

EMPLOYEE SHARE OWNERSHIP FOR BUILDING THE CAPITAL MARKETS UNION

AGAIN: THE NEED FOR A EUROPEAN ACTION PLAN

EFES POSITION PAPER
RESPONDING TO THE PUBLIC CONSULTATION
ON THE CAPITAL MARKETS UNION MID-TERM REVIEW 2017



EUROPEAN FEDERATION OF EMPLOYEE SHARE OWNERSHIP

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THE NEED FOR A EUROPEAN ACTION PLAN - AGAIN

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Abstract

The EU is strongly underdeveloped compared to the US considering employee share ownership, and employee share ownership contributes much more to the solidity and to the stability of capital markets in the US than it does in Europe. The underdevelopment of employee share ownership hampers also Europe in terms of productivity, growth, job creation, as well as in the fields of pensions or business transmission, especially considering SMEs.

The CMU Action Plan should face this through two new measures: First, a dedicated European Action Plan should be set up to promote European convergence in this field. Secondly, the ignorance of the ESOP scheme is a dramatic handicap for Europe, leading to the fact that employee ownership in SMEs is practically unknown in Europe compared to the US. The CMU Action Plan should remedy this.

THE NEED FOR A EUROPEAN ACTION PLAN - AGAIN¹

The EU is strongly underdeveloped compared to the US considering employee share ownership, and employee share ownership contributes much more to the solidity and to the stability of capital markets in the US than it does in Europe. The underdevelopment of employee share ownership hampers also Europe in terms of productivity, growth, job creation, as well as in the fields of pensions or business transmission, especially considering SMEs.

Furthermore, it is known that employee shareholders are mostly stable investors, acting for the long-term as industrialists rather than just financial investors. They represent the closest link between finance and the real economy and the best personification of capital ownership democratization. This is exactly what we need more in Europe.

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The EU is strongly underdeveloped compared to the US considering employee share ownership, with a 20 years lag. Consequently, employee share ownership contributes much more to the solidity and to the stability of capital markets in the US than it does in Europe.

Europe counts 10 million employee shareholders compared to 30 million in the USA. European employee shareholders hold 350 billion € in shares of their company (mainly large ones), while just the single ESOP scheme in SMEs counts for 1.300 billion \$ in the US.

On the other hand, employee ownership is geographically unbalanced within the European Union, with a lag of 30 years between lead (North/Western) and late (South/Eastern) European countries.

The differences among European countries rely essentially on the existence or not of adequate incentive legislation. Some incentive legislation do exist in 15 countries of the EU in 2017 compared to 12 in 2015.

This lag is detrimental to all, and it demonstrates the need for efforts to achieve European convergence in this field. The lag is too long. Think about technology, a lag of 30 years means that the lead countries would be busy with implementing the 5G standards while the last ones would be just discovering the fax. It is detrimental for

¹ See European Commission - [Public Consultation on the CMU mid-term review 2017](#), and the EFES position paper of 8 May 2015: [Employee Share Ownership for Building the Capital Markets Union](#).

large companies from the lead countries of the North/Western side of Europe which cannot easily extend their share plans to their employees in all European countries. It is detrimental for employees in the late countries of the South/Eastern side of Europe who cannot enjoy the benefits of employee share ownership.

The underdevelopment of employee share ownership in Europe is a dramatic handicap which the CMU Action Plan should take in account through two new measures:

First, a dedicated European Action Plan should be set up to promote European convergence in this field.

On the particular point of financing for innovation, start-ups and non-listed companies, it is a fact that employee ownership and stock options are used and encouraged for start-ups by a growing number of EU countries. We recommend a policy of European convergence on this point, to be part of the European Action Plan.

Secondly, the ignorance of the ESOP scheme is a dramatic handicap for Europe, leading to the fact that employee ownership in SMEs is practically unknown in Europe compared to the US. The CMU Action Plan should remedy this.

The recent "Pilot Project for the Promotion of Employee Ownership and Participation" organized by the European Commission (with Final Report on 28.10.2014) enlightened the need for a European Action Plan in this view, with the launch of a virtual information centre in all EU languages, an action program to raise awareness about employee ownership and participation, the setting up of a reliable information and statistical tool, and the promotion of adequate legislation providing optional simple, uniform incentive models. This European Action Plan should be part of the CMU Action Plan.

The underdevelopment of employee share ownership hampers Europe in terms of productivity, growth, job creation, as well as in the fields of pensions or business transmission, especially considering SMEs.

Some key findings to illustrate the point:

1. In SMEs: The annual growth rate of ESOP companies in the US is by 2.5% higher compared to similar non-ESOP companies (See National Center for Employee Ownership - [Research on Employee Ownership, Corporate Performance, and Employee Compensation](#)).

2. In large French companies: The absenteeism rate is by 51% lower in companies having employee share plans (See France Stratégie - [Policy Brief 210](#) - Employee participation and social performance: new challenges for French companies in a context of crisis, 2011).

3. At macroeconomic level: The balance of costs and benefits from the ESOP policy in the USA counted for the following numbers in Federal Budget 2014. The estimated tax cost to the US Federal Government for ESOP-specific incentives in 2014 was 2 billion \$, while lower job losses from ESOP companies compared to non-ESOPs saved the Federal Government 17 billion \$ due to lower unemployment expenses, leading to a positive balance of 15 billion \$ from the ESOP policy in 2014 (See Corey Rosen - [The Impact of Employee Ownership and ESOPs on Layoffs and the Costs of Unemployment to the Federal Government](#), 2015).

4. The most typical employee ownership scheme in the US is the ESOP scheme, essentially shaped for SMEs, with practically no equivalent in Europe. The ESOP scheme encourages SMEs transmission to employees. It is designed as a pension plan, usually as a long term operation (30 years). Financially it usually works as a LBO: As a legal person, the ESOP purchases the company shares thanks to a bank loan, in name of the employees. Employees don't invest any own money in the operation, their risk is minimal.

The ESOP scheme is a significant way for the US economy to provide bank financing for SMEs equity. The some 10.000 ESOP companies in the US count some 10 million employee owners holding total assets of more than 1.300 billion \$ in 2014. By comparison, Europe counts only 300 similar majority-employee-owned companies, with some 300.000 employee owners holding 17 billion € in 2016.

The ignorance of the ESOP scheme is a dramatic handicap for Europe. The effectiveness of the ESOP scheme is essentially due to strong tax incentives. On one hand, capital gain tax exemptions do encourage family owners to sell to employees, on the other hand, tax exemptions on benefits facilitate the whole scheme.

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Let's come back farther on particular points related to the following sections of the consultation document: B. Making easier for companies to enter and raise capital on public markets. D. Fostering retail investment and innovation. E. Strengthening banking capacity to support the wider economy. F. Facilitating cross-border investment.

B. Making easier for companies to enter and raise capital on public markets

We refer to our answer above, showing that employee share ownership contributes much more to the solidity and to the stability of capital markets in the US than it does in Europe, and that a policy of European convergence has to be promoted in this field.

Member States in CEE face the biggest challenges not only in terms of underdevelopment of their public markets but particularly in terms of underdevelopment of employee share ownership.

On the other hand, we ask for permanent attention to employee share plans in view of being exempted from regulations applying to the public at large, - employees of a company are not the public.

D. Fostering retail investment and innovation

We agree that the underdevelopment of capital markets hampers the EU. In this context, the decline of the direct retail investors contribution appears as a key-point. At the contrary, the number of employee shareholders in Europe rose continuously from practically zero in the early eighties to the present level of some 10 million.

Furthermore, it is well known that employee shareholders are mostly stable investors, acting for the long-term as industrialists rather than just financial investors. They represent the closest link between finance and the real economy. This is exactly what we need more in Europe.

However, we repeat that employee share ownership is dramatically underdeveloped in Europe compared to the US, with 10 million employee shareholders here, and 30 million in the US.

Employee share ownership constitutes nevertheless a very important conduit for individual share ownership and equity investment education even in Europe. It is therefore a key success factor in achieving one of the main aims of the CMU initiative: To foster retail investment into capital markets, and to help stop the damaging multi-decade trend highlighted in the CMU Action Plan of the EC: "Today, retail investors in Europe ... are less directly involved in capital markets than in the past ... the proportion of retail investors among all shareholders is less than half the level it was in the 1970s."

In addition to this, the US were able to implement an effective dedicated scheme for employee ownership in SMEs, and it is a pension plan.

The ESOP scheme is promoted since 1974 in the US through fiscal policies, with no equivalent in Europe (since 2014, the UK has launched the Employee Ownership Trust scheme inspired by the ESOP, but with less efficiency). It opened an astute way for the US economy to provide bank financing for SMEs equity. The some 10.000 ESOP companies in the US count some 10 million employee owners holding total assets of more than 1.300 billion \$ in 2014. By comparison, Europe counts only 300 similar majority-employee-owned companies, with some 300.000 employee owners holding 17 billion € in 2016.

As a pension tool and a business transmission tool, the ESOP scheme is a significant source of refinancing for the US economy. The ignorance of the ESOP scheme is a dramatic handicap for Europe. It should be implemented also here.

E. Strengthening banking capacity to support the wider economy

The ESOP scheme is a significant way for the US economy to provide bank financing for SMEs equity, with no equivalent in Europe. The some 10.000 ESOP companies in the US count some 10 million employee owners holding total assets of more than 1.300 billion \$ in 2014. By comparison, Europe counts only 300 similar majority-employee-owned companies, with some 300.000 employee owners holding 17 billion € in 2016. The ignorance of the ESOP scheme is a dramatic handicap for Europe. It should be implemented also here.

F. Facilitating cross-border investment

The underdevelopment of employee share ownership hampers Europe in terms of productivity, growth, job creation, as well as in the fields of pensions or business transmission.

Furthermore, employee ownership is geographically unbalanced within the European Union, with a lag of 30 years between lead (North/Western) and late (South/Eastern) European countries.

The differences among European countries rely essentially on the existence or not of adequate incentive legislation. Some incentive legislation do exist in 15 countries of the EU in 2017 compared to 12 in 2015. The first obstacle to cross-border developments in this field is thus that 15 countries do have incentive legislation, when 13 others don't.

This lag is detrimental to all, and it demonstrates the need for efforts to achieve European convergence in this field. The lag is too long. It is detrimental for large companies from the lead countries of the North/Western side of Europe which cannot easily extend their share plans to their employees in all European countries. It is detrimental for employees in the late countries of the South/Eastern side of Europe who cannot enjoy the benefits of employee share ownership.

The underdevelopment of employee share ownership in Europe is a dramatic handicap which the CMU Action Plan should take in account through a dedicated European Action Plan to promote European convergence in this field.

The recent "Pilot Project for the Promotion of Employee Ownership and Participation" organized by the European Commission (with Final Report on 28.10.2014) enlightened the need for a European Action Plan in this view, with the launch of a virtual information centre in all EU languages, an action program to raise awareness about employee ownership and participation, the setting up of a reliable information and statistical tool, and the promotion of adequate legislation providing optional simple, uniform incentive models. This European Action Plan should be part of the CMU Action Plan.