabel proposes a transnational approach to develop a European Employee Stock Ownership Plan (ESOP). The utility of such a common European legal vehicle is demonstrated across the entire life cycle of an enterprise, with a focus on how it can facilitate business succession in SMEs, drawing on best practices from the EU Member States, the UK and the USA.

(6) Finally, in the light of the tour d'horizon on EFP of this Special Issue, Jens Lowitzsch makes policy recommendations at the national level and to the European Commission. His contribution, last but not least, highlights the complementarity of employee and consumer financial participation in the context of the "Proximity and Social Economy industrial ecosystem" and the energy transition.

This Special Issue is based on the so-called PEPPER Reports [1], in particular PEPPER V, which is the latest of five reports starting in 1991. The different aspects of the analyses presented draw on the most recent data on the scope and impact of various EFP schemes in EU companies. They use this information and the most recent legal and regulatory changes in individual MS to develop policy recommendations for concrete actions to implement the commission's policies on the promotion of employee ownership. In some respects, the conclusions of the PEPPER V report are similar to a number of previous policy documents (particularly those by the 2003 High Level Expert Group and the 2013/2014 Pilot Project for the Directorate General MARKT), which, however, were not or only partially followed. However, unlike previous studies, the recommendations of this report come at a particular point in time, where, in response to an EU-wide public discussion on fair and equitable participation in the aftermath of the COVID-19 pandemic, both the European Parliament and the European Commission have shown an explicit interest in taking concrete action.

2. Context, aims and scope of the PEPPER reports

The European Commission's interest in EFP has grown substantially since publication of the first PEPPER Report (details of the policy development are described in the first paper of this Special Issue). With the recommendation on EFP of 27 July 1992, the European Council encouraged its active promotion by all EU Member States. To move the issue forward, in 2002 the commission published a communication on a framework for the promotion of EFP. Opinions drafted by the European Economic and Social Committee as well as reports and studies by the European Parliament and a 2014 resolution further emphasised the growing importance of EFP, particularly with respect to SMEs. Already in the 2012 Action Plan, the commission had committed itself to several measures intended to encourage long-term shareholding. However, inasmuch as many different issues are involved (such as taxation, social security contributions and labour law), the commission has highlighted the importance of analysing ESO in more detail, particularly its internal market dimension, stating, "*the Commission will identify and investigate potential obstacles to trans-national employee share ownership schemes, and will subsequently take appropriate action to encourage employee share ownership throughout Europe*" (EC Communication Action Plan, 2012, p. 11).

This was the background for the European Commission putting promotion of employee shareholding on its action plan to reform European company law and corporate governance [2] and embarking on the 2013/2014 Pilot Project for the Directorate General MARKT, which developed a "Five-Point Plan to Promote Employee Participation" [3]. The Pilot Project concluded that if the policy objectives of promoting EFP at the EU level are to be successful, measures beyond the assessment of the current situation and the identification of best practices are necessary. Information-sharing and awareness-raising are crucial in the short to medium term, while creating a level playing field for EFP through a European legal framework was deemed important in the long term. A package of different short, medium and long-term initiatives, combined in a five-point action plan to promote EFP, was suggested. Making the necessary and relevant information available to those needing such information (especially SMEs) and the promotion of best practice examples for EFP could be accompanied by means of a voluntary code of conduct for EFP, to be regularly amended by, e.g. a commission expert group. Parallel measures to raise awareness, e.g. a European EFP Day, could accompany and frame the above measures. With regard to the much-needed transparency on taxation and social security contributions for the various national EFP schemes, an online effective tax rate calculator was developed to quantify the effective tax burden for EFP schemes across the EU-28, thus providing a representative comparison of the effect of tax systems and of specific tax incentives. Finally, regarding the harmonisation of national legislation, a binding legal framework on EFP was considered. However, to avoid conflict with existing national EFP models, an optional Common European Regime for EFP was identified as a more pragmatic policy option.

In response to these European Commission goals, the most recent PEPPER V Report of 2024 undertook to:

(1) Benchmark the incidence of EFP schemes across the EU-27 and the UK, drawing on the various available rounds of cross-country surveys and showing the dynamic of EFP between 1999 and 2021.

(2) Assess EFP across the EU-27 and the UK, explaining the reasons for widely divergent approaches between Member States and identifying problems with cross-border implementation of EFP schemes and

(3) Analyse regulatory and non-regulatory actions that might be proposed or undertaken by the European Commission to promote EFP and in particular ESO.

Within these parameters, the principal concerns were the differences pertaining to different types of enterprises in terms of size and sectors including for the first time start-ups, the specific obstacles to the spread of ESO schemes and the challenges confronting SMEs in particular with regard to business succession.

3. Types of employee financial participation plans in the EU

Financial participation of employees is a form of remuneration, in addition to regular pay systems, that enables employees to participate in profits and enterprise results (Uvalić, 1991; Robinson *et al.*, 1995). It can take a variety of forms:

(1) Individual ESO (employee shares or stock options but excluding executive stock options);

(2) ESOPs (i.e. collective ESO, with shares acquired through an intermediary entity, financed by a share of profits allocated to employees in addition to their remuneration) and

(3) PS (in cash or shares, paid immediately or deferred), including gain sharing.

Individual ESO provides for employee participation in enterprise results in indirect ways, through receiving dividends, appreciation of share values or both [4]. Shares may be distributed for free or may be sold at market price or under preferential conditions; the latter may include sale at a discount rate (Discounted Stock Purchase Plan), sale at a lower price through forms of delayed payment (usually within a capital increase) or by giving priority in public offerings to all or a group of employees. There are also *employee stock options*, which – unlike executive stock options granted to reward individual performance – are broad-based and offered to all or a majority of employees. The company grants employees an option, which entitles them to acquire shares in the company at a later date, but at a price fixed at the time the option is granted. The potential gain from rising share prices is the primary reward conferred by options.

In *ESOPs*, the acquisition of shares is facilitated through a separate intermediary entity usually set up by the company and financed by a profit share paid in addition to wages and – of course – dividends of the shares acquired. Essentially, the structure is as follows:

(1) The company establishes an ESO fund for the benefit of its employees, and shares are held and managed in the trust by a separate entity (in continental Europe by a limited company, foundation, or association; in the UK, Ireland and North America, usually a trust).

(2) The fund is financed by a combination of company contributions and loans. The former are free shares or cash, usually as part of a PS agreement with the employees. The trust may borrow money directly from a bank or from the company, which may utilise a loan from a bank or other lender.

(3) Shares are either acquired directly from existing shareholders or through a new share issue. They are held collectively in trust and are only allocated to individual employees' accounts, or distributed, after a specific holding period.

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

PS – strictly defined – means the sharing of profits between employers and employees by giving the latter, in addition to a fixed wage, a variable income directly linked to profits or some other measure of enterprise results. In contrast to individual incentives, this concept involves a collective scheme, which generally includes all employees. In practice, PS can take various forms. The formula may include profits, productivity and return on investments. It can provide employees with immediate or deferred benefits; it can be paid in cash, enterprise shares or other securities; or it can be allocated to special funds invested for the benefit of employees. A related form of participation is the concept of *gain sharing*, designed to provide variable pay and usually to encourage employee involvement by rewarding employees for improvements in individual and organisational performance. In addition to the basic salary, usually to reward individual or small unit performance, gains, measured by a predetermined formula, are shared with employees through cash bonuses [5].

Although ESO and PS are often used in combination, a distinction has to be made between the two, particularly because of fundamental differences in taxation and with regards to participation in decision-making. Both forms are often embedded in asset accumulation or employee savings plans, which offer a vehicle to allocate and invest sums received in other schemes. While PS, employee share schemes and stock options are relatively widespread in the EU, ESOPs are predominantly found in countries with an Anglo-American tradition, e.g. the UK and Ireland (Shanahan and Hennessy, 1998). However, ESOP-like schemes exist in other countries, e.g. in France, where enterprise mutual investment funds (FCPE) pool monies from PS schemes and voluntary employee and employer matching contributions are made to buy shares in the employer company, take part in capital increases, or receive free shares [6]. With regard to ESO, it should be kept in mind that 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 (Pérotin, 2002, p. 8).

To link these many and very diverse EFP models found in the EU Member States, a commission-financed project developed the "Building Block Approach", which includes all the above-mentioned forms of financial participation practiced and stresses the potential of combining different forms of EFP tailored to the situation and needs of individual enterprises (Lowitzsch *et al.*, 2008) [7]. This approach reflects the postulates of the 2002 Commission Communication, i.e. that all EFP schemes should: be regularly applied; be calculated according to a predetermined formula; be treated as an addition to wages; provide variable employee benefits linked to enterprise performance; have all employees as beneficiaries;

cover all types of enterprises, both private and public; be used in all enterprises irrespective of size; be simple; include employee information and education and be voluntary. The European Parliament has also endorsed it [8].

Therefore, and since ESO is often funded by PS schemes, this Special Issue reviews the entire range of EFP, however, with a focus on employee ownership.

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Notes

1. See https://www.eurofound.europa.eu/en/pepper-reports.
2. European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies, COM(2012)0740; Section 3.5. Employee share ownership.
3. For details see Lowitzsch *et al*. (2014) Study on the Promotion of Employee Ownership and Participation, Brussels 2014; this study for DG MARKT summarises the results of the Pilot Project.
4. To defer the valuation problem in unlisted SMEs, capital participation may initially take the form of an employee loan to the firm, creating corporate debt (external capital) then converted into company shares. Valuation of the shares to be acquired through the loan can be postponed until the moment of the actual conversion into shares (debt-to-equity) without impeding the implementation of the scheme.
5. The formulae 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).
6. According to the Association Francaise de la Gestion Financière (AFG) in 2013, out of a total of EUR 98bn managed in FCPEs, ca. EUR 37bn were invested in share plans of the employer company.
7. With forewords of the then Presidents of the European Parliament Hans Gert Pöttering (DE/EN/FR) and Jerzy Buzek (PL).
8. Own-Initiative Report on financial participation of employees in companies' proceeds; 2013/2127 (INI) – 18 December 2013, recommendation no 19.

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