Brussels, 6 December 2002

PRELIMINARY DRAFT OPINION

of the

Section for Employment, Social Affairs and Citizenship

on the

Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions On a framework for the promotion of employee financial participation

(COM(2002) 364 final)

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Rapporteur: **Mr Sepi**

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To the members of the Study Group on
Employee financial participation
(Section for Employment, Social Affairs and Citizenship)

N.B.: This document will be discussed at the meeting on **17 December 2002**, starting at **2.30 p.m**.

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On 5 July 2002 the Commission decided to consult the Economic and Social Committee, under Article 262 of the Treaty establishing the European Community, on the

Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions – On a framework for the promotion of employee financial participation
(COM(2002) 364 final).

The Section for Employment, Social Affairs and Citizenship, which was responsible for preparing the Committee's work on the subject, adopted its opinion on …. The rapporteur was **Mr Sepi**.

At its ... plenary session (meeting of ...), the Economic and Social Committee adopted the following opinion ...

1. Introduction

1.1 Employee financial participation in company profits and results has been the subject of numerous official initiatives in the various Member States, as well as within many companies.

1.2 Participation can take the form of direct profit-sharing, or of share ownership, the aspect on which the present opinion concentrates.

1.3 The need for a debate on this subject is growing in the light of the Lisbon strategy: if the strategy's objectives are to be met, employees must be closely involved in corporate governance.

1.4 The importance of corporate governance has been cast into sharp relief over recent months, as cases of serious mismanagement of company finances have emerged.

1.5 The completion of the single market, the on-going integration of the European financial market, and the series of mergers and restructuring operations to which this will give rise – fuelling workers' concerns for the future – have generated new momentum in this direction.

1.6 As the Commission document says, employee financial participation can make an important contribution to realising the overall goals of the European Union. Numerous studies and practical examples clearly indicate that if it is introduced in the right way, employee financial participation not only enhances productivity and company competitiveness and profitability, but can also encourage workers' involvement, improve the quality of work and contribute to greater social cohesion.

1.7 A number of cases, principally in the US, have however revealed that over-exposure of workers and their pension funds, coupled with unscrupulous financial dealings by the management of some companies, makes financial participation programmes dangerous if not properly regulated.

1.8 The EESC therefore warmly welcomes the Commission's communication, which launches a debate on this subject, although it does not believe this to be the only way of involving workers in company decision-making.

2. **The content of the communication**

2.1 The communication sets out to provide a framework for Community action to promote the widespread introduction of financial participation, in accordance with the principle of involving as many employees as possible both within each company and throughout the entire production system, by means of the active involvement of the social partners.

2.2 This overall framework is built around three points:

2.2.1 identifying general principles for financial participation, with the aim of forging a common approach for initiatives by the Member States and by the social partners;

2.2.2 identifying the main transnational obstacles currently impeding adoption of financial participation initiatives on a European or international scale, and devising the appropriate measures to address such obstacles;

2.2.3 identifying instruments for promoting wider dissemination of financial participation, encouraging exchanges of information and experience, and research into this area.

2.3 Regarding the general principles governing financial participation, the Commission has identified a core of fundamental elements on the basis of the experience gained in the main countries and following the studies and discussions which have taken place. These elements, on which a broad consensus has been reached, are set out below.

2.3.1 voluntary nature of financial participation schemes, for both enterprises and employees;

2.3.2 discrimination-free access to financial participation schemes for all employees, while recognising some differentiation of conditions reflecting the diversity of interests and needs of different categories of employee;

2.3.3 clarity and transparency of participation schemes, both in the set-up phase, when workers should be duly consulted, and in day-to-day management, with the adoption of predefined formulas for participation in company results;

2.3.4 regularity of schemes. These should not be one-off exercises, but as far as possible a permanent feature of company/employee relations;

2.3.5 limits to the risk for employees, given the high level to which they are exposed compared to other investors;

2.3.6 income from financial participation to be complementary to, rather than a substitute for, wages and salaries;

2.3.7 compatibility of financial participation schemes with worker mobility, to avoid creating barriers or deterrents to mobility.

2.4 Turning to the problem of supranational obstacles impeding the dissemination of financial participation at European level, in the Commission's view full-scale harmonisation of legislation on financial participation schemes, in order to offset the negative effects of diversity in taxation, social security and legal arrangements, would be inappropriate. This could stand in the way of the flexibility needed when framing national policies.

2.4.1 The Commission firstly points to more intensive exchange of experience as a valuable way of overcoming obstacles, particularly cultural ones.

2.4.2 In contrast, the Commission considers specific measures to be necessary for other types of obstacle. Attention is firstly drawn to the need to deal with the issue of double taxation, either by interpreting existing OECD agreements or, where this is not enough, by incorporating them in such a way as to meet the specific requirements of EU Member States.

2.4.3 More generally, the Commission has set up a working group to put forward practical proposals to deal with each type of transnational obstacle to financial participation schemes.

2.5 With regard to the aim of extending the coverage of financial participation, the Commission believes it should help create favourable environments by means of a series of initiatives designed to:

2.5.1 foster exchange of information, with benchmarking of national policies and practices;

2.5.2 boost the social dialogue on financial participation, stimulating and promoting initiatives by the social partners;

2.5.3 consider extending experiments with forms of financial participation to small- and medium-sized enterprises and the public and non-profit sectors;

2.5.4 improve information by promoting research and studies, in particular for the systematic collection of data on the use and dissemination of financial participation schemes, and closer microeconomic analysis of financial participation in terms of business strategic and financial policies and industrial relations;

2.5.5 facilitate the building of Europe-wide networks so that information exchanges, analysis and research can be put on a permanent footing.

2.5.6 The Commission also plans to provide financial support for such initiatives, making use of Community funding channels.

3. General comments

3.1 Employee financial participation in company results and profits is an integral feature of the modern market economy, contributing to the objective of maximising added value.

3.1.1 A number of factors, linked to changes to the ways capital is allocated and factors of production are organised, are leading to a shift away from the conventional division between capital and labour regarding responsibility for running companies and the corresponding sources of income (profits for capital, wages and salaries for labour).

3.1.2 The growing importance of human capital facilitates progressively closer involvement of employees in the enterprise function, and this is paralleled by growth in their participation in economic results.

3.2 In most of the major EU countries, this participation takes place on an individual level, through an increase in the variable element in pay, such as incentive bonuses or stock/share options for individuals or specific groups of employees (usually with higher skill levels).

3.3 In contrast, forms of financial participation for all, or broader categories, of workers are rare, and are very uneven between the Member States.

3.3.1 Precisely such broad forms of financial participation can provide the greatest benefits for the European business system, by bringing the industrial relations system into closer line with the objective, laid down by the March 2000 Lisbon summit, of making the European economy "the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion".

3.3.2 Financial participation can offer an efficient means of maximising investment – by both employers and employees – in know-how and vocational skills, increasing the value of human capital. It has been demonstrated that there is a positive correlation between introducing forms of financial participation and investment in occupational training. The risk that one party may appropriate the benefits of investment in human capital, which requires companies and workers to cooperate, acts as a real disincentive. Employers may fail to reward workers for higher output; workers may leave a company after benefiting from training, using it to seek a new job elsewhere. Financial participation schemes can provide an effective means of consolidating a long-term relationship between employees and their employer, reducing the risk of opportunistic behaviour by either, with one side grabbing all the benefits of investment in human capital.

3.3.3 Financial participation is also seen to be structurally tied in with company transparency. Implementing financial participation schemes firstly requires that companies become more "open" in information terms, so that they can identify and monitor the profitability indicators deriving from financial participation, and secondly spurs companies to give a quantitative and qualitative boost to communication with employees regarding strategy and outcomes, so as to give real effect to the worker involvement in company affairs which financial participation entails.

3.3.4 This generates greater transparency in companies involved in financial participation experiments, and in particular makes them more receptive to the idea of transparency. This receptiveness can have a positive effect on relations with the product and capital markets, especially for companies which are not yet listed on a stock exchange.

3.3.5 In view of the potential importance of financial participation in harnessing human capital and increasing company transparency and communications skills, its extension to the entire economic system of European countries should be encouraged. This also applies to sectors where economic activity is not organised in the same way as in for-profit businesses, the area in which the main financial participation experiments have so far been conducted. Bringing financial participation to the SME, public and non-profit sectors of course requires adjustments to their specific circumstances.

4. General principles

4.1 No European Union strategy in this field can be defined without firstly establishing a number of common principles for financial participation schemes. These general principles constitute an essential foundation for shaping financial participation in the EU countries, and for ensuring that its features are compatible with the objectives of increasing the competitiveness of European enterprises, improving the quality of work and contributing to social cohesion, which underpin the EU policy formally set out at the Lisbon summit.

4.1.1 These principles must not result in a single, rigid model for participation; rather, they should provide a basis for seeking a common path for initiatives by the Member States and the social partners, using flexible forms capable of fitting in with the specific features of individual countries and the economic settings in which they are implemented.

4.2 The general principles laid down by the Commission represent a valuable contribution to this end. The EESC would emphasise in particular how important it is for financial participation schemes to guarantee the principle of their voluntary nature for both businesses and individual workers, the principle of non-discrimination for workers, the principle of clarity and transparency of schemes and the principle of continuity.

4.3 An equally important principle, which merits rather closer examination, is the principle that financial participation should not be an obstacle to worker mobility. Financial participation schemes indeed imply a trade-off between this principle and the aim of encouraging worker "loyalty" to employers. In this connection, it should also be borne in mind that flexible employment arrangements are being widely introduced in the main EU countries, differing from the conventional open-ended employment contracts.

4.3.1 The question then arises of how to prevent financial participation becoming yet another instrument for widening differences between workers who, while working for the same company, are employed under different contracts. The EESC's view is that a double principle should be applied: financial participation should not discourage worker mobility, but at the same time workers who enjoy greater intrinsic employment mobility should not suffer discrimination under financial participation schemes.

4.4 Turning back to the general principles guiding financial participation schemes, collective bargaining in disseminating such schemes is of key importance. As it develops, financial participation can effectively play a key role in European companies, provided it becomes an integral part of the industrial relations system.

4.5 Another point to make is that no distinction is made in the Commission's principles between different forms of financial participation. Not only the practical implementing arrangements, but also the purpose and applicability of the two main forms of financial participation – profit-sharing and share ownership – can vary substantially.

4.5.1 Share ownership represents the fullest form of participation, since a share in capital creates a more powerful and enduring company-employee link, with employees becoming an integral part of the company process. However, this greater involvement goes hand-in-hand with greater risk-bearing on the part of employees as a result of the possible fluctuation of future share values. The risks are all the greater where shares are not listed on a regulated market, since there are no objective parameters for determining and monitoring share values, and there is no option of selling shares on a market enjoying the necessary liquidity.

4.5.2 Participation in the form of profit-sharing, on the other hand, is more practicable in settings other than companies operating for profit, since it can be introduced in a flexible way and adjusted to a range of organisational structures.

4.6 In the light of this distinction, the European Economic and Social Committee would also highlight the contribution that financial participation schemes, particularly in the form of equity participation, can make to corporate governance.

4.6.1 Employee shareholders can help improve corporate governance in their companies, since they represent a type of investor concerned with the long-term performance of the business, compared with the pervasive short-termism which is characteristic of market investors, even institutional ones.

4.6.2 By playing an active part in company affairs through the machinery provided under company law (primarily shareholders' assemblies, but also other forms of shareholder activity), employee shareholders can make a significant contribution to monitoring company management: a function of increasingly vital importance in ensuring that companies are run as consistently as possible with the interests of all shareholders.

4.6.3 It is therefore suggested that the principles include that of maximising the contribution of employee shareholders to the corporate governance of those companies which set up financial participation schemes. This aim must be pursued by (i) avoiding any form of discrimination against shareholder employees in terms of voting rights (as can occur, for example, by distributing shares with restricted voting rights), and (ii) measures to promote the practical exercise of such rights, facilitating employee shareholder involvement in company affairs through freely decided forms of association.

4.6.4 More generally, the proposed increase in employee involvement in company capital, through the development of financial participation schemes, depends on a greater commitment to ensuring that corporate government arrangements for European businesses are more effective. This means stronger safeguards for all minority shareholders, and more robust machinery for company democracy. In this regard, the EU initiative on corporate governance should be reinforced, with the specific aim of devising means for striking a better balance in the incentive and monitoring systems governing the ownership/control relationship within European companies.

5. **Transnational obstacles**

5.1 Differences between tax systems, in the general legal framework and in the cultural environment, especially within industrial relations arrangements, can constitute major obstacles for companies which wish to set up financial participation schemes covering employees from more than one EU country.

5.1.1 The Commission's communication clearly identifies these problems, and indicates a number of possible areas for action to remove the main obstacles.

5.2 The EESC agrees that full-scale harmonisation of rules on financial participation schemes is impracticable: it could stand in the way of the flexibility needed when framing national policies to the point where they cannot be implemented.

5.3 The European Economic and Social Committee supports the Commission's approach, and urges that priority be given to seeking closer coordination of current practices, by means of guidelines and agreements on the general principles and the introduction of measures to facilitate mutual recognition.

5.3.1 The EESC would also stress that the most effective way of removing transnational obstacles is to define European financial participation schemes which are adaptable to the various national contexts, allowing them to be transposed to the European level.

5.3.2 It is also important, in this connection, to devise a European scheme for offering shares or options to employees which can cope with the differences regarding the compulsory publication of prospectuses and exempt them from this obligation.

5.3.3 The European Economic and Social Committee would point to its opinion on the Proposal for a Directive of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading[1], which argued that the proposal inappropriately limited the scope of the exemptions, by excluding from them rights offerings and offerings of employee share options.

6. Towards a wider dissemination of financial participation

6.1 Wider introduction of financial participation depends to a considerable degree on the existence of a favourable environment in the legal, tax-related, cultural and industrial relations spheres.

6.2 The European Economic and Social Committee considers that the framework of initiatives proposed by the Commission is at present commensurate with the objective of promoting the dissemination of financial participation. One of the areas which should be examined in greater depth is the issue of financial participation in companies not listed on regulated markets. Particular problems arise for such companies in terms of the quality, amount and promptness of financial information and, in the case of shareholding, of the way share values are set and whether they can be transferred, there being no market to set prices and offer opportunities for sale.

6.2.1 The issue of financial participation in unlisted companies assumes particular importance if the aim is for such participation to become an integral feature of European economic systems, since in most European countries, companies listed on regulated markets account for only a

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[1] EESC opinion in OJ C 80 of 3.4.2002 (rapporteur: **Mr Levitt**).

minor portion of economic activity. More specifically, account must be taken of the particular nature of three different sectors: small and medium-sized enterprises, non-profit enterprises, and the public sector.

6.2.2 The first problem arising with regard to SMEs is that of ensuring proper transparency of results and profitability/financing prospects, given that considerable opacity is a typical feature of such enterprises. Under these circumstances, the provision of specific financial participation measures must be flanked by – and can contribute to – a more open approach to information by SMEs.

6.2.3 Financial participation can also help solve another structural problem affecting SMEs: how to secure access to external funding to increase the rate at which they can grow in size. Preparing financial participation plans, especially in the form of employee equity participation, can send a powerful message to financial institutions regarding a company's potential for growth. A message of this kind can help overcome the in-built reticence of outside sources of finance towards young and/or small businesses. While on the one hand employees, as company "insiders", are better informed on growth potential, on the other this potential is boosted by the greater contribution made by employees who are involved in company outcomes.

6.2.4 For SMEs, consideration should also be given to the idea of studying forms of financial participation at company pool level, particularly where businesses are operating within designated industrial districts.

6.2.5 Turning to financial participation in non-profit bodies and the public sector, it is firstly stressed that the entities operating in these sectors are generally of a legal standing such as to rule out financial participation in the form of equity participation. Attention should therefore focus on participation in results. Here again, the particular nature of these enterprises, whose results are reflected primarily in the quantity and quality of services provided, should be borne in mind. There have been some interesting experiments in this field, as in the Irish public sector, which merit closer examination. Under the Irish experiment, a fund was established with amounts earmarked for decentralised bargaining, which are distributed to public sector employees in proportion to the specific service provision targets they meet in defined fields of activity.

7. Conclusions

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