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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

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1. INTRODUCTION

The debate on the financial participation of employees in profits and enterprise results – either directly through profit-sharing or indirectly through share-ownership – has recently gathered significant momentum across Europe.

While employee financial participation has already had a long and successful tradition in a number of Member States, in many others only very little progress could be observed for a long time. This has changed more recently. Many Member States have now embarked on initiatives, which aim at promoting the use of financial participation schemes and at creating a more favourable environment for their introduction.

There are a number of developments that have contributed to this renewed interest in the issue of employee financial participation. At the Lisbon summit in March 2000, the EU has set itself the objective of becoming "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".

Employee financial participation can make an important contribution to realising this goal. Many studies and many concrete examples clearly indicate that if it is introduced in the right way employee financial participation does not only enhance productivity and the competitiveness and profitability of enterprises, but that it can at the same time encourage workers' involvement, improve the quality of work and contribute to greater social cohesion.

The positive experiences with financial participation schemes in many countries have certainly contributed to putting this issue on the political agenda throughout the EU. In particular the experience of the US shows the important impact financial participation can have in terms of economic growth, fostering industrial change and making sure that all workers participate in this growing prosperity.

In addition, a growing number of enterprises have started to realise the potential of employee financial participation schemes. For them, employee financial participation has become increasingly important as an instrument for motivating employees, aligning employees' interests with those of shareholders and for recruiting and retaining staff.

At the same time, recent events in relation to the breakdown of a number of enterprises which had share-ownership schemes in place have also demonstrated the potential risks that may be involved in financial participation schemes. At least in some cases it has become obvious that more could and should have been done to protect workers and to limit their exposure to unreasonable risks. This is particularly the case for schemes which formed part of pension plans and in which basic principles concerning risk diversification and transparency were not applied. These examples have highlighted very strongly that in order to make the best use of employee financial participation it is indispensable that some general principles are followed.

Main objectives

Following the announcement of a Communication and an action plan on financial participation in the Commission's Social Policy Agenda of June 2000, the main objectives of this Communication are to

- provide orientation for the further development of employee financial participation in Europe by outlining a set of general principles,

- promote a greater use of employee financial participation schemes across Europe by presenting a framework for Community action for the years 2002-2004,

- address the transnational obstacles which currently impede the introduction of European-wide financial participation schemes, proposing concrete actions for overcoming them.

This Communication builds upon a number of previous initiatives at EU level:

- In 1991 the Commission published the PEPPER I report on the 'Promotion of participation by employed persons in profits and enterprise results'[1], which summarised the situation concerning financial participation in Europe at the time.

- On the basis of this report, the Council adopted a Recommendation[2] in 1992, which invited the Member States to acknowledge the benefits of a wider use of financial participation, taking into account the responsibilities of the social partners, in accordance with national law and/or practice.

- The PEPPER II report[3] on the application of the Council Recommendation underlined the fact that financial participation schemes are associated with a number of important benefits, especially in terms of higher productivity levels, employment and workers' involvement. It further stressed that the development of financial participation was strongly influenced by government action, in particular through the availability of tax incentives. However, it also concluded that the general approach of Member States' policies to Pepper schemes had not greatly changed and that there was little exchange of information.

- In its Resolution on the Pepper II report, the European Parliament made a number of calls for action on the Commission, the Member States and the social partners, aiming at a wider diffusion of financial participation schemes.

This Communication reflects the outcome of an extensive consultation process which was launched by a working paper published in July 2001[4] and which involved all key stakeholders and in particular social partners.

All the responses from Governments, social partners, experts etc, welcomed the Commission's initiative to relaunch the debate on financial participation and encouraged further actions to promote its wider use. Broad consensus existed in particular on the general principles identified in the working paper, on the need to tackle transnational obstacles, and on the desirability of an intensified exchange of information and experiences, including a benchmarking exercise and the identification of good practice.

This process also included a conference organised jointly with the European Foundation for the Improvement of Living and Working Conditions

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1 Supplement 3/91, Social Europe.

2 Council Recommendation of 27 July 1992 concerning the promotion of participation by employed persons in profits and enterprise results (including equity participation) (92/443/EEC).

3 Report from the Commission Pepper II COM(96) 697.

4 Financial participation of employees in the European Union. Commission Staff Working Paper. SEC(2001)1308.

Main elements

In line with the objectives set out above and with the outcome of this consultation process, this Communication will focus on the following main issues:

- General principles for financial participation,
- Transnational obstacles,
- Promoting a wider dissemination of financial participation in Europe.

2. FINANCIAL PARTICIPATION: MAIN TRENDS AND CHALLENGES

2.1. Forms of financial participation

The financial participation of employees in enterprise profits or enterprise results can take many different forms. The common element and the main distinguishing feature is that it aims at associating employees – usually on a collective basis – in enterprise profits and/or results.

The Pepper reports and the Council Recommendation identified two main categories of financial participation schemes: profit-sharing and employee share-ownership.

Profit-sharing implies the sharing of profits by providers of both capital and labour by giving employees, in addition to a fixed wage, a variable part of income directly linked to profits or some other measure of enterprise results.

Employee share-ownership provides for an indirect participation of employees in enterprise results either through receiving dividends and/or through an appreciation of employee-owned capital.

Share options constitute a further form of employee financial participation, which is closely related to employee share-ownership but which has also some specific features. Share options give employees a right to buy company shares at a certain price for a specified period of time. They are similar to share-ownership schemes insofar as they can ultimately lead to the ownership of shares. However, unlike share ownership schemes they do not necessarily imply the actual ownership of a stake in the company.

Related to profit-sharing are so-called '**gainsharing**' schemes. Such schemes are not linked to the financial performance of an enterprise, but to other criteria such as increases in productivity, cost reductions or certain qualitative objectives. They are therefore in general closer to performance-related pay than to financial participation. However, to the extent that such schemes are based on relatively broad performance measures and that these measures are applied at a collective level gainsharing can serve the function of financial participation. This is of particular relevance with regard to the public or non-profit sector, where standard forms of financial participation may not be applicable.

In practice, a large variety of financial participation schemes exists, which are not confined to those just described but which may also combine different elements of different approaches. Financial participation schemes may thus also include asset accumulation or employee savings plans, provided that contributions to these schemes are related to enterprise results and/or that these schemes contribute to establish some form of employee share ownership.

The great diversity of existing employee financial participation schemes not only across but also within Member States reflects the variety of objectives associated with financial participation. The existence of a variety of different financial participation schemes is essential for the adaptation of employee financial participation to different respective needs and objectives. In order to make full use of the various benefits offered by the financial participation of employees it will very often be preferable to make more than just one system available or to develop combinations of different forms.

This Communication does therefore not limit its attention to any specific form of employee financial participation but will address the general issues that arise in relation to promoting a wider dissemination of employee financial participation in its different forms. It is important to acknowledge that the choice, which the variety of available schemes gives to enterprises and employees, is an important asset, which needs to be further developed.

2.2. Benefits of financial participation

The participation of employees in profits and enterprise results is associated with a number of potential benefits for enterprises, employees and the economy as a whole.

According to a recent study carried out for the Commission[5] the main reasons for enterprises to introduce financial participation are to encourage employees to take a greater interest in the success of the company, to create a feeling of belonging to the company and sharing common goals, and to encourage a greater alignment of employees' interests with those of the shareholders. Financial participation is also an important instrument for recruiting and retaining staff. In addition, it improves the motivation of employees, enhances their loyalty and long-term commitment, increases productivity, and improves competitiveness and profitability. Finally, financial participation can also be an important instrument for raising capital, in particular in the case of start-up firms.

For employees, financial participation contributes to a closer identification with their enterprise and to a better involvement in its affairs and in its progress. Especially when it is linked to other participatory management practices and to the modernisation of work organisation, financial participation can improve the quality of jobs and boost job satisfaction. Moreover, financial participation schemes support the wealth formation of employees and allow them to participate more in the economic growth generated in an economy than it would be possible through wage income alone.

A number of studies[6] also suggest that financial participation has a positive impact on employment levels and that it can in particular improve the stability of employment over the business cycle. Financial participation can also enhance the link between overall income and productivity, in the sense that enterprises with higher productivity levels are likely to enjoy higher profits for a time, in which employees will share. This may also have beneficial effects on labour market functioning and employment levels. Especially in connection to the financing of start-up firms and the provision of venture capital to new enterprises financial

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[5] F. van den Bulcke (2000): A company perspective on financial participation in the European Union. Objectives and obstacles.

[6] For an overview see for example European Foundation for the Improvement of Living and Working Conditions (2001a): Recent trends in employee financial participation or European Foundation for the Improvement of Living and Working Conditions (2001b): Employee share-ownership and profit-sharing in the EU.

participation schemes can play an innovative and important role with regard to economic growth and industrial change.

Financial participation schemes thus contribute also to the achievement of social policy objectives by leading to a more widespread participation in wealth creation and better social cohesion.

Many empirical studies on the impact of financial participation have found a positive relationship between financial participation and different performance measures. This link is strongest and best established with regard to profit sharing. A number of important studies also report a positive impact on motivation and job satisfaction.

Some recent studies emphasise in particular that the positive effects of financial participation schemes are greatest when they are well-designed and embedded in a general context of participatory management based on partnership. The benefits of financial participation schemes also seem to be most pronounced when they are used in combination with other human resource policy instruments, such as training, or with the introduction of new forms of work organisation.

Both theoretical as well as empirical studies thus highlight the important benefits employee financial participation can have. This underlines the need for enhanced efforts by all actors at all levels to make financial participation available at a larger scale and to extend its coverage.

2.3. Recent trends in employee financial participation

Two main features characterise the development of financial participation schemes in Europe:

- The overall use of employee financial participation is limited. While profit-sharing is more developed, share ownership in particular is not very widespread.

- In addition, financial participation is very unevenly developed in different Member States. While some Member States have a long tradition in promoting employee financial participation, in others it is used only at a very limited scale.

According to a study by the European Foundation for the Improvement of Living and Working Conditions (covering 10 Member States) 72% of enterprises did not have any financial participation scheme at all in 1997.[7] Share ownership schemes in particular were very rare and existed only in 9% of companies. Financial participation schemes were most common in **France** and the **UK**, with more than 50% of companies having such schemes.

Financial participation schemes were also more prevalent in larger enterprises. Eighty percent of enterprises with less than 49 employees did not apply any financial participation scheme. In contrast, around one third of larger enterprises with more than 200 employees had introduced financial participation schemes.

More recent data for enterprises with more than 200 employees[8] show that less than half of the enterprises had profit-sharing schemes in place in 1999/2000 and that less than one third had share-ownership schemes (see Table 1).

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7 European Foundation for the Improvement of Living and Working Conditions (2001a).
8 European Foundation for the Improvement of Living and Working Conditions (2001b).

Table 1: Financial participation schemes by country (share of business units with financial participation schemes in %, 1999/2000)

	Share ownership	***Of which broadly based (covering more than 50% of the workforce)***	**Profit-sharing**	***Of which broadly based (covering more than 50% of the workforce)***
Austria	9	*41*	66	*38*
Belgium	29	*38*	22	*55*
Denmark	21	*70*	15	*52*
Finland	30	*50*	35	*77*
France	41	*56*	87	*97*
Germany	20	*50*	71	*25*
Greece	23	*23*	19	*39*
Ireland	34	*47*	29	*83*
Italy	15	*13*	15	*53*
Netherlands	45	*47*	59	*93*
Portugal	5	*40*	25	*67*
Spain	19	*26*	25	*52*
Sweden	26	*46*	27	*70*
UK	45	*67*	37	*81*
EU total	**31**	***52***	**45**	***63***

Source: European Foundation for the Improvement of Living and Working Conditions (2001b): Employee share-ownership and profit-sharing in the EU.

The differences in the diffusion of financial participation in different countries are reflected in different approaches of Member States policies. Employee financial participation has a long tradition in both **France** and the **UK**, where government policies have continuously promoted the use of financial participation schemes. In **Ireland**, **Finland** and the **Netherlands**, the Pepper II report had noticed increased government support for financial participation, including the introduction of new legislation and improved incentives. In the other Member States government support for financial participation was either limited or completely lacking. In some countries, including **Germany**, **Spain** and **Italy**, appeals had been made by the governments to the social partners to put financial participation on their agenda.

In the meantime, the debate on financial participation has gathered momentum at a number of levels. With regard to Member States, it is no longer only the traditional frontrunners that promote very actively financial participation. Over the last years, new legislation and new initiatives were adopted in a number of countries, including **Belgium**, **Ireland**, **Finland**, **Austria** and the **Netherlands**. Further measures were also introduced in **France** and the **UK**. In **Italy** employee financial participation has been included in a recent White Paper on labour market reforms. In **Germany**, there have also been renewed appeals to the social partners to take up financial participation as an issue in collective bargaining.

This new momentum can also be observed at social partner and enterprise level. Both at national as well as European level, social partners are playing an increasingly active role in the promotion of financial participation. Finally, employee financial participation schemes are also more and more widespread at enterprise level, and have in many cases become an indispensable instrument of human resource policy.

These recent initiatives clearly reflect the growing awareness for the benefits of financial participation. Nevertheless, more needs to be done in order to promote the use of financial participation even further. In addition, the uneven development across Europe makes this an area where the exchange of experiences is particularly useful. This Communication therefore proposes a number of concrete actions aiming at such an intensified exchange of information and experiences as well as the identification of good practices.

In view of the upcoming enlargement of the EU, special attention has to be given to the situation in **candidate countries**. On the whole, employee financial participation is only very little developed in Central and Eastern European candidate countries. The privatisation process brought about a certain surge in schemes for employee ownership and management and/or employee buy-outs in a number of countries. Even in those cases, the importance of employee ownership has in the meantime tended to decline again.

There exist a number of specific obstacles for the development of financial participation in Central and Eastern Europe:

- Especially in cases where employee ownership emerged by default rather than by design, employee-owned enterprises often face severe financial difficulties.
- Interest in employee share ownership on the part of employees tends to be limited; very often employees have a preference for selling their shares almost immediately.
- With the completion of privatisation, favourable tax arrangements that existed in some countries for the purposes of employee buy-outs are expiring.
- In virtually all candidate countries there is a complete lack of any legal or fiscal framework or any supportive policy for the development of employee financial participation in its different forms.

Given these challenges, this Communication will suggest a number of measures which are particularly aimed at addressing the specific situation in candidate countries.

2.4. Synergies with other Community initiatives

The different benefits of employee financial participation make it an integral element in achieving the Lisbon objectives. Financial participation is an excellent example of a policy which can simultaneously address economic, employment and social objectives in a mutually reinforcing way. When introduced in the right way, financial participation can render enterprises more profitable and competitive, improve the motivation, commitment and job satisfaction of workers, enhance the quality of work and last but not least contribute to a more equitable distribution of income and wealth.

Promoting employee financial participation thus also shows that investing in the quality of work and industrial relations is not only and not primarily a cost factor but also a productive factor contributing to higher productivity, social cohesion and higher social standards, as it was outlined in the Commission's communication of June 2001 on "Investing in quality"[9].

In this context, financial participation can further play an important role for the development of European capital markets and most notably risk capital markets. This was explicitly acknowledged in the Broad Economic Policy Guidelines for the year 2000 as well as in the Commission's communication on "Risk capital: a key to job creation in the European Union"[10]. Especially when compared to the experiences in the US, there exists still a huge, largely unused potential for the further development of financial participation as part of an overall strategy aimed towards stimulating the growth of new, dynamic companies. The promotion of financial participation is thus also part of the structural reforms needed to realise Europe's potential for growth, employment and social cohesion.

In addition, financial participation is an important element in the modernisation of work organisation. The Commission's Green Paper on "Partnership for a new organisation of work"[11] emphasised the potential role of the participation of employees in profits and enterprise results in modernising work organisation, making a valuable contribution to the competitiveness of European firms, to the improvement of the quality of working life and to the employability of the workforce. By enhancing the identification of employees with their enterprise and their involvement in its affairs, employee financial participation plays an important role for the successful modernisation of work organisation and for giving greater responsibility to employees.

Financial participation is thus also closely linked to the European Employment Strategy and the Employment Guidelines. It reinforces the objectives of the adaptability pillar, rendering both enterprises and the workforce more adaptable to economic change. Moreover, by providing a possible source of financing for start-up firms and by fostering an entrepreneurial spirit among employees it also makes an important contribution in relation to the entrepreneurship pillar.

By contributing to a closer alignment of employees' interests with those of other shareholders, and by ensuring that employees take a more active and long-term interest in the development of their enterprise, financial participation also supports the emergence of more transparent and effective corporate governance.

The recent discussion on corporate social responsibility shows very clearly the importance for enterprises to take into consideration the interests of their various stakeholders. This is not only important in its own right and for making sure that enterprise policies are socially and environmentally responsible. It is also associated with very tangible benefits for enterprises themselves and is therefore in their own best interest. The Commission's Green Paper on corporate social responsibility[12] underlines these benefits for both companies and society

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[9] Employment and social policies: a framework for investing in quality. COM (2001) 313.

[10] Risk capital: a key to job creation in the European Union. SEC(1998) 552.

[11] Partnership for a new organization of work. COM(97) 128

[12] Promoting a European framework for corporate social responsibility. COM (2001) 366.

when companies acknowledge their social responsibilities and take on board social and environmental concerns.

Promoting a wider dissemination of employee financial participation is therefore not only important in respect to the immediate benefits associated with it, but also because of its links with important policy areas and objectives. There is thus a clear need for intensified efforts at all relevant levels to make sure that more enterprises and employees can benefit from the advantages of financial participation.

2.5. Challenges for employee financial participation:

The need for action

The discussion so far has clearly underlined the need for further action in the field of financial participation. This is reinforced by a number of concrete challenges:

- There is a clear need to strengthen the use of financial participation schemes across Europe. So far and despite some recent progress, the overall use of financial participation in Europe is limited and is developed very unevenly across Member States.

- Experience with financial participation also reveals a need to extend the coverage of financial participation schemes. As highlighted above, small and medium sized enterprises in particular face a number of specific problems in introducing financial participation schemes (see also section 5.3). At the same time, it is also important to consider possibilities for extending financial participation to the public and non-profit sector. In a number of countries such as Finland or Ireland some steps in this direction have already been made.

- As more and more enterprises are operating at an international scale and start introducing financial participation schemes for their employees in different countries, transnational obstacles become increasingly problematic.

- These transnational obstacles are set to become even more relevant since the introduction of the euro. The associated deepening of economic integration implies that companies will operate even more at a European-wide level. In addition, with the euro financial participation schemes – and the benefits derived from them – become even more directly comparable for employees working in different countries.

- The enlargement of the European Union poses a number of further challenges with respect to financial participation. In most candidate countries, employee financial participation is only very little developed and in most cases there are no general legal and fiscal frameworks in place for its development.

Legal aspects concerning Community initiatives in the field

The purpose of this Communication, which is in line with Article 140 of the EC Treaty, is to promote financial participation across the EU by relaunching a Community wide debate there on, improving knowledge on various schemes and suggesting some actions which should be undertaken at all levels for the intensification of the relevant efforts.

3. GENERAL PRINCIPLES

The overview of different forms of financial participation has shown the great variety of financial participation schemes. At the same time, there also exist a number of core elements and principles which characterise most financial participation schemes and Member States policies. The general principles identified here reflect this basic consensus and can act as a reference point for the identification of good practice. They should thus inspire the promotion of financial participation schemes across Europe and serve as a guideline for Member States, social partners and enterprises.

Voluntary participation

Financial participation schemes should be voluntary for both enterprises and employees. The introduction of financial participation schemes should meet the actual needs and interests of all parties involved, and should therefore not be imposed. Obviously, this does not preclude that some elements of financial participation are made mandatory, or that financial participation is introduced on the basis of legislation or collective agreements. Government support programmes and the provision of a clear legal framework are important elements in promoting the use of financial participation schemes. The involvement of the social partners can also be a major factor in making sure the success of financial participation.

Extending the benefits of financial participation to all employees

Access to financial participation schemes should in principle be open to all employees. While a certain differentiation may be justified in order to meet the different needs and interests of employees, financial participation schemes should aim at being as comprehensive as possible and treating employees on similar terms.

Among the main benefits of employee financial participation are the increased identification of employees, creating a feeling of belonging and improving the motivation of staff. Any discrimination between employees would run completely counter to these objectives and should therefore be avoided.

Clarity and transparency

Financial participation schemes should be set up and managed in a clear and transparent way. This is important for the acceptance of such schemes and allows employees to assess fully the possible risks and benefits involved. Priority should be given to clear, comprehensible plans, with an emphasis on the transparency for employees. In this relation it is particularly important that employees or their representatives are informed and consulted about the details of financial participation schemes which are to be introduced.[13]

Especially share-ownership schemes will almost inevitably involve a certain complexity. In this case, it is important to allow for adequate training for employees to enable them to assess the nature and details of the scheme in question.

Schemes should also be managed in a transparent way. Enterprises should strictly adhere to existing accounting standards and disclosure rules. In addition employees should receive

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[13] This results also from the obligation under Directive 2002/14/EC of the European Parliament and of the Council of 11 March 2002 establishing a general framework for informing and consulting employees in the European Community to inform and consult employees or their representatives on changes in relation to work organisation or contractual relations.

regular information and should be informed about any developments which may have a major impact on their investment.

Predefined formula

Rules on financial participation in companies should be based on a predefined formula clearly linked to enterprise results. This is a major element in ensuring the transparency of such schemes. Also with view to the motivation, commitment and identification of staff it will obviously be preferable to adopt a clear and predefined formula rather than decide on any profit-sharing scheme only ex-post.

Regularity

Financial participation schemes should be applied on a regular basis and should not be a one-off exercise. This is particularly important if such schemes are aimed at enhancing and rewarding the long-term commitment and loyalty of staff. It is obvious that this regularity in the application of schemes does not imply that the benefits derived from them remain stable over time. It lies in the nature of financial participation schemes that the bonuses received will vary depending on enterprise results and profits and that in some years no bonuses will be paid at all or that there may be a fall in the value of employees' investments.

Avoiding unreasonable risk for employees

Compared to other 'investors' employees tend to be more exposed to adverse economic developments affecting their enterprise. For them, it is not only their investment that is at stake, but potentially also their income and their job itself.

The extent to which financial participation schemes involve risks for employees depends, however, on the details of each scheme. In general, cash- or fund-based schemes are likely to involve only limited risks. Also in relation to share-ownership plans possible risks for employees depend to a large extent on the details of each plan, including for example the length of any retention period, provisions concerning an earlier sale of shares, or ceilings on the amounts that can be invested.

Given the potential risks for employees involved, due consideration should in any case be given in the introduction and running of financial participation schemes to the avoidance of any unreasonable risks. At the very least, employees have to be warned of the risks of financial participation resulting from fluctuations in income or from limited diversification of investments. As set out above, financial participation schemes should also be introduced and managed in a clear and transparent way. When designing financial participation schemes, consideration should be given to develop mechanisms or to give priority to such schemes, which avoid excessive risks for employees taking into account the objectives pursued with the respective scheme.

Distinction between wages and salaries and income from financial participation schemes

A clear distinction has to be made between income from financial participation on the one hand and wages and salaries on the other. In some specific cases (for example for top executives or in the case of start-up firms) income from financial participation, and in particular stock options, may constitute an important part of the overall remuneration. In general, however, financial participation cannot be a substitute for pay and fulfils different, complementary roles. Any income from financial participation should therefore be paid in addition and above a fixed wage, which is determined according to national rules and practices. In this respect, social partners can of course bargain over pay and terms of financial participation as they see fit.

Compatibility with worker mobility

Financial participation schemes should be developed in a way that is compatible with worker mobility both internationally and between enterprises. Policies towards financial participation in particular should avoid creating barriers to the international mobility of workers.

One of the main objectives of financial participation obviously is to enhance the long-term commitment and loyalty of employees to their enterprise. However, at the same time more and more employees are faced with increased demands for mobility and flexibility in working life. Adequate provisions that take into account both the company's interest in a long-term commitment of their employees and the employees' right to mobility should therefore be made in the design of financial participation schemes for dealing with any problems resulting from a termination of contracts.

4. TRANSNATIONAL OBSTACLES

4.1. The problem

Financial participation schemes and policies towards financial participation in Europe are characterised by a huge diversity. As such this diversity does not pose any problems and should in fact be welcomed as an important factor in making sure that employee financial participation systems are best suited to the respective circumstances at national and enterprise level.

However, these differences can also imply severe obstacles to the use and development of employee financial participation at a transnational level. Differences in tax systems, with regard to social security contributions, in the general legal framework or also cultural differences make it very often impossible for enterprises to develop and apply a common financial participation scheme across Europe.

Where enterprises introduce schemes that are open to all their employees in different Member States, this will normally involve substantial costs and a huge administrative burden. In many cases, these costs will be prohibitively high for enterprises. Moreover, even if such schemes are applied across Europe, they will need to be adapted to different national circumstances. This implies that employees in different countries will in fact not be treated equally even though they participate in what should be the same financial participation scheme.

Moreover, existing differences do not only put a burden on enterprises, they can also act as a barrier to the free movement of workers and in some cases also to the free movement of capital, especially where they give rise to problems of double taxation.

Overall, these transnational barriers therefore prevent a wider dissemination of financial participation schemes in Europe. It would obviously be more logical and easier for companies to set up one and the same financial participation scheme, with only a few and limited national adjustments. This will be particularly relevant in the case of a European Company, which will operate under one single set of rules in many important areas, and where it would only be consistent if it could use a common financial participation scheme as well.

4.2. What are the main obstacles?

Taxation

Differences in taxation systems can lead to two sets of problems. Firstly, such differences can give rise to double taxation issues. This is primarily a problem in relation to stock options. For employees of an enterprise who move from one country to another these differences can mean that they are either taxed twice or in some cases not taxed at all. None of the current double taxation agreements between Member States have specific provisions covering the taxation of stock options. However, the existing, more general provisions, for instance those on income from employment (Article 15 of the OECD Model Convention), could possibly be interpreted in such a way as to provide a solution, as is currently being explored within the framework of the OECD.

Secondly, differences in fiscal systems can also imply substantial administrative costs for enterprises wishing to introduce financial participation schemes in different countries. They will inter alia have to take into account different rules on the deductibility of costs, different rules on minimum retention periods, different rules on any potential discount offered to employees, different rules on the timing of taxation, or different rules concerning the eligibility for any preferential tax treatment.

Social security contributions

Differences in the treatment of income from financial participation with regard to social security contributions can add to the complexities involved in introducing such schemes. Not only the level of social security contributions may differ across countries. In some cases income from financial participation may be exempted completely from social security contributions.

In addition, the level of social security contributions sometimes deters firms from extending financial participation schemes to certain countries. This is particularly the case because very often the actual income from financial participation schemes will only be known ex post. Facing very high potential social charges can thus entail incalculable risks for enterprises.

The actual rules on social security contributions themselves need not always be totally clear-cut. This legal uncertainty for enterprises and employees acts as an additional obstacle to extending financial participation schemes.

Legal differences

Legal differences between Member States also play a role in impeding the introduction of financial participation at a transnational level.

In the case of share-ownership plans, differences in securities laws and in particular in relation to prospectus requirements can be problematic. In accordance with Council Directive 89/298/EEC there should be an exemption from prospectus requirements for employee share plans. However, in practice this may not cover all schemes, the exemption may not be automatic, and the details of this exemption may differ from one country to another.

Specific problems may arise also in relation to employment law, concerning for instance eligibility criteria or the termination of contracts, including severance pay or the portability of shares or stock options. Differences in data protection laws can also complicate the actual administration of financial participation schemes.

Cultural differences

Enterprises may further encounter problems in introducing financial participation schemes at a transnational level, because of cultural differences, different attitudes towards financial participation, different national traditions or differences in industrial relations systems. Depending inter alia on national traditions and policies, employees and social partners may have different attitudes to different forms of financial participation.

For the most part, these differences obviously have to be taken as given. At the same time, more information and a more intensified exchange of experiences may go a long way towards reducing any potential problems arising from these cultural differences.

Lack of mutual recognition of financial participation schemes

A fundamental problem for the introduction of employee financial participation in an international context is the general lack of mutual recognition.

In a number of countries there exist special, tax-approved financial participation schemes which sometimes enable enterprises and employees to benefit from preferential treatment with respect to taxes or social security contributions. In some cases this may also involve separate institutions or funds which are created with regard to the administration of such schemes. In most cases it is not possible to open these schemes to employees in other countries. Enterprises which operate internationally will therefore usually have to forego the benefits offered by such schemes, if they do not want to introduce financial participation schemes for only part of their employees.

Lack of information

The introduction of financial participation schemes at an international level is also hampered by a general lack of information about existing financial participation schemes or policies towards financial participation. Overcoming this lack of information may be prohibitively costly especially for smaller enterprises and may deter them from even contemplating the introduction of such schemes. In addition, this lack of information can also limit the potential for national authorities being willing to recognise existing financial participation schemes in other countries and making it possible for employees in their own country to contribute to them.

4.3. The way ahead

It is clear that the different obstacles call for different solutions, also depending on the kind of financial participation scheme under consideration.

In many cases, better information and an intensified exchange of experiences may go a long way towards alleviating obstacles. This is especially the case with regard to cultural obstacles..

In the other cases and in relation to the current lack of mutual recognition and the variety of national fiscal or social security systems the Commission considers that it has to be very attentive to the possible negative effects deriving from the application at national level of such schemes, as to the free movement of capital or to the right of establishment. Until now however no existence of such barriers to the free movement of capital or to the right of establishment came into the knowledge of the Commission.

The Commission has also considered seriously obstacles created by double taxation. In order to avoid such problems it is crucial that financial participation schemes are covered by double taxation agreements. Here several possible ways are open: Either there is the possibility that existing agreements could be interpreted as covering such schemes, as currently explored within the OECD with regard to cross-border tax issues raised by employee stock options. The OECD work, where the EU Member States as well as the Commission are actively participating, has led to proposals for possible interpretations and solutions, notably in relation to timing mismatches, the determination of the period of employment to which an option relates and cases where the employee's country of residence changes.

Or if sufficient solutions are not found within the existing framework of double taxation agreements, new provisions could be included. This would necessitate the re-negotiation of existing double taxation agreements and would therefore be a cumbersome procedure. As outlined in the Commission Communication "Towards an Internal Market without tax obstacles – a strategy for providing companies with a consolidated corporate tax base for their EU-wide activities" [14] a way forward may be to agree an EU version of the OECD model convention and commentary (or of certain articles) which meet the specific requirements of EU membership. In the Communication the Commission announced its intention to start technical discussions with Member States on these issues with the aim of coming forward with a communication on the matter in 2004.

Regarding differences in tax systems, social security regulations and legal systems a number of different options exist. It has to be emphasised that a full-scale harmonisation of existing rules on financial participation schemes is not necessary in this respect. There exist, however, a number of possibilities which would make it easier for enterprises to introduce financial participation schemes at European level.

A closer co-ordination of current practices in the field of financial participation, the formulation of certain voluntary guidelines, or an agreement on certain general principles (concerning, e.g., such issues as the timing of taxation, retention periods or coverage ratios) could already make an important difference. Other options would include steps towards an easier mutual recognition of existing systems, or the development of one or more European financial participation schemes which would be adaptable to different national contexts.

Actions

- The Commission will set up a working group of independent experts in 2002. The mandate of the group will be to identify and analyse the existing transnational obstacles in more detail and in particular with regard to the Treaty rules, and to explore the different options that are available for alleviating them. Member States experts and social partners will be closely associated in the work of this group. The group is to present its final report and a set of recommendations in 2003. Based on this report a decision on further actions will be taken. As regards the taxation problems these will primarily be dealt with in the context of the follow-up to the study on "Company taxation in the internal market".[15]

[14] COM(2001) 582 final, pp. 14-15.
[15] SEC(2001) 1681.

5. TOWARDS A WIDER DISSEMINATION OF FINANCIAL PARTICIPATION

5.1. Developing favourable environments for financial participation

The use of employee financial participation schemes is strongly influenced by supportive government policies. In some cases, Member States have already developed clear and comprehensive legal frameworks. Very often, this is combined with financial incentives to make these schemes even more attractive. In a number of countries, the creation of such favourable environments has taken place in close co-operation and with the support of the social partners. In others, government support for financial participation is largely limited to selected incentive measures or to appeals to the social partners to include financial participation as a topic in collective agreements.

In order to further develop the financial participation of employees in profits and enterprise results in Europe, it will be important that Member States continue and intensify their efforts in providing a favourable legal and fiscal environment, taking into account the Treaty rules on state aid and EU policies on harmful tax competition. The general principles of financial participation outlined above should give orientation and act as a guideline in this respect.

Given the different state of development of financial participation in different countries, there is a huge potential for an intensified exchange of information and experiences. So far, there have been only little initiatives in this regard and it seems that there is still a widespread lack of information on the potential and possibilities of employee financial participation.

Actions

The Commission will promote the exchange of information and identification of good practice through the following actions:

- Financial participation will be included in the peer review programme under the Employment Guidelines. A first peer review concentrating on the UK Partnership Fund will be organised in 2002. Member States are invited to present further initiatives to this peer review programme.

- In order to organise a more structured exchange of information the Commission will prepare a benchmarking of national policies and practices. In this respect, a feasibility study will be carried out in 2002, which will explore practical and conceptual issues. The actual benchmarking exercise will be carried out in 2003. The results will be presented and disseminated in 2004. After this first round of benchmarking it will be decided whether this should become a regular exercise and at what intervals this should best take place.[16] The results of the feasibility study and the benchmarking exercise will be submitted for discussion to the Group of Directors-General for Industrial Relations.

- The Commission will continue to support projects, studies and the creation of networks that aim at a larger dissemination of information about financial participation.

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[16] The intention is not to add to the existing processes for policy co-ordination, but to put in place a flexible instrument for a systematic exchange of information and experiences as well as the identification of good practice.

- The Commission will promote the organisation of national conferences which bring together the key stakeholders in the field of financial participation, aiming at the transfer of information and experiences across Europe.

- In order to tackle the particular challenges faced in candidate countries, the Commission will continue to support initiatives aimed at

– raising awareness for the benefits and possibilities of financial participation,

– improving information about existing policies and schemes,

– developing appropriate legal and fiscal frameworks,

– establishing and developing networks.

5.2. Developing social dialogue

Social partners have a crucial role to play in the further development of employee financial participation. In many cases, social partners have already taken a very constructive approach with some remarkable results. In a number of cases, however, there exist still a number of reservations and apprehensions especially on the part of trade unions.

These apprehensions very often have to do with the possible risks involved for employees, with the implications for wage flexibility and the wage bargaining process, and with the implications for industrial relations. It is important to note that there exists no systematic evidence that would link employee financial participation with lower wage rates or that would show a negative impact on collective bargaining. To the contrary, a recent study by the European Foundation for the Improvement of Living and Working Conditions (2001b) concluded that financial participation does not weaken the role of trade unions or works councils, and that there is even a positive correlation with other forms of direct or representative participation.

There are a number of reasons why social partners' contributions to the further development of employee financial participation are critical:

- There is strong evidence suggesting that the benefits of financial participation are greatest when such schemes are introduced through a partnership approach and when they are embedded in an overall approach of participative management. It is therefore crucial to further develop social dialogue on this issue and to make sure that financial participation is introduced in a way that makes the best use of its potential.

- The general principles outlined above suggest a number of areas where social partners could play a key role in making sure that existing financial participation schemes are indeed in line with these principles. This concerns in particular such issues as the avoidance of unreasonable risks, the clarity and transparency of schemes or training needs.

- Given the fact that many businesses are operating on an increasingly international level, financial participation should be promoted further as an issue for discussion in European Works Councils and in relation to the European Company Statute.

- Social dialogue can make an important contribution to overcoming some of the obstacles that still exist, including at transnational level, for a wider use of employee financial participation schemes. This includes an exchange of information and a sharing of experiences at social partners' level, which could address existing apprehensions and problems and could lay the foundation for the further, balanced and mutually beneficial development of employee financial participation.

Actions

- The Commission will place particular emphasis on supporting initiatives of social partners on financial participation, including

– the exchange of information and experiences,

– the creation of networks,

– research and studies.

- Social partners are invited to explore further the possibility for social dialogue, including at sectoral and multinational level.

5.3. Extending the coverage of financial participation

The benefits of employee financial participation are in principle not confined to those sectors where it is currently most common, i.e. larger, profit-oriented enterprises. The development of schemes that are applicable to sectors and enterprises which at the moment do not normally take advantage of employee financial participation is therefore an important challenge for a wider diffusion of employee financial participation. This concerns in particular SMEs, but also the public and non-profit sectors.

SMEs face a number of particular problems in relation to introducing financial participation schemes for their employees. Very often, the costs and administrative complexities in developing such schemes will be prohibitively high for smaller firms. When taking into account the limited number of employees of SMEs the (fixed) costs of such an undertaking may also appear disproportionate relative to the potential benefits.

At the same time, employee financial participation schemes entail some important advantages specifically for SMEs. In addition to the general benefits mentioned above, financial participation can for instance play a particular role in the provision of start-up finance for new enterprises. Financial participation can also be an important instrument for SMEs for attracting and keeping key personnel. Finally, financial participation schemes often offer solutions in cases where the succession in family-run SMEs poses difficulties.

The unique problems and opportunities of SMEs with regard to employee financial participation call for specific targeted solutions and measures of support. It is important to develop financial participation schemes that are adapted to the particular needs of SMEs which allow them to take advantage of the different benefits offered by financial participation.

The logic underlying the benefits of financial participation is also not confined to profit-oriented enterprises. In principle, it should be possible to realise the same benefits also in other sectors, such as the public or non-profit sectors. Moreover, if financial participation schemes were limited exclusively to commercial enterprises this would imply that large parts of the working population would be excluded from the benefits of financial participation.

It is obvious that standard forms of financial participation can hardly be applied in these sectors. However, the notion of financial participation is not necessarily confined to a financial measure of enterprise results. This has already been emphasised in relation to gainsharing as a possible form of financial participation. As with the case of SMEs there seems to be a clear need for further research on the possibilities of extending financial participation to these sectors and enterprises.

Actions

- The Commission will give special attention to the particular situation of SMEs in its different initiatives proposed in this Communication.

- The Commission will carry out studies and promote research on the particular problems faced by SMEs in introducing financial participation.

- The Commission will support research and other initiatives studying the possibilities for extending financial participation to the public and non-profit sector.

5.4. Improving information through research and studies

Despite the significant amount of information and research that has become available over the past decades on various aspects of employee financial participation, there still remain some important gaps. More research is for instance needed on the framework conditions that need to be satisfied for a successful introduction of financial participation. Other aspects, including inter alia the links between financial participation and employment also merit further attention. The same is true for macroeconomic implications of financial participation schemes.

At a more fundamental level, only patchy data is available in general on employee financial participation. This includes basic issues such as coverage ratios or amounts involved. More research is therefore also needed on the incidence of financial participation.

A further important gap in the literature concerns the interrelationship between financial participation and other aspects of enterprise policies and industrial relations. Some recent research has started to address these questions, but much more work will be needed in this context.

Actions

The Commission will continue to support and to carry out research projects which are aimed at filling existing gaps. Particular attention will be given to the following dimensions:

- Collection of data on the use and dissemination of financial participation schemes.

- Implications of financial participation for enterprise performance, employment, the quality of work and social cohesion.

- Links between financial participation and other elements of enterprise policies and industrial relations.

- The situation and particular problems for the development of financial participation in the candidate countries.

The Commission also invites the European Foundation for the Improvement of Living and Working conditions to continue its work in the area of employee financial participation.

5.5. Building networks

In order to enhance the dissemination of information and experiences and to raise the awareness for the potential of financial participation it will also be important to foster an ongoing dialogue at European level. This should cover all relevant aspects, including the co-operation at technical levels, for example on issues such as taxation or accounting practices, but also the continuous exchange between social partners, or a co-operation between Member States on issues of common interest.

It is also important that the different measures envisaged in this Communication are supported and accompanied by a continuous debate between all actors concerned. In order to provide a more permanent basis for this, the creation of networks or the extension of existing networks will be particularly useful. The Commission will therefore continue to support the building of such networks at all relevant levels.

Actions

The Commission will promote and support the building of networks in the following areas:

- Academic networks,
- Networks of experts,
- Social partners,
- Companies,
- Institutes,
- Associations active in the field of financial participation.

5.6. Financial support for initiatives on financial participation

Financial support for the actions identified above will be available through different channels:

- Promoting employee financial participation is one of the key objectives under budget line B3-4000 on Industrial Relations and Social Dialogue. Projects and initiatives to be supported within this framework concern especially the exchange of information and best practice, raising awareness, improving knowledge of financial participation systems, and the provision of training for the social partners.

- Projects on employee financial participation can also be supported in the framework of Community Incentive Measures on Employment. This concerns particularly initiatives exploring the links between employee financial participation and the European Employment Strategy, notably in relation to the adaptability pillar and the entrepreneurship pillar. The Council and the European Parliament reached a political agreement on these Community incentive measures, covering the period 2002-2006, in February.

- Under Article 6 of the European Social Fund Regulation, the Commission can finance innovative measures that seek to promote new approaches and identify examples of good practice which can subsequently improve the implementation of the operations supported by the ESF, including especially in the areas of corporate social responsibility or the modernisation of work organisation.

- Research on employee financial participation will also be eligible for funding under the Commission's Framework Programme for Research and Technological Development.

6. CONCLUSIONS

Despite recent progress towards a wider dissemination of employee financial participation in Europe, its actual use remains limited and very uneven between Member States. Given the various benefits of financial participation for enterprises and employees and its potential contribution to realising the objectives set out at the Lisbon summit, there is a need for all actors at all relevant levels – Member States, social partners, enterprises – to step up efforts to promote a wider use of employee financial participation throughout Europe.

This Communication has set out a framework for action at Community level with a view to support such a wider diffusion of financial participation. Its main elements are

- Raising awareness and improving information on the benefits of employee financial participation;

- Intensifying the exchange of information and experience as well as the identification of good practice through benchmarking, the creation of networks, and the promotion of national conferences;

- Addressing and alleviating transnational obstacles;

- Encouraging the further development of social dialogue on the issue;

- Supporting further research and studies on the different dimensions of employee financial participation.

The Communication has also identified a set of general principles which should guide the development of financial participation in order to make the best use of its potential. These principles act as a reference framework for Member States, social partners as well as enterprises.

The actions outlined in this Communication initially cover the period 2002-2004. At the end of this period, the progress made in relation to the objectives set out in this Communication will be assessed, closely associating all the stakeholders in this issue. On the basis of this evaluation a decision on appropriate future initiatives will be taken.