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EMPLOYEE FINANCIAL PARTICIPATION IN BUSINESSES: EXPECTATIONS AND EXPERIENCES PART II

INTRODUCTION

In view of the events in recent years that have revived doubts about the basic principles and durability of traditional forms of capitalism and the directions of its reform, the interest in employee financial participation (EFP), including widespread employee ownership may return. Its popularity has grown during the last three decades in Europe, encouraged by a growing commitment of the European Commission (EC) to popularize it. Much empirical evidence on the successful implementation of EFP has been gathered and new instruments have been implemented. However, the outcome of research on the direct dependence of EFP schemes in companies on their economic performance is rather ambiguous. Moreover, questions can be asked on the relevance of EFP for emerging new forms of labor and employment. This article is intended, first, to remind us about the legacies of the past and, second, to present recent forms of financial participation. It also includes a short discussion of the main research questions raised in connection with EFP effects on the enterprise performance and tries to summarize its results.

This paper is a second part of a larger study on financial participation of employees (EFP) in their companies.¹ The first part was devoted mainly to the idea of employee financial participation, its economic and social justification, its

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¹ Due to space constraints, the study was split into two parts; the first one was published in the same journal in the previous year (2014, nr 3), Błaszczyk, 2014, pp. 314–332.

general evolution and its relevance today. Additionally, the efforts of the EU bodies to disseminate the idea and practice of EFP were presented. The second part of the study focuses more on practical aspects of employee financial participation, its implementation in most advanced countries, and discusses shortly the EFP research findings.

The paper comprises four sections. It begins with outlining the concept of financial participation and its main forms, making a clear distinction between employee financial participation (EFP) and employee participation in management (EPM), or non-financial participation. It also outlines the rationale for financial participation, addressing its main objectives and shortly deals with the mutual links between financial and non-financial participation. The second, longest section reports on the historical evolution of the different forms of financial participation, such as the American and English *Employee Stock Ownership Programs* (ESOPs), German *Kapitalbeteiligung* or French *participation*, and presents the legal and financial instruments in the business environment fostering their implementation. The third section discusses the recent recommendations of the EU concerning institutional arrangements of EFP in Europe. In the final section, we conclude with a short presentation of recent research questions on EFP.

1. FINANCIAL PARTICIPATION VS. WORKERS' PARTICIPATION IN MANAGEMENT

*Financial participation*² is the participation of employees in the profits and/or assets of the company. It refers to financial benefits, property and rights resulting from this fact. By contrast, *workers' participation in management* (*non-financial participation*)³ means employee representation in business management (on various levels) and refers to employees as social partners. Thus, both concepts of employee participation have different meaning, very different ideological roots and justifications, different practical and legal forms. Having said this, we have to agree that both concepts of employee participation have at least one important feature in common. That is, the concept of management where the worker is perceived as a valuable and value-adding participant of the enterprise, and not only as a small part of a larger mechanism. It is based on a premise that the employees have to understand and accept the enterprise system and business logic in which they find themselves in order to be better motivated to work.

² German term: "materielle Beteiligung der Arbeitnehmer".

³ German term: "Mitbestimmung" (English: "codetermination").

1.1. NON-FINANCIAL PARTICIPATION

The rights of employees to take part in the decision-making process (sometimes referred to as co-management) are derived solely from a labor-based legitimization; that is, they result from employees' share in work, not in property⁴. In most countries of continental Europe, *non-financial participation* is regulated by law (at least since the 1980s) and operates in the majority of large companies⁵. Institutions supporting non-financial participation have been created at different levels of business management and have taken different forms in different countries, including, in particular, direct and indirect, or "representative", participation. The most common and most popular form of indirect participation involves employee councils, which are usually elected and established at the department level throughout the company. Their primary role is to serve as information and consultation entities and, in some areas, to enable participation in the decision-making process. Another important form of indirect participation is co-management at the level of entire company, which involves the participation of employees' representatives in boards of directors of public limited companies. Since 2001, in addition to national legislation regulating this type of co-management, European companies are subject to an amended EU-Joint Stock Company Statute, which includes the participation of employees' representatives in the governing bodies of such companies⁶.

It is the author's view, in Europe, this type of non-financial participation at the enterprise level has sometimes exceeded its rational scale. The most far-reaching forms have not always proven to be the most beneficial for the business or for the employees themselves. For example, board of directors' "parity co-management"⁷ set out in the 1951 Act (the so-called "Montanmitbestimmung" Act), which was compulsory for enterprises employing over 1,000 workers in the coal and steel industry in the Federal Republic of Germany (FRG), led to a mass exodus of businesses wanting to avoid this law. These businesses used various strategies, such as redeployment of production, division of companies into smaller units and/or dismissal of employees⁸. Similarly, a less radical⁹ Co-management Act of 1976, mandatory in all German joint stock companies

⁴ In its most extreme form, the labor-based argumentation was encompassed in the concept of the classic self-governing enterprise (owned collectively by the employees). The analysis of this form can be found in Błaszczuk (1990).

⁵ Details can be found in Błaszczuk (1988) and more up-to-date information can be found in Lowitzsch (2011).

⁶ This concerns multinational corporations operating in several EU countries.

⁷ This refers to an equal number of employee representatives and shareholder representatives in the board of directors, and the human resources director selected by the employees (Błaszczuk, 1988, pp. 82–82).

⁸ One hundred large companies employing one million people were subject to this law when it was approved in 1951. In 1980 the group consisted of only 35 companies employing half a million people.

⁹ Under the terms of this act, the shareholders' representation on the board of directors has the majority thanks to the additional voice of the Board's chairman (representing shareholders).

employing more than 2,000 people, led to a similar business “escape strategy”, which began already during the negotiations regarding the legislation in the first half of the 1970s and took on such forms as changing the legal form of companies, reducing the number of employees, changing the companies’ by-laws to reduce board of directors’ authority, forming internal committees and advisory teams to the board of directors composed solely of shareholder representatives, etc.). According to some critics of the most far-reaching forms of employee participation in management, these were merely healthy attempts to escape from wrong-headed requirements that would have limited their ability to make rational management decisions. Analyses of the German economy of the late 1980s have shown that companies with far-reaching employee rights to co-manage at the board of directors level avoided risky decisions and developed strategies focused mainly on maintaining existing jobs and not attempting deep restructuring (Benelli 1983; FitzRoy, Kraft 1987).

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

Although it should be noted that, in addition to the legally required forms of participation in management, many companies (especially smaller ones) voluntarily offer additional forms of non-financial participation as a result of the particular needs of the companies. This type of participation often arises in connection with the introduction of financial participation and the need to attract employees and involve them in the process. An interesting, though less popularized, form of non-financial participation is the so-called *direct* workplace *participation*, which consists in creating autonomous working groups, quality circles and other similar institutions that enable employees to manifest their initiative and creativity in shaping both the work environment and work process. It seems that this type of non-financial participation that was introduced particularly in the Scandinavian countries (Rudolf 1982) deserves special attention in the current situation, taking into account both the needs of today’s businesses (the ability to introduce rapid changes and innovations), as well as the characteristics of the work environment (the increasing level of education and growing aspirations).

1.2. FINANCIAL PARTICIPATION

Employee financial participation in companies covers a very wide spectrum of solutions ranging from participation in profits, through individual shares in equ-

ity and employee stock options, to employee ownership systems like ESOPs, specially designed to serve this purpose, which combine employees' participation in the profits and capital of companies¹⁰. *Financial participation* is thus an umbrella term referring to various forms of supplementing employees' fixed remuneration with a variable component of earnings, the value of which depends on the profit or loss of the company. However, the term should only be used to describe solutions used regularly and universally and covering the majority of employees of a given company¹¹. One of the main features of financial participation is that it is introduced voluntarily, on the initiative of the entrepreneurs. However, legal and tax incentives play an important role as well. *Financial participation* creates additional economic and legal bonds between the company and its employees. All financial participation schemes are based on a similar idea: to make the employees co-beneficiaries of the company or, in the most far-reaching systems, co-owners. The main types of employee financial participation within their two basic forms: employee profit sharing schemes and employee share ownership were presented in the previous part of the paper (Błaszczuk, 2014, pp. 317–322). Thus, we will only shortly mention here the main justifications for EFP, presented there in a more detailed way. At the forefront are the demands for greater fairness in the compensation of workers, who are not treated merely as a cost but also as the most creative factor of production. Secondly, one of the most frequently cited economic reasons to implement financial participation is to improve individual and collective motivation at work. By introducing additional benefits linked to the company's performance, it is expected that employees will show greater interest in the quality of their work, greater ability to work in teams, and greater identification with their enterprise. However, for the entrepreneur, the important justification lies in the ability to enhance the flexibility of remuneration in response to changes in market conditions and the company's bottom line. For smaller companies, implementing employee equity-sharing can help to improve the capital structure (by increasing shareholders' equity) and to resolve succession issues when the owner retires. In the case of large companies, the key arguments for financial participation are the improvement of internal communication, more sustainable employment and the implementation of a more effective HR policy (Guski and Schneider, 1986, p. 28).

On the macroeconomic level, social and economic benefits linked to the financial participation consist in giving a chance for a more equitable distribution of wealth (without expropriation or redistribution) and the resulting changes in social stratification and attitudes. Another important goal of financial participation is to increase society's capacity to save and invest, as well as to promote knowledge of the market economy and the acceptance of its rules. Finally, in many countries, financial participation aims to strengthen directly the pension

¹⁰ The term *employee financial participation* concerns *individual* property rights, hence it does not cover the legal form of cooperative which assumes *collective* ownership of an economic entity.

¹¹ This far-reaching interpretation derives from the 2002 EC report (European Commission, 2002).

system by allowing employees to accumulate large savings on their supplementary pension accounts.

The question we should address now is: what are the links between financial and non-financial participation? As it was mentioned above, smaller companies, that are not obliged to do so, often voluntarily offer additional forms of non-financial participation as a result of the particular needs of the companies. These cases often take place in connection with the introduction of financial participation and the need to attract employees and involve them in the process. Generally, it is hard to imagine a stable and well working system of financial participation in an enterprise without the understanding and acceptance of employees of its rules and their involvement in establishment of this system. This explains the minimal demand for employee representation and exchange of information. On the other hand, in literature, we can find very different views on that topic. One extreme position is that without far reaching involvement of employees in business decisions, there is no chance for successful implementation of financial participation schemes. Another extreme position is that combining employee financial participation and non-financial participation in one company is “too much” and it could destroy the power balance between owners/managers and workers/employees. We think that there is no easy answer to this question and in each case, the institutional “equipment” for financial participation should be very carefully considered and adjusted to the local needs, in order to avoid ideological traps, and should introduce efficient working schemes, beneficial for both sides.

2. FINANCIAL PARTICIPATION: HISTORY AND RECENT STATUS

2.1. EARLY HISTORY

The tradition of employee financial participation dates back to the early nineteenth century, when the first attempts were made to create systems enabling employees to receive regular shares in profits. In the middle of the nineteenth century, profit-sharing schemes were already successfully implemented in companies across Great Britain and Germany. One of the best-known cases was the system of financial participation in profits introduced in 1847 by the German economist J.H. von Thünen in his own estate of Tellow in Mecklenburg (Thünen, 1850). Interestingly, the capitalized profit shares in this system were assigned to the creation of future employee retirement security. This system lasted until the owner’s death and the estate’s subsequent sale at the end of the nineteenth century. Attempts to implement financial participation also have a long history in France, where at the end of the nineteenth century it was attempted to pass a law imposing employee financial participation in company profits. Employee participation systems were developed in a systematic way from the bottom up in European countries, in Great Britain and in the United States until the Great Depres-

sion in the early 1930s, when they collapsed along with the economy¹². The renewed development of financial participation began after World War II.

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

2.2. THE DEVELOPMENT OF FINANCIAL PARTICIPATION AFTER WORLD WAR II

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

¹² It was estimated that in Great Britain in 1929, over a quarter of a million employees participated in such systems (Estrin et al. 1987).

2.3. EXAMPLES OF NATIONAL SOLUTIONS¹³

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

2.3.1. FRANCE

In France, which is one of the few countries where financial participation is required by law, efforts were first concentrated on programs enabling employees to share in profits and to participate in corporate savings plans. In 1959, under President de Gaulle, the government passed a decree obliging all enterprises to introduce so-called participatory systems giving employees the right to a share of the company's profits. The decree was then reviewed in 1962 and 1967. Initially, these were cash payments out of profits. Later, deferred payments were added¹⁴, which were made into special participatory funds, where they had to be held for three years in exchange for tax benefits. The form of profit distribution is usually determined by collective agreements. Since 1967, increasingly broad employee savings plans, implemented voluntarily by entrepreneurs, have been introduced in addition to the required profit-sharing. Participation in these plans is voluntary for employees and most often requires a financial contribution from both parties. These savings funds are later used to purchase company stocks or shares in external investment funds. In the first case, employee share ownership is created and can be further enhanced by the right of employee savings funds to acquire company stocks while enlarging its capital, if employees hold less than 3% of shares in the company's capital stock. In the 1980s, these legal solutions were supplemented and expanded. Furthermore, financial participation was placed high on the political agenda with the passage of a law requiring financial participation programs to be part of negotiations between employers and trade unions. In the 1990s, additional tax benefits were extended to employees exercising the right to purchase options, provided they did not sell them within a given period. In 2001, two new types of savings plans were introduced – one designed for employees of small businesses, and the other for pension purposes. Today, as

¹³ Most historical information included in this section is taken from Blaszczyk (1992), and newer data are taken from Lowitzsch, Hashi, Woodward (2009) and Lowitzsch (2011). A detailed review of solutions implemented in a larger number of countries in Europe and outside is presented in Kozłowski (2013)

¹⁴ Since 1967, deferred payments out of profits have been obligatory in all companies employing more than 100 people and, since 1986, in those employing more than 50 people.

a result of the implementation of these laws, France has a rich and multi-faceted system of employee financial participation.

2.3.2. BELGIUM

In Belgium, various proposals to create mandatory or voluntary forms of profit-sharing were hindered by both the uncompromising attitude of trade unions and the reluctance of the majority of political parties. As a result, it was not possible to implement any incentives for financial participation until the early 1980s, when efforts were undertaken to introduce financial participation in a different way, i.e. by creating financial facilitation projects for employee shareholders, which were gradually transformed into laws. Subsequent bills, passed in 1982, 1983, 1986 and 1987, introduced an incentive system to encourage employees to purchase shares in their own companies, whereby a specified amount¹⁵ set aside for the purchase of shares would be tax exempt, if these shares were frozen for five years. This facilitation concerned the purchase of newly issued shares by all employees in joint stock companies, limited liability companies, and foreign companies and their subsidiaries subject to taxation within the country. The supplementary act of 1990 stipulated that shares issued to employees alone could not exceed 20% of the company's capital stock. A law was also passed in 1984 to regulate employee rights to purchase stock options and associated privileges. These rights apply to all employees of the types of companies listed above. The law also specifies a maximum amount¹⁶ for which an employee may purchase options and stipulates that the options must be frozen for at least two years and that the capital gain derived from the difference between the purchase price and selling price is not taxable. In 1999, the revised law on options determined that no social contributions should be paid on the employee capital gains on stock sales. These regulations made financial participation very attractive for both employers and employees in Belgium, where the high tax progression and relatively high social security payments can be avoided by paying out a part of employee income in the form of options. For the same reason, these solutions met with opposition from trade unions, which demanded higher primary wages and the protection of high social security contributions instead of financial participation. At the end of the 1980s, many Belgian enterprises introduced voluntary employee profit-sharing programs in the form of share certificates. The 2001 act on employee ownership and profit-sharing schemes brought all existing tax advantages related to financial participation programs under a single regulatory umbrella and introduced common systemic rules, including requirements of universal participation of all employees in such schemes, approval of schemes by an employee representative, and the right of employees owning shares to vote. At the same time, it also introduced

¹⁵ In the beginning, the sum amounted to 40,000 Belgian francs but was later lowered to 20,000.

¹⁶ This was 500,000 Belgian francs or 25% of the employee's income from the previous year.

limits¹⁷ for financial participation programs in companies and allowed institutions for collective management of employee shares to be established. An important element of the act was the introduction of the foundations for establishing savings funds based on deferred employee profit-sharing in small companies. Despite considerable political difficulties in Belgium, a multifaceted employee financial participation system, with extensive possibilities in practice, has thus been established.

2.3.3. GERMANY

In the post-war period, West Germany¹⁸ approached fostering employee financial participation from a different angle, i.e. by supporting savings and efforts to reduce financial inequalities among citizens and by rebuilding the middle class. Laws introduced since 1961 aimed to support these attempts by creating financial incentives for systematic saving in various forms, including the acquisition of shares in companies and incentives for employers to partially finance these acquisitions¹⁹. As part of the national policy to create wealth, a new term was coined, namely “wealth-increasing expenditures”²⁰, which refers to regular payments by the employer (beyond payroll) for the benefit of employee savings, subject to an additional state premium. The upper limit of annual savings and the premium amount were determined by the state²¹, whereas specific amounts were negotiated by the employer and employee representatives in collective or workplace agreements. Initially, public benefits referred equally to all forms of long-term savings (e.g. construction, housing or insurance savings, or savings on the purchase of shares or bonds). After 1984, clear legal priority was given to savings in the form of capital aimed at creating wealth in the hands of employees, either in their own company or with institutional investors. The Participation Act of 1986²² differentiated the premiums that could accrue from different types of savings, in favor of equity-sharing²³. It also greatly expanded the range of possible forms of employee equity-sharing schemes that could benefit from these premiums, to include stocks, bonds, shares in limited liability companies, as well as other less-known forms of investment in own business

¹⁷ The yearly expenditures on financial participation programs cannot exceed 10% of annual remuneration and 20% of the company's profit before tax.

¹⁸ Most of the data concerning Germany are taken from Blaszczyk (1992), which also contains detailed information on regulations implemented in Germany, together with their financial engineering.

¹⁹ “Vermögensbildungsgesetze”.

²⁰ “Vermögenswirksame Leistungen”.

²¹ Initially the limit was 312 DM per year, which was raised to 936 DM at the end of the 1980s.

²² “Vermögensbeteiligungsgesetz”.

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

and beyond²⁴. These benefits were conditional upon meeting some formal requirements and providing employees with the freedom to choose the form and location of their investment. In order to receive an untaxed savings premium from the state, the savings had to be frozen for a period of six years; however, the company's subsidy to the employee is subject to taxation and social security payments. Additional incentives to invest in equity-sharing were introduced with changes in fiscal law, whereby the capital gain resulting from the difference between the market price of shares and the price at which they were issued to employees²⁵ was exempted from income tax (and from social security payments). As a result of these long-standing forms of support for employee savings and investments, stemming partially from employers, partially from the state and only in small part from the employees themselves, such employee capital savings programs exist in most German businesses. The most widespread form of employee participation is profit sharing via profit-sharing systems created by combining savings plans with employee shareholding promotion measures.

2.3.4. GREAT BRITAIN

In the UK, legislation supporting employee ownership in companies was initiated in the 1978 Finance Act and then expanded in 1984 and 1988 by the Income and Corporation Taxes Act and the 1989 amendment to the Finance Act. Originally, the facilities only included tax relief for employees participating in "approved all-employee profit-sharing schemes", recognized by the Inland Revenue, which meant that the employees received grants consisting of company shares, with a fixed upper limit²⁶, free of charge or at preferential prices. These shares could be sold after two years; however, only after a five-year period could the granted amount be exempted from income tax. The tax on capital income was maintained regardless of the length of the grace period. In subsequent years, other facilities for employee stock options were introduced, related to regular savings plans ("savings-related share option schemes"). These facilities covered employees who declared having saved a certain amount of money (up to 150 pounds) every month for a period of 3–5 years. By the end of this period, the total amount saved could be spent on acquiring shares at a price that was 20% lower than the issue price (at the beginning of the savings period).

By establishing the institution of a "qualifying employee share ownership trust" (ESOT) and introducing special exemptions from corporate income taxes on the amounts invested by companies into these trusts, the act of 1989 significantly expanded the opportunities for investing within the framework of

²⁴ Such as employee loans to their company, attestations and usage rights, shares in silent partnerships, cooperative shares, as well as fund shares, share certificates and foreign securities accepted in the FRG.

²⁵ Up to the amount of 500 DM per year.

²⁶ Initially the limit was 10% of annual employee income or 5,000 pounds per year, which was raised to 6,000 pounds in 1989.

employee share ownership. The ESOTs can use the money received from the company to purchase its shares, repay loans with the interest received, pay dividends and shares to shareholders, as well as cover other expenses²⁷. The employees have similar tax advantages and withdrawal periods, as in the case of profit sharing and saving schemes described above. The legislation of 1989 was designed to facilitate the establishment of employee equity-sharing schemes and to increase their popularity among all companies, not just those listed on the stock exchange. ESOTs can be set up in smaller companies, which do not issue stock, in which case they serve as an internal market for the company's shares. Additionally, the ESOT can invest outside the company as a collective fund.

Legislation on employee share ownership was revised again in 2000 as the Share Incentive Plan (SIP). The SIP confirmed and extended the tax advantages for both employees and employers on savings intended for share purchases. Up to a specified amount, the money set aside for share purchases is deducted from taxable income. Furthermore, employers may transfer their shares to employees free of charge; the latter can then sell their shares after five years without being subject to income tax or social security contributions.²⁸ Due to the significant administrative burden on businesses in carrying out such plans, the law allows for the plan's administration to be outsourced to third parties, which is often done in practice. Thus, the UK offers many financial advantages to employees and companies introducing financial participation schemes. The process, however, is controlled by detailed regulations and scrutinized by the tax office. The scale of different forms of financial participation in UK was already significant in 2006, when shareholder-approved plans associated with participation in profits and stock options were present in 5,000 companies and included approximately one million people, and other savings plans were present in more than 4,000 companies covering 2.6 million workers (Lowitzsch 2011, pp. 28–31).

²⁷ To obtain a corporate tax exemption, the company is required to fulfill a number of conditions, such as extending the benefits to all employees and disbursing the money received by the trusts from the company in a timely manner.

²⁸ Four categories of employee shares were distinguished in the SIP framework: “free shares”, i.e. stocks obtained for free from the employer, with a maximum value of 3,000 pounds per year; “partnership shares”, i.e. stocks that employees can purchase from non-taxable remuneration, with a value of up to 1,500 pounds per year or 10% of the annual income; “matching shares”, i.e. double stocks that employers can add to every “partnership share” they purchase; and “dividend shares”, i.e. dividends obtained from the other three types of stocks, which can be reinvested into these stocks for up to 1,500 pounds per year. All of these stock types may be sold immediately, in which case they are subject to regular taxation and social security payments. If the stocks are kept in the system for 3–5 years, they are subject to lower tax and social payment rates, and if they are kept for over 5 years, the employee is exempt from paying taxes and social contributions. If the employee leaves the company before the grace period, s/he pays lower taxes and social contributions or, if justified, is completely exempt from them.

Since 2012, a new political action of the Tories government has taken place, called “employee ownership”²⁹. This has been confirmed in many public announcements of government members who claim that employee ownership helps “to create a fairer society shared by all and a stronger economy, which distribute its rewards, is diverse and sustainable”³⁰. Another official statement said that employee owned business with higher employee engagement “boost the retention, innovation and motivation of their employees”³¹. What is new in this approach, is the statement that employee ownership can be seen as one of business models in the economy (like charity, franchise or management buy-out) with its own diversity, which should be seen as its strength (direct, indirect³² and hybrid models). Since indirect model needs some elaboration, in order to produce well working arrangements, the government published in 2014 guidance documents for establishing employee benefit trust or trustee company and accompanying guidance on tax issues. Additionally, new tax reliefs have been considered by the Office of Tax Simplification (OTS) and implemented in the Finance Act 2013 in order to enable wider employee share ownership.

Unfortunately, the employee ownership in its new version has been strongly politicized. The government has introduced from 1 September 2013 an employee shareholder status, which gives additional benefits in receiving shares exempted from capital gain tax in exchange for fewer employment rights than before. The latter arrangement has met adverse reaction and criticism among employees.

Paying no heed to this reaction, the government official statement is that “employee ownership provides a “win-win” outcome, for both a business and its staff, benefits that can be relevant at every stage of the business life cycle and that work across all sectors and size of business.” (Nuttal, 2014).

2.3.5. UNITED STATES OF AMERICA

In the United States, modern forms of support for employee participation were preceded by a long-term state policy aimed at supporting equity-savings among employees and at encouraging employers to allocate their funds for this purpose. In the mid- to late 1940s, high economic prosperity was accompanied by rigorous control of wages and high tax progression. This prompted several companies to develop plans for employee profit-sharing, under which the transfer of income to employees was exempt from income tax, if the shares were frozen for a ten-

²⁹ Graeme Nuttal, a Government’s Independent Adviser on Employee Ownership defined it as follows : “Employee ownership means a significant and meaningful stake in a business for all its employees.” Nuttal (2014), in: “What research must do to improve the health of employee ownership in the U.K?”. Speech delivered at the International Conference on Employee Ownership. Research and Practice, University of York, 2–3 April 2014.

³⁰ Nick Clegg (Deputy Prime Minister) (2013), Robert Oakeshott Memorial Lecture, 27 March 2013 and other speeches (2012 – 2014).

³¹ Speech of Business Secretary Vince Cable at the first Employee Ownership Day, on 4 July 2013.

³² Where shares are held on behalf of employees through an employee benefit trust.

-year period. Most of the plans introduced at that time were designed as supplementary pension funds for employees and included either employee profit-sharing systems within the company or systems whereby the shares were transferred to pension funds outside the company. In the following years, despite the abolition of wage controls, profit-sharing plans developed rapidly and their number doubled every five years.

In the 1970s state policy priorities changed, and the state began to give more and more support to employee share ownership in companies. The initiator of the original institutional solutions for American employee ownership was Louis O. Kelso, a lawyer, economist and visionary, who in 1956 organized the first buyout of a company by its employees under an employee stock ownership plan. Kelso actively promoted this type of ownership³³ until his death in 1991.

In 1974 the Congress passed the first law³⁴ in support of employee ownership plans called ESOPs (“Employee Stock Ownership Plans”). The ESOP is an institutional solution that allows for collective acquisition of shares/stocks by employees in the companies employing them, on credit, which is later repaid from the profits of the enterprise. The employees become full-fledged owners of their individual shares after the loan is repaid by the trust managing the ESOP. However, they cannot freely dispose of their shares until they either retire or leave the company. In the following fifteen years, the Congress passed 15 more acts favoring the ESOP concept, the most important of which was the Tax Reform Act of 1983, enacted under President Reagan. This act provided tax relief to all parties interested in setting up and running ESOPs, under the condition that the plans did not lead to discrimination and were available to all employees. Under these provisions, the taxable income of the company was decreased both by the company’s contribution to the ESOP on behalf of its employees (up to 15% of the wage bill per year) and by contributions used to repay bank loans used for purchasing employees shares, including interest. ESOPs were exempt from income tax, bank income on the loans to ESOPs were subject to a 50% tax relief, and the owners of the companies who gave shares to ESOPs were exempt from capital gain tax, conditional upon the reinvestment of these assets in other stocks. The employees were obliged to pay income tax only after the withdrawal of their shares from the ESOP trust, usually when they retired³⁵. In such favorable conditions, the employees could become owners without incurring any costs on their part. Hence, a proliferation of ESOPs began. All these facilities were subject to numerous restrictions aimed to prevent fraud, which in turn led to considerable complexity of fiscal regulation and a high degree of administrative control. These

³³ Among Kelso’s numerous publications, two deserve special mention: *The Capitalist Manifesto* (1958) and *Democracy and Economic Power: Extending the ESOP Revolution Through Binary Economics* (1986).

³⁴ Employee Retirement Security Act (Erisa). Its author, Russell Long, was a Democratic senator from Louisiana, although ESOPs were also supported by Republicans, including three Republican presidents.

³⁵ The financial architecture of ESOPs is shown in more detail in Blaszczyk (1992).

factors in turn mean that helping to set up an ESOP has become a profitable business for several thousand legal and consulting firms. It has also had a negative impact on the federal budget. Due to the reliefs and tax exemptions discussed above, lost revenues to the budget between 1977 and 1983 were estimated at US\$3 billion³⁶ to 9.9 billion³⁷. Despite this fact, the idea of the ESOP as an institution promoting employee financial participation assisted by loans turned out to be very interesting and has survived not only in the United States but has also been adopted in many countries around the world. In the United States, the ESOP as an institution has remained almost unaltered, though amendments to and interpretations of the law have become too numerous. An important feature of the ESOP is its universality, i.e. the possibility for it to be set up in almost any type of business, regardless of legal form and size. This has enabled ESOPs to be set up in even the smallest family-owned companies. So far, Europe has not introduced such a flexible legal form of financial participation.

As popular as establishing ESOPs in United States was in the late 1970s and 1980s, in the 1990s a wide dissemination of employee stock option plans began. While ESOPs were created mostly in smaller and unlisted companies, the stock option purchase plans could be introduced in large companies. In 2000 it was estimated that the number of stock option owners equaled or exceeded the number of ESOP members (both approximately 8 million)³⁸. After 10 years the total number of different type employee owners was estimated at 28 million (NCEO, 2012)³⁹. Furthermore, it is estimated that the capital included in employee ownership now constitutes about 8% of the total capital of all commercial companies and each employee of a company that has an ESOP receives an annual average revenue equivalent to US\$4,443 and has an account worth an average of US\$55,836. At the end of 2009, ESOP capital resources were estimated at approximately US\$869 billion.

* * *

Concluding this part, we should remind one important observation that was presented in the first part of our paper, concerning the scale and size of EFP in Europe and the USA. The observation was that in all analyzed countries, there is a fairly high percentage of companies practicing various forms of financial participation (from several to several dozen percent in different categories), but the percentage of employees who actually benefit from these programs is much lower. This means that the potential scope of financial participation is much greater than its use in practice. This leads us to the question: why this potential cannot be used?

³⁶ According to data of the ESOP Association.

³⁷ According to Estrin et al. (1987).

³⁸ According to Joseph Blasi from the National Center of Employee Ownership, in 2000 in the United States there were approximately 8.5 million ESOP members in approximately 11,000 companies and 7–9 million share option owners in several thousand companies (Blasi et al. 2000, p. V).

³⁹ More detailed statistics are presented in Błaszczuk 2014, p. 323 .

3. EU RECOMMENDATIONS

In the previous paper, the EU efforts promoting and fostering employee financial participation and the obligatory principles for proper institutional arrangements of EFP, defined by the EU bodies were presented. Now, we turn to the EU guidelines published more recently, concerning EFP practice.

Recent recommendations of the European Socio-Economic Committee steer towards combining various forms of financial participations in such a way as to make employee shares funded by profit-sharing. In its opinion, the Committee indicates that in some large European companies there already are models of employee ownership where purchasing shares through trusts is financed by profit shares paid in addition to wages. Usually, for this purpose, a separate intermediary entity⁴⁰ is created, which, acting as a trust, manages the shareholding of the employee. The governance of this entity should be a direct expression of the will of all employee shareholders, with no influence from management, in a democratic way. The Committee lists 10 examples of such companies and describes the stated goals of their financial participation schemes⁴¹. In three of these cases, the declared purpose of introducing financial participation was “enhancing the loyalty and motivation of employees”, in three others “privatization and strategic shareholding” and in remaining, “financing of the company’s growth”, “business succession” or “spin-off”.

While tax incentives, according to the Committee, are not a must for financial participation, they have been shown to provide positive and important leverage for its wider implementation. However, in the opinion of the Committee, since the EU lacks competence over taxation issues, there is a need to develop “a facultative, simple, uniform incentive model, with the same tax arrangements and incentives throughout the EU, [which] could considerably boost the number of cases where there is a willingness to introduce EFP” (European Socio-Economic Committee 2010). It also proposes to take deferred taxation as the lowest common denominator for the development of the proposed model. Before the European model is established, the Committee calls for mutual recognition of individual Member States’ schemes for businesses operating across borders. As Europe unites, the differences in employees’ rights to financial participation in their companies become particularly visible and can have an adverse effect on both labor mobility and enterprise competitiveness. Therefore, an important argument can be made in favor of the attempt to give equal rights in this regard to all employees within the European Union.

⁴⁰ In continental Europe it is a limited company, foundation or association, and in Anglo-American countries it is usually a trust.

⁴¹ These include: AUCHAN (France), HOMAG AG (Germany), Pfalz Flugzeugwerke PFW Aerospace AG (Germany), Voestalpine AG (Austria), Oktogonen Foundation (Sweden), Herend-ESOP (Hungary), Tullis Russell ESOP (United Kingdom), the Eircom ESOP and AerLingus-ESOP (Ireland).

4. RECENT RESEARCH QUESTIONS ON EFP AND THEIR RELEVANCE FOR US

The main justifications for introducing EFP in modern enterprises seem to be obvious. The potential benefits for employees and employers are clearly visible. More and more companies around the world voluntarily implement EFP schemes and later broaden them, and numerous governments decide to support EFP systems with financial incentives.

There is a large body of literature on EFP⁴² but the research approach, scope and methods differ significantly from each other which results in difficulties in comparisons. Therefore, unambiguous research outcomes on the overall connections between EFP and economic performance of companies are missing. Also, a comprehensive theory of workers financial participation does not exist, though there are some promising psychological approaches⁴³ trying to understand the sources of employee motivation in connection with EFP schemes.

There is a common conviction that the influence of financial participation on the final performance of company is a very complex issue that depends on many factors and its clarification needs deep and interdisciplinary research (for detailed analysis see Kozłowski, 2013). Therefore, newest research focuses more on investigation of the impact of chosen factors of institutional arrangements of EFP schemes or chosen outcomes of them. The findings of this research may explain why the potential of financial participation has not been achieved to a larger scale.

The question why financial participation is working well in some companies while it brings no visible results in others is not only linked with the construction of the participation scheme in the company but also with its understanding by employees. Research findings suggest that financial participation can motivate employees to more intensive and innovative work when they are really involved in the company's business. This may be achieved by efforts aimed at better information for employees, establishing much stronger communication channels and sometimes introducing additional forms of non-financial participation. Financial participation is thus only one – though important – instrument of raising the employees' self-esteem and consequently expecting from them improved attitude towards the problems of the company. As we have mentioned in the first part of the study, there is evidence from USA after the last economic crisis that financial participation had a positive influence on the survival of companies and maintaining employment. This has also to do with the workers' attitude toward their company.

There are many important arguments in favor of employee financial participation. Since the practice in Poland in this area is very limited, there is a need

⁴² See for example Estrin and Jones, 1992; FitzRoy, and Kraft, 1992; Kruse and Blasi, 1997; Blasi at al., 1996; Pendleton 2001; Perotin and Robinson, 2004; Kruse at al., 2004; Poutsma at al., 2006.

⁴³ Bakan at al., 2004.

to further explore the nature of institutional arrangements serving the financial participation of employees, their linkages with other economic institutions, and to consider their implementation. To conclude, we need to learn from the most advanced countries and companies how to make financial participation work for the benefit of enterprises, employees and the society at large.

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ABSTRACT

The second part of our study on employee financial participation (EFP) is mainly devoted to the presentation of experiences and achievements of EFP in most advanced European countries and the US. Historical evolution and recent institutional arrangements of EFP together with their regulatory and fiscal environment are shown. While thousands of European and US companies broadly recognize and successfully use EFP as a tool for better management, the outcome of research on the direct dependence between introduction of EFP schemes in companies and their economic performance is rather ambiguous. Many researchers claim that EFP schemes may work most successfully where the communication systems enable employees to understand their role and potential benefits from EFP.

Keywords: Financial participation, industrial democracy, profit sharing, employee share ownership, European countries, USA.

JEL Classification: A13, D02, G32, J54, M52

PARTYCYPACJA FINANSOWA PRACOWNIKÓW W PRZEDSIĘBIORSTWACH: OCZEKIWANIA A REZULTATY PRAKTYCZNE

STRESZCZENIE

Druga część studium o partycypacji finansowej pracowników (EFP) poświęcona jest głównie omówieniu doświadczeń i osiągnięć EFP w najbardziej zaawansowanych krajach Europy Zachodniej i USA. Przedstawiona jest historyczna ewolucja

powstawania EFP oraz ich dzisiejsze formy instytucjonalne, wraz z otoczeniem regulacyjnym i finansowym. Podczas gdy tysiące przedsiębiorstw europejskich uznaje i z powodzeniem stosuje EFP jako narzędzie dobrego zarządzania, wyniki badań naukowych dotyczące bezpośredniej zależności między wprowadzeniem EFP a poprawą wyników ekonomicznych firm są niejednoznaczne. Wielu naukowców sądzi, że systemy EFP mogą zdać egzamin tam, gdzie systemy komunikacji umożliwiają pracownikom zrozumienie ich roli oraz potencjalnych korzyści z EFP.

Słowa kluczowe: partycypacja finansowa, uczestnictwo pracowników w zarządzaniu, udziały w zyskach, akcjonariat pracowniczy, plany własności pracowniczej, kraje europejskie, USA.