



# Financial participation for small and medium-sized enterprises: Barriers and potential solutions

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## What is financial participation?

Originally defined in the Pepper Report (1991), financial participation describes any arrangement under which employees may receive money or other assets with monetary value, linked to the financial performance of their employer. Financial participation involves the payment (or potential payment) of rewards that are over and above basic pay and in which all or most employees in a company are able to participate.

### What it can include

Financial participation includes the following arrangements:

- profit sharing - the distribution to employees of cash sums, according to the profits earned by the company in which they are working;
- gain sharing - the distribution to employees of cash sums for achieving some other target, such as productivity improvements;
- share ownership - ownership by employees of shares in their employer's company, with the prospect of capital growth and dividends according to the extent to which the employer's business grows and generates profits that may be distributed. Share ownership can be direct or it can take indirect forms, such as trust or silent partnership arrangements.

### What it does not include

Financial participation has to be distinguished from participation in decision-making, although the two frequently complement each other. Companies operating successful financial participation plans will often be managed with high levels of information disclosure and consultation, but the two elements are not always combined.

Many employers provide financial benefits for their employees, unconnected to the performance of the company. These would not normally be classed as financial participation arrangements and include schemes such as pension or savings plans with independently managed investments.

There can, however, be instances where the distinction between such arrangements and employee financial participation may become blurred. For example, the French *Plan d'Épargne d'Entreprise* (PÉE) may make investments for employees which are financed by profit sharing or by the employer matching the employee's contribution. Those investments may either be in the employer's company or be more diversely invested.

### Financial participation for senior employees

Companies considering financial participation often make it a priority to establish performance-related rewards for directors and senior managers. These businesses may be more aware of the connection between the contribution made by senior staff and the company's business performance, compared with the contribution to performance of employees more widely. They may also feel that, if cash or shares for financial participation rewards are scarce, it is more logical for managers to receive a performance element in their remuneration. Managers are also more likely to be aware of current practice in other firms and may negotiate a reward package that includes financial participation.

Larger companies may be less susceptible to such selective participation, as their greater access to expertise can enable them to appreciate the benefits of a wider financial participation.

Part of the challenge for this report is to find ways of encouraging small and medium-sized enterprises (SMEs) to adopt financial participation more widely.

## **Forms of financial participation**

Although the different types of financial participation can broadly be classified along the lines already described, they are applied in very different ways across the EU. The range of choices available in different Member States also varies widely:

- in France, the principal tax incentives for financial participation relate to profit-sharing (compulsory for all enterprises over 50 employees) and plans involving long-term investment in shares in the employer company;
- in the UK and Ireland, financial participation and tax incentives have been much more dominated by share options, although the creation of the income tax-relief Share Incentive Plan (SIP) in 2000, and the requirement to treat the value of options as a company expense, may change this;
- in Germany, tax incentives are limited;
- in Portugal, there is little financial participation.

## **Reasons for introducing financial participation**

Employers typically introduce financial participation plans for one or more of the following reasons:

- to provide a motive and reward for contributions to the company's success;
- as a tool to help employees understand what drives success in their business;
- to attract high-quality employees;
- to retain high-quality employees and/or employees in whom the company has made a major training investment;
- to reduce the marginal cost of labour;
- to encourage team spirit.

Ultimately, the employer's goal will normally be to improve productivity, and thus increase the financial return on investment.

### **Wider benefits**

While governments can be expected to be enthusiastic about productivity improvements, they may also see financial participation as offering a macro-economic benefit, namely an increase in employment.

### **Are the benefits proven?**

There is solid international evidence that financial participation has a positive or neutral effect on productivity. In a review of studies from more than 20 countries (Pérotin and Robinson, 2003), the following conclusions were drawn:

#### *Productivity*

- financial participation has a positive or neutral effect on productivity;
- financial participation plans give employees an incentive to work more and better, communicate with management and colleagues, and cooperate with each other;

- according to international evidence, profit sharing has a slightly stronger effect on total productivity than employee share ownership, although it is difficult to compare absolute levels of effects across different studies and countries;
- larger financial involvement has a greater effect on productivity;
- cash profit sharing appears to have a short-term effect, whereas employee share ownership seems to have a more sustained effect;
- growing evidence suggests that both cash profit sharing and share ownership have greater productivity effects if: employees are well-informed about their employer's business, there is good communication with management, and employees are able to participate in governance and decisions. This is particularly true for employee share-ownership arrangements;
- there are no clear conclusions about the impact a trade union presence has on productivity;
- employer policies to fight ethnic and race discrimination and promote equality of opportunity - which are likely to lead to more employees being involved in participation plans - may increase the effect of employee share ownership on productivity.

#### *Employment*

- both profit sharing and employee share ownership can increase a firm's demand for labour by increasing productivity;
- a firm which reduces its marginal cost may also experience an increasing demand for labour;
- while there is little evidence that employment will be more stable in profit-sharing firms, there is some evidence that they may respond less to downward labour demand shocks and more to upward surges than other firms.

#### **Are the two benefits compatible?**

This research might suggest that financial participation can create a virtuous circle in which employers - taken as a whole - experience productivity gains and the wider economy benefits from increased employment. However, while employers' objectives will frequently be compatible with this wider macro-economic goal, financial participation plans will sometimes have characteristics that could be perceived as negative from a macro-economic perspective. For example, where employers structure financial participation so that its goals include employee retention, this might contravene any wider goal of labour mobility, seen in itself as an important component in increasing employment.

It might be argued that any macro-economic disadvantages due to a decrease in labour mobility would be compensated for by other economic gains resulting from the employer firm retaining its valued employees. This would be extremely hard to measure, but it can certainly be argued that policymakers should consider the bigger picture, taking care not to place undue emphasis on passing specific tests.

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## Financial participation in SMEs

### Background

The European Commission's definition of small and medium-sized enterprises (as set out in its recommendation of 6 May 2003) is used in this report. Under that definition, an enterprise may be regarded as an SME if it has:

- fewer than 250 employees;
- an annual turnover of not more than €50 million or an annual balance sheet of not more than €43 million, or both.

After the publication of the Pepper Report in 1991, followed by Pepper II in 1996, the European Foundation for the Improvement of Living and Working Conditions (subsequently referred to as the Foundation) commissioned an extensive investigation into financial participation arrangements in the European Union. In July 2002, the European Commission published *On a framework for the promotion of employee financial participation*, in the drafting of which the Foundation was closely involved.

The report states that the benefits of financial participation are, in principle, not confined to larger enterprises and that it is important to develop forms of financial participation applicable to, among others, SMEs.

The following benefits, specific to SMEs, are mentioned:

- attracting and keeping key personnel;
- provision of start-up finance for new enterprises;
- ownership succession in family-run businesses.

The report acknowledges that SMEs face particular problems in introducing financial participation schemes, including prohibitively high costs and administrative complexity.

It also identifies a clear need for further research on financial participation in SMEs.

The European Economic and Social Committee and the European Parliament have each expressed their views in response to the report and have voiced a particular interest in studies on financial participation in SMEs.

### European Economic and Social Committee

The European Economic and Social Committee's views on financial participation in SMEs are summarised below:

- generally, unlisted companies face difficulties regarding the quality, amount and promptness of financial information. It is also necessary to examine how share values can be determined and how shares can be transferred;
- experiments in different forms of financial participation for SMEs should be considered and specific types of financial participation devised for SMEs;
- there may be a trade-off between encouraging worker mobility and worker loyalty;
- financial participation in SMEs needs to be studied in more detail: cooperative SMEs or WLCs (workers' limited companies) could serve as a frame of reference;

- proper transparency of results and financial prospects must be ensured. Financial participation measures must be flanked by, and can contribute to, a more open approach to information by SMEs;
- consideration should be given to pooled forms of financial participation, particularly where businesses are operating within designated industrial districts;
- employee share ownership can help struggling businesses survive.

### **European Parliament**

With regard to SMEs, the European Parliament:

- recognises that there are particular risks and difficulties involved;
- insists that, in situations where employees invest their own money, they should enjoy at least the same ownership rights as any comparable owner, especially if they cannot freely dispose of their investment;
- considers further research necessary on the connection between financial participation and demand for labour;
- emphasises the particular difficulties encountered by SMEs in implementing financial participation and states that the cost and administrative problems may be considered prohibitive;
- recommends that Member States promote models of participation suitable for SMEs, such as dormant partnerships, and calls for EU research into what other forms of financial participation are suitable for SMEs and what forms already exist or should be established by Member States;
- calls for advisory bodies to be set up by regional authorities and/or regional workers' alliances;
- proposes alternative investment vehicles under which funds received by employees from profit sharing may be pooled with funds of employees from other enterprises and invested outside the workplace;
- calls for SME employees holding shares in their employer's company to be protected against bankruptcy, for example by insurance or bank guarantee; and for the same principle to apply to employee financial participation arrangements which are linked to pension plans.

### **Forms of financial participation suitable for SMEs**

The question of which forms of financial participation are suitable for SMEs will mostly be answered by the findings of this research. Various recommendations then follow.

However, it is useful first to identify the current structures available to SMEs in the European Union.

#### **Profit sharing and gain sharing**

Arrangements for profit or gain sharing may involve the following principal choices:

- immediate profit sharing;
- deferred profit sharing, where any allocated profit share is held in the employee's name for a fixed period before being paid out. This may be held in the form of shares;
- gain sharing, under which a cash sum may be paid out for achievements in productivity improvement or cost reduction.

At first sight, profit-sharing arrangements present few problems for SMEs since, as long as measurable profits exist, the main ingredients for a successful profit-sharing plan appear to be present. However, other factors often discourage SMEs from choosing this route, such as simple inertia (in various disguises) and lack of know-how.

Gain sharing tends to be more complex than profit sharing since it involves measuring what may be a less tangible benefit to the company.

### **Employee share ownership**

The principal choices for structuring employee share ownership in a company or other enterprise in the EU are:

- share options;
- free shares;
- free shares to match purchased shares;
- purchased shares;
- silent partnerships;
- leveraged arrangements under which employees can participate in the growth in value of a much larger number of shares than those they have bought, with protection from the risk of share price falls;
- collective arrangements under which shares are held for employees in a trust or another arrangement on behalf of employees;
- cooperatives in which shares may carry a fixed value.

In principle, each of these options is also suitable for SMEs. However, SMEs encounter a number of problems in establishing employee share ownership arrangements. The table below shows some issues that arise specifically for SMEs (as opposed to larger companies whose shares are listed on the stock exchange) that are considering financial participation plans involving shares:

Table 1: *Issues faced by SMEs in the area of employee share ownership*

<b>Arrangement</b>	<b>Issues arising for SMEs</b>
Share options	How will option holders be able to monitor growth in share value? How will option holders sell their shares after they have exercised their option? What will be the impact (if any) on the company's profit and loss account?
Free shares	Each of the above issues also applies to free shares.
Free shares to match purchased shares	As above.
Purchased shares	As above, apart from impact on profit and loss.
Silent partnerships	Although such arrangements do not involve ownership of shares in a limited liability company, an enterprise creating a silent partnership may face similar difficulties in arranging for silent partners to turn their investment into cash.
Leveraged arrangements	As these involve a bank guarantee or other hedging arrangement, they will often be difficult, complex and expensive to structure.
Collective arrangements	More complex to establish than arrangements involving direct share ownership.
Cooperatives and employee-owned companies	Not suitable for companies which remain majority-owned by founders.

### **Combining employee share ownership and profit or gain sharing**

Arrangements also exist under which profit sharing may lead to employee share ownership. An employer may establish a savings plan involving investment in the employer's shares, partly financed by contributions from the same employer's profit-sharing plan.

There may be cases where the savings plan involves investment in other companies. In this case, consideration needs to be given to whether the arrangement continues to be a financial participation plan.

### **Examples of financial participation**

The following are examples of financial participation arrangements in different EU Member States. The main focus is on plans that carry tax incentives:

- Immediate profit sharing: *Intéressement* in France, under which profit-related cash payments are made to employees, is an example of this scheme. These payments are not liable for social security and income tax payments, if retained in a separate savings plan (*Plan d'Épargne d'Entreprise* or *PÉE*) for five years. Three million employees were involved in this scheme in 1997.
- Deferred profit sharing, such as *participation* in France, under which profit-related cash payments are allocated to employees but may not be distributed until at least three years have passed, with 50% income tax relief after three years and 100% after five years. Unlike *intéressement*, *participation* is compulsory in enterprises with more than 50 employees. 4.8 million employees were involved in such plans in 1997.
- Gain sharing: These schemes include key performance indicator (KPI) plans, used in companies throughout the EU and beyond. Typically, these deliver a cash reward to employees based on an agreed measure of performance. Approaches vary according to the needs of the particular business. A manufacturing company may make productivity its KPI, whereas an essential KPI for a retail business may be customer satisfaction.
- Share options, such as savings-related share options in the United Kingdom. Employees are granted an option whereby, if they agree to save a monthly amount with a savings institution over the option period (normally three or five years), at the end of that period, they will have saved sufficient funds (including tax-free rolled up interest) to finance the exercise of options. There is no income tax on option gains. 1.28 million employees were granted options in the UK tax year ending April 2002.
- Free shares, such as profit-sharing schemes in Ireland, where employees may receive free shares without paying income tax if shares are retained (in a trust) for three years. A similar arrangement exists under the UK Share Incentive Plan, where the retention period is five years. Spain also provides income-tax relief for free shares if they are retained for three years.
- Free shares to match purchased shares: An example for this is the French *PÉE*, under which matching contributions by employers are not liable for income tax and social security payments (depending on how they are invested).
- Purchased shares, such as the UK Share Incentive Plan (SIP), under which employees are granted relief against income tax and social security for salary invested in shares in their employer. The employer also receives relief against social security. Shares must normally be retained (in the trust) for five years. Growth in value of shares is free of tax on capital gains. 830,000 employees purchased SIP shares in the UK tax year ending April 2002.
- Silent partnerships: These are particularly common in Germany and Austria, where many enterprises are run as partnerships. Employees are allocated an equity (and/or cash) interest in the enterprise, but not involving any liability to share in losses. The arrangement therefore emulates share ownership in a limited liability company.



- Leveraged arrangements: These have been established by a number of French and German-based companies. If employees purchase a minimum number of shares, they can also benefit from a proportion of any increase in value of a larger number of shares bought for employees by a fund financed by bank loan. Any gain to employees from share price rises is multiplied, but they are protected from share price falls. Any potential loss to the company is covered by a hedging arrangement.
- Collective arrangements: These involve shares held by one person or company for the benefit of all employees, such as employee trusts in the UK.
- Cooperatives: Spanish labour cooperatives and workers' companies have shown a great capacity for job creation, achieving a 23.3% increase in employment between 1994 and 1998 (Poutsma, 2001). They are exempt from tax on capital transfers and pay a reduced corporation tax.

# Barriers encountered by SMEs

A range of barriers and challenges have been identified that are commonly encountered or perceived by SMEs in relation to establishing and running employee financial participation plans. This information is based on:

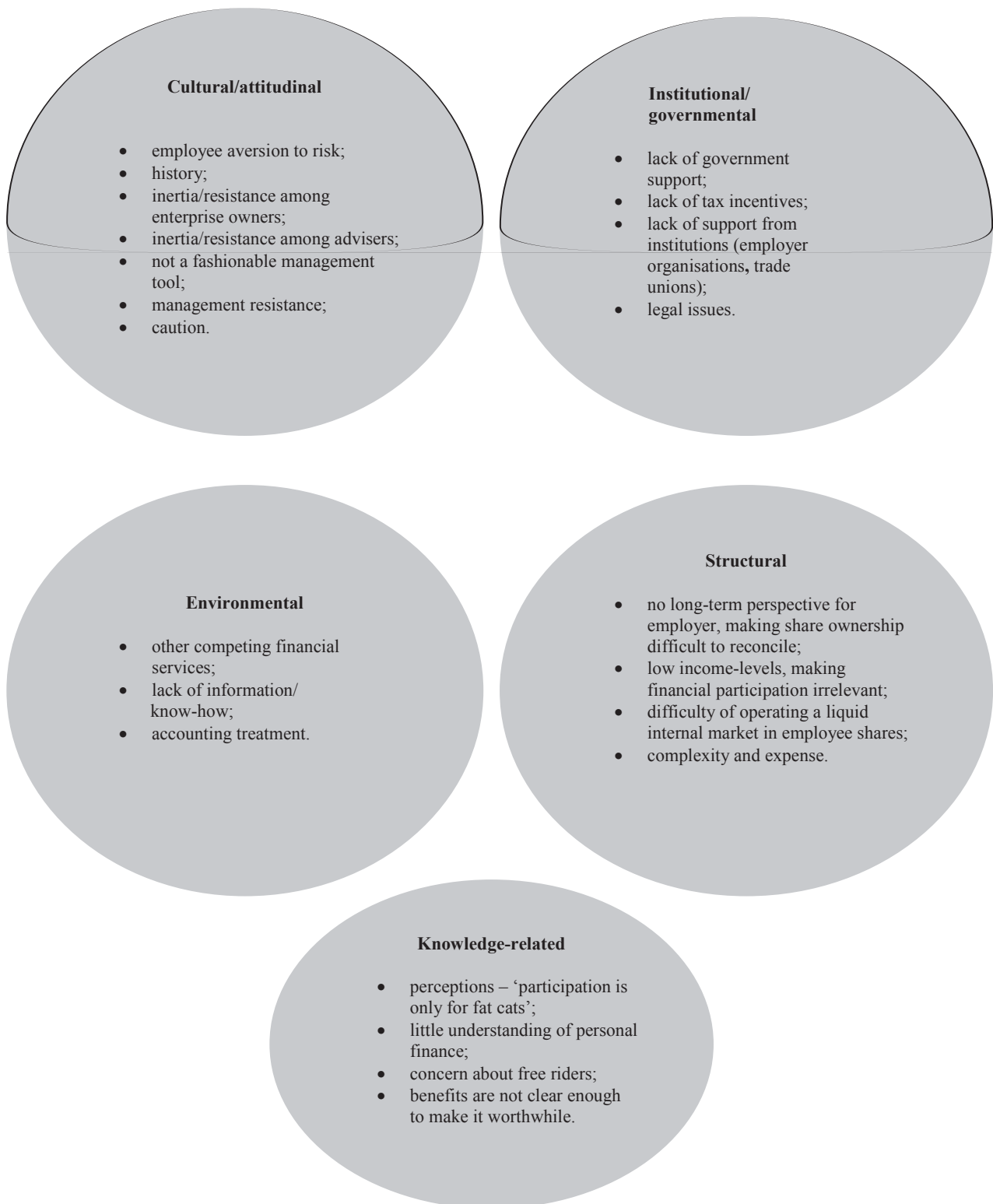
- interviews with and/or completion of a questionnaire by SMEs and organisations representing SMEs in Austria, France, Ireland, the Netherlands, Poland, Slovenia and the UK;
- the author's own practical experience as a specialist adviser to SMEs on financial participation plans;
- a report on views and policies of peak organisations in financial participation (Pendleton, 2003);
- the views of experts present at a workshop organised by the Foundation in Brussels in October 2003.

## **Overview of barriers and challenges**

The barriers and challenges faced by SMEs fall in five categories:

- cultural;
- institutional/governmental;
- environmental;
- structural;
- knowledge-related.

Figure 1: *Barriers to financial participation in SMEs*



## Detailed view of barriers and challenges

### *Cultural*

- **Employees' aversion to risk:** Risk is intrinsic to financial participation, but does not always involve risk of losing money. In non-contributory plans, the risk is only that of non-receipt of financial benefits. In contributory plans, mainly those involving share purchase, there is a risk of loss; and, since share values in SMEs tend to be strongly linked to stock market values, this has been highlighted in the last two or three years. Highly publicised failures of companies such as Enron may have reinforced this risk aversion, and reduced levels of trust. From a trade union perspective, contributory share plans are frequently regarded in a less positive light than non-contributory plans. The risk of loss may make a contributory financial participation plan fundamentally different from non-contributory plans.
- **History can affect attitudes.** The Swedish business environment tends to associate financial participation with the country's wage earner funds legislation of 1983, which provided for compulsory transfer of Swedish enterprises' ownership to bodies representing employees. The legislation is now largely discredited in Sweden and was repealed in the early 1990s. Nonetheless, financial participation is frequently regarded in Sweden as a potential repeat of what is widely considered to have been a damaging failure.

However, this type of effect need not be permanent. Government policy in the United Kingdom of the early 1970s can be argued to have had a similar effect: a number of failing state-owned businesses were converted into worker cooperatives, all of which eventually went bankrupt. Although this was mainly due to management issues and poor business models, employee share ownership acquired a bad reputation. Its reinvention in the 1980s by a free-market Conservative government as a form of worker capitalism has, to a large extent, laid those painful memories to rest.

In many new Member States, employee share ownership is negatively associated with communist-era collectivist structures. People can be unfamiliar with the concept of the owner-managed business that has its own employees. Where this form of cultural barrier exists, it may be wise to focus first on creating a strong cadre of owner managers before introducing the notion of financial participation for employees.

- **Inertia/resistance among owners.** Business owners often do not have the time or resources to consider financial participation, and they are far less likely than larger companies to employ professional human resources managers who may be aware of the potential benefits of financial participation and how such arrangements work. Even where financial participation has been considered, it is often given low priority as a tool for business growth. Resistance may be more overt in some cases, particularly in relation to employee share plans: proprietors are frequently concerned that such plans will reduce or even remove their control or influence, and take value away from them as their percentage holding reduces. In practice, these concerns can normally be addressed, but there is a 'Catch 22' problem to overcome, as the opportunity to do so only arises if an owner decides to consider financial participation - which they will often not do because of their in-built perceptions.
- **Inertia/resistance among advisers.** It often falls to a company's accountant or lawyer to advise on and help structure a financial participation arrangement. Frequently, there are legal and taxation hurdles to overcome, making this sort of professional advice indispensable. But, in these often relatively conservative professions, the concept of financial participation may seem to offend what are considered to be basic principles of business structure, such as profits are for entrepreneurs, fixed wages are for employees.
- **Management resistance.** For most managers, the exercise of power is an extremely important part of their role, and financial participation can be seen as a threat to this power. Managers may wonder if an employee share-ownership plan will undermine their authority, as the people they manage will be part-owners of the company. They may feel that rewards to employees under a financial participation plan do not fairly reflect their own contribution to business success. These legitimate concerns can be addressed by involving management in the plan design stage; but this can only be done when financial participation first comes onto the enterprise's agenda. If management resistance (conscious or sub-conscious) prevents financial participation ever being considered, other measures are clearly called for.

- **Not a fashionable management tool.** This may often be connected with history, as in the case of Sweden. Managers and owners may be reluctant to put their heads above the parapet and establish a financial participation plan if none of their peers are doing so. This phenomenon is by no means universal but, in countries where past experience has led to a natural caution, it will often be observed. Experience also suggests, however, that, once successful participation plans have been pioneered, are clearly successful and know-how is available for other companies considering something similar, attitudes will begin to change.
- **Caution.** Fixed forms of financial participation give certainty, those connected with the company's performance may lead to uncertainties, which can be a cause for concern for owners and managers. There may be concern that a profit-share (or share distribution) in a good year will create expectations for the future and, if these expectations cannot be met because of reduced profits, employee morale may suffer. This sort of risk is, of course, intrinsic to any form of financial participation. While there is a risk of employee morale and motivation dipping in years when financial participation does not produce a financial reward, enterprises can be reminded that, if their business is fundamentally sound, the overall longer-term impact of financial participation is likely to be positive. Clear and honest communication can be a major factor in overcoming this potential problem.

#### *Institutional/governmental*

- **Lack of government support.** Governments will often be in a strong position to champion financial participation, whether through active incentives (mainly tax breaks), creating a participation-friendly legal environment (such as company and securities laws), or coordinating an infrastructure which facilitates participation. Enterprises in different Member States report different experiences. For example, Dutch companies that answered the questionnaire universally stated that government support was poor, whereas UK and French companies all felt that their respective governments offered strong support. Where government policy is not supportive of financial participation, this may not be easy to change as there are always many voices competing for government attention. However, where influential bodies, such as employer organisations and/or trade unions, make a clear and strong demand for government support, this may help the call for financial participation to be heard.
- **Lack of tax incentives.** Several Member States have created tax incentives for both employers and employees, which may have encouraged companies to establish financial participation plans. There is some support for this measure among companies that already have a financial participation plan, although the majority indicate that they would have established their plan irrespective of whether tax incentives were available. This may suggest that, among the 'converted', financial participation makes good business sense as long as the tax treatment is no worse than for cash salaries. For the unconverted, a tax incentive may encourage them to change behaviour.
- **Lack of support from institutions.** There is a very mixed picture here:

Where there is support from employer organisations, it is often reactive rather than pro-active (Pendleton, 2003). Employer organisations tend to support participation, but they do little to help their members understand the benefits or find out how to set up participation plans. A coherent and rigorous analysis of financial participation in SMEs - that shows plausible benefits, a realistic assessment of potential problems, and broad examples of successful structures - might be a useful starting point in encouraging employer organisations to take this issue more seriously.

European trade unions are traditionally cautious of financial participation arrangements, which are often considered to undermine collective bargaining on fixed forms of remuneration. The FGTB (Belgian Socialist Trade Union, with close to 1.2 million members), for example, has published a members' guide to employee share ownership which emphasises its high-risk nature and expressly states that the benefits claimed for employee share ownership may be questionable. However, attitudes seem to be more flexible at local or enterprise levels; none of the companies the author has talked to saw trade union attitudes in their own company as anything other than positive. Increased support from trade unions cannot realistically be sought without guarantees for the maintenance of fixed salaries, a clear and

convincing case for advantages not just for the employer but also for employees, and the availability of participation structures which enable gain but have no or only a limited risk of loss.

As employers are more likely to take the lead than trade unions, the first priority in any initiative aimed at seeking support from the social partners should be employer organisations, without ignoring the importance of identifying participation structures that can be welcomed by trade unions. In the longer term, developing a best practice in employee participation that is supported by both employer and employee organisations should be considered.

■ **Legal issues.** While legal structures in some Member States do not facilitate financial participation plans, the picture is by no means universally negative. The European Commission's Cross-border report (2003) gives some examples of laws and regulations which may impede financial participation:

- in Greece, the administration of profit-sharing plans is highly regulated, making them unattractive to employers;
- in some Member States (for example Austria, France and Portugal), companies are prohibited from giving financial assistance to third parties to enable them to acquire shares;
- in a number of Member States, the operation of financial participation schemes in one year may give rise to an employment right to participate in the scheme in future years.

Ultimately, each Member State will have to pass legislation if it considers the potential benefits sufficiently great. Equally, the EU may consider establishing an overall policy on financial participation, as canvassed in the Cross-border report, which would help promotional bodies argue the case for legislative change in their own Member States.

#### *Environmental*

■ **Other competing financial services.** As Member States move away from state and/or non-contributory pension provision and towards contributory private pensions and medium-term savings, employees will see increasingly heavy demands being put on their limited savings resources and it will be imperative for them to devote a substantial proportion of those resources to diversified investments. This may mean that financial participation arrangements requiring employee contribution will be of limited attraction. This may make non-contributory arrangements the more realistic choice, especially for SMEs.

■ **Lack of information/know-how.** In many Member States, particularly those with low levels of financial participation, there is no organisation aiming to promote participation.

In those Member States that have achieved some level of employee financial participation, there are often one or more associations promoting participation and providing resources for companies that already operate financial participation plans or are considering doing so. However, these associations typically have very limited resources and member subscriptions are often their main source of income. Larger companies are usually the principal funders and naturally expect a strong return on their investment, with their needs taking priority. Although what is good in financial participation for a larger company is often also good for a smaller one, SMEs have their own needs too. Financial participation plans, especially those involving employee share ownership, are often more complex in SMEs than in larger listed companies.

Promotional bodies focused on providing SMEs with an A to Z of participation (from 'what are the benefits?' to 'how can we do it?'), with access to experienced advice, could add considerable value. Chapter 4 sets out a number of examples where promotional bodies have been effective in this area.

■ **Accounting treatment.** New accounting measures specified by the International Accounting Standards Board (IASB) will impact on employee share plans operated by companies reporting financially in countries which adopt IASB standards. This includes the UK, and it is possible that other Member States will adopt accounting standards reflecting those of the IASB. The proposals will require all but the smallest companies to treat share-based rewards as an accounting expense. Although this already happens in many cases, share options granted at market value are frequently

not treated as an expense, and it is on those options that the proposals will have the biggest impact. Companies granting options will be required to value them and charge that value to profit and loss over the life of the option. For SMEs, valuation of an option will often be costly and complex. Alternatively, companies will be allowed to make a charge in their profit-and-loss account on option exercise, equal to the option gain enjoyed by the employee.

It is too early to predict the impact of these measures on SMEs, but a growth in enthusiasm for granting options seems unlikely among companies obliged to account under these principles.

### *Structural*

- **No long-term view for employers, making share ownership difficult to reconcile.** This may be more of an issue for share plans than for profit or gain sharing, because share ownership has mainly longer-term qualities, whereas cash-based participation is much more commonly short term. Some SME employers may, however, give little consideration to the long term, as their horizon is often more focused on the shorter-term imperative of generating positive cash flow.

Some SMEs are likely to lack a longer-term view, particularly the smallest enterprises run as ‘lifestyle businesses’, and it is neither realistic nor necessarily always desirable to aim to change their behaviour. Cash participation may be a more suitable solution for them.

However, many do not have such a short-term outlook. In fact, SMEs in several Member States are renowned for their focus on the long term - making employee share ownership potentially more compatible than shorter-term cash participation.

- **Low income levels, making financial participation irrelevant.** Employees earning low wages will have little enthusiasm for financial participation and, if the low wages are due to the employer’s low profitability, the problem is compounded. Any trade union representing those employees may see any form of financial participation as at best irrelevant and at worst a dangerous distraction from the far more important task of raising basic pay to more acceptable levels.

However, it would be wrong to say that financial participation has no role in such situations. This area is strewn with difficult questions of social policy, but any debate should take into account the positive potential that financial participation can offer, even in a low-pay environment. International companies operating all-employee share plans frequently offer shares to employees in low-pay jurisdictions, such as Africa and India. Take-up levels in those countries can be very high as, for many workers, the share plan is their first opportunity to acquire capital. There is no reason why the same argument should not apply to SMEs operating in the EU; it can certainly be argued that lowly paid employees should not be deprived of the opportunity to acquire capital.

- **Difficulty of operating a liquid internal market in employee shares.** If employee share ownership in an unlisted SME is successful and uses shares whose value is not fixed, it is likely that, over the longer term, employees will accumulate shares in their employer which have considerable value. Eventually, many of those employees will wish to sell their shares, and the absence of a public share market may make that process difficult. There may not be enough other employees wishing to buy, particularly if the company’s share price is considered to have reached a peak. Companies will frequently need to provide cash to finance an internal share market, but may have difficulties sourcing the amount of cash required. Companies surveyed which operate all-employee share ownership have not generally regarded this as a problem but, as most of them have only created their share plan in recent years, employee demand to sell simply may not yet have grown to significant levels.

Companies in which the majority of shares are held by or on behalf of employees may be most susceptible to this risk. A higher proportion of the company’s shares will be subject to demand to sell and, if this cannot be achieved internally, there may be pressure to place the company for sale on the open market. This effect may be magnified where the internal share market specifies a lower share price than that which could be obtained if the entire company were sold



to a third party, as is often the case. For example, in the early to mid 1990s, employee shareholders in a number of employee-owned UK bus companies received offers for their shares from larger national public transport companies. These offers valued their shares at levels substantially in excess of any price which could be supported by the company's own internal share market, and were thus impossible to resist.

This means that high levels of employee share ownership may cause their own problems in the long term, unless the company does not intend employee share ownership to be a long-term option.

- **Complexity and expense.** This can be a major barrier for SMEs, which have limited resources to devote to designing and operating a financial participation plan, and often a very small budget for engaging professional advice.

Simple models need to be available which are easy to understand, quick to establish, simple to run and do not require extensive professional advice. Cash-based participation is usually more suitable than share-based arrangements, which are necessarily more complex.

If tax incentives are available, the conditions need to be as few in number and as simple as possible. Recent experience in the UK illustrates this point. In 2000, two new tax-approved share plans were introduced by the government: the Share Incentive Plan (SIP) and Enterprise Management Incentives (EMI). They are fundamentally different in nature. The SIP is an all-employee plan, with a choice as to how employees may enjoy tax relief for the acquisition of shares, and accompanying complexity. EMI is a selective share option plan, quick and simple to establish and only available to smaller companies in certain trades. In the tax year 2001-2002, 34 unlisted and smaller listed companies established an SIP, whereas 1,914 established an EMI plan. This significant difference in popularity cannot be attributed entirely to EMI's relative simplicity - EMI and SIP perform different roles and EMI's selective nature is likely to be a major factor in its higher take-up. However, from the author's own experience, that relative simplicity does encourage many companies to establish an EMI plan rather than any other form of financial participation.

#### *Knowledge-related*

- **Perceptions - participation is only for 'fat cats'.** Negative publicity about directors of large listed companies being rewarded for failure and feathering their own nests without any apparent accountability to shareholders can sometimes mask the much more wholesome reality of all-employee financial participation arrangements (and indeed many selective arrangements). Standards of corporate governance are rapidly improving and listed company shareholders are far more willing to police financial participation arrangements. The 'fat cat' phenomenon will become less common (although it is unlikely to disappear entirely), creating a much better opportunity to show all-employee financial participation in the favourable light it deserves. Now is a good time for governments, social partners and promotional bodies to take the lead in dispelling this misconception, as part of a wider programme of informing both employers and employees about the role that financial participation can play in their enterprise.
- **Low understanding of personal finance matters.** Employees are often woefully ill-informed about financial matters. It is axiomatic that financial participation may only be effective if employees understand how it works, but there is frequently a poor understanding of both financial participation and other forms of employee benefit. While larger companies have financial resources to provide clear and effective guides to their employees, smaller ones do not. When employees enter the workplace armed with a good understanding of personal finance, the communication task for smaller companies will be made easier. Employees will value the potential of financial participation more if they understand how it works in comparison with other forms of benefit their employer may provide.
- **Concern about free-riders.** Organisational behaviourists think there is a risk that all-employee financial participation plans do not establish enough connection between the efforts of the individual employee and the reward they may derive from the plan. Thus some employees (the free-riders) might be over-rewarded, while others are under-rewarded. This can also be a practical concern for SME owners or managers.



However, research suggests that, in practice, any such effect will be at least balanced, and often outweighed, by the positive motivation experienced by non-free riders. Pendleton, Poutsma, van Ommeren and Brewster (2001) found no evidence of any free-rider effect in companies with 250 or more employees, and this is supported by the author's own experience as an adviser to SMEs. If there were a free-rider effect, it may be logical to expect it to be less common among smaller companies.

Nonetheless, this is a concern that needs addressing, and any guidance on financial participation for SMEs should do so.

- **Benefits are not clear enough to make it worthwhile.** This is a truism, the logical extension of which is that every SME would have a financial participation plan if they felt the benefits were sufficiently clear. This is, of course, unlikely in reality, and an understanding of the benefits alone will often not be enough to spur an enterprise to establish a participation plan. However, it is reasonable to suggest that, if the benefits were more widely understood, many more SMEs would operate a plan.

SMEs may either be unaware that financial participation involves benefits, or they may accept that there can be benefits but not consider them valuable enough to make establishing a participation plan worthwhile.

#### **Are these problems peculiar to SMEs?**

Many, or perhaps even all, of the problems described on the previous pages might also afflict larger enterprises not falling within the SME definition. For example, there are many large companies that are not yet convinced of the benefits of financial participation. However, the issues identified above are particularly relevant to SMEs because:

- larger companies are more likely to have the resources to overcome many of these problems, whereas SMEs remain in need of alternative methods of support. A larger company is also more likely to have professional expertise in human resources issues than an SME;
- although enterprises of all sizes may encounter these problems, they are experienced more acutely in smaller ones.

#### **Which are the most important problems?**

The following are perceived to be the principal problems encountered by SMEs with regard to employee financial participation:

- *knowledge-related*: benefits are not clear enough to make it worth doing;
- *cultural/attitudinal*: inertia/resistance among enterprise owners;
- *structural*: complexity and cost;
- *governmental/institutional*: lack of tax incentives; legal problems.

Other problems viewed as being particularly important are:

- *governmental/institutional*: lack of government and institutional support;
- *cultural/attitudinal*: inertia/resistance among advisers;
- *environmental*: lack of information/know-how;
- *knowledge-related*: low understanding of personal finance.

# Potential solutions

## Approaches

As the previous chapter shows, an SME will not have to try very hard if it is seeking reasons not to introduce a financial participation plan; and the potential benefits of financial participation will not even have the opportunity of being considered. This chapter highlights the positive role financial participation can play and provides signposts that can guide Member States wishing to encourage their SMEs to choose this route.

The analysis in the previous chapter suggests that any solutions could involve the following approaches:

- tackling the culture of inertia and resistance among enterprise owners;
- increasing government support, including, but not limited to, tax incentives and legal structures;
- creating an environment in which information and know-how are easily accessible and where institutional support can add significant value;
- identifying workable structures of financial participation, keeping it simple and affordable;
- spreading knowledge about the benefits of participation and ways in which it can operate.

The methods by which these approaches can be addressed may frequently overlap.

### Tackling inertia and resistance among enterprise owners

This issue cannot be seen in isolation from the related question of how to spread knowledge about the benefits of financial participation. Enterprise owners will not be interested in overcoming their resistance unless they believe that financial participation benefits their business.

The first step is to promote a wider understanding of those benefits throughout Member States. Key ways to achieve this might include:

- encouraging institutions, in particular employer organisations, to explain the benefits to their members through written and/or web-based guides, case studies of successful financial participation, and practical ‘why and how’ workshops;
- fostering the creation of effective promotional bodies in Member States, either dedicated to the particular needs of SMEs or, if part of a larger organisation, with sufficient resources allocated to those needs.

There are several examples of how this is already being done successfully in some EU Member States:

In France, Fondact (association for participative management, employee savings, and responsible shareholders) played a key role in the preparation of the Loi Fabius, which created new choices of financial participation and, in conjunction with a number of other organisations, ran a road show in 2002 to explain the new plan to smaller companies.

The Netherlands Participation Institute completed a national survey for the Dutch Secretary of Finance in 2002, which received wide media coverage. Employee share ownership in the Netherlands has more than doubled between 1996 and 2001 (from 4% to 9%). The institute has sold 1,000 copies of a checklist on how to implement an employee share ownership plan and it also provides know-how through presentations, workshops, articles and its website.

In the UK, ProShare makes annual representations to the UK Treasury on fiscal measures which could be taken to foster employee share ownership, and these suggestions are frequently reflected in changes to tax legislation. For example, in 2003, ProShare suggested a major relaxation in the way in which UK employees may receive tax relief to purchase shares in their employer (under the Share Incentive Plan, SIP). This took effect in the UK's Finance Act for that year. ProShare organises an annual dinner and employee share ownership awards. It also holds regular training courses aimed at different levels of expertise.

The UK Employee Share Ownership Centre has combined with one of the UK's two leading employer organisations, the Institute of Directors, to promote financial participation through one-day seminars.

### **Increasing government support**

The most effective way of increasing government support in Member States may be first to obtain greater support from some of the institutions mentioned above. National governments may be as sensitive to 'bottom up' pressure from organisations representing enterprises in their own countries as they would be to 'top down' pressure from the EU.

Government support could take three forms:

1. creation of tax incentives;
2. removal of legal barriers;
3. 'soft support', such as the willingness to promote financial participation, including support and finance for any bodies to which the responsibility for promotion is devolved.

One major way in which the European Union might assist this process could be the preparation of a generic step-by-step action plan for Member State governments wishing to increase the rate of financial participation in their country. Among other things, this action plan would:

- summarise the benefits of financial participation at both a micro-economic and macro-economic level;
- identify major legal areas which commonly impede financial participation and provide models for overcoming them (informed by the experiences of Member States that have done so);
- describe some typical forms of tax incentives applied in certain Member States, and - if possible - give evidence of the impact those incentives have had on the popularity of financial participation plans;
- describe some key models for successful financial participation in Member States. These would need to reflect the diversity of business structures in the European Union. For example, in some Member States, the limited liability company is a very common business vehicle, enabling employees to become shareholders without taking responsibility for the company's debts. In others, like Germany and Austria, partnerships are more common. This has led to the widespread use of 'silent partnerships', under which employees receive a participation unit similar to a share. This is financed from company profits and carries interest and a right to participate in future growth, but often does not involve liability for company losses. Any recommended models would have to acknowledge these different needs;
- recommend a consultative approach to any legal and taxation changes, involving experts from the social partners, SMEs (and larger enterprises if the changes affect employers of all sizes), professional advisers and experts in organisational behaviour;

- provide a model for how governments might promote financial participation in ‘softer’ ways, using as examples organisations in other parts of the European Union - and beyond - which have been successful in this field. Organisations such as Fondact (France), the Irish Profit Sharing Association, AGP (Germany), ProShare and the Employee Share Ownership Centre (UK), and the Netherlands Participation Institute may each be potential models. Further afield, the National Center for Employee Ownership (NCEO) in the US is another potentially useful model;
- identify key professionals who need to become more familiar with the principles of financial participation (such as human resources personnel, company secretaries, accountants and lawyers), and suggest ways in which their familiarity with financial participation could be enhanced (for example, urge their professional bodies to place it higher on the agenda of continuing education);
- provide suggestions as to how the benefits of financial participation can be positively communicated in the business community and also among trade unions, creating balanced perceptions.

### **Creating an environment in which information and know-how are easily accessible**

Making information and know-how accessible is partly dependent on having a clear and relatively simple choice of financial participation structures. The know-how should then follow more easily. Addressing this question is partly related to obtaining government support, which is likely to be a key stage in identifying workable structures.

Once that is done, information and know-how can be made more accessible in various ways, such as:

- establishing networks of knowledgeable and SME-friendly advisers, perhaps organised by employer organisations;
- encouraging employer organisations to provide ‘why and how to’ guides to financial participation, and to organise networking events at which SMEs can exchange experiences and practical ideas;
- fostering a higher quality of knowledge among professionals about financial participation;
- consulting with trade unions to ensure that financial participation models can benefit from their support.

### **Identifying workable structures of financial participation**

Any guide produced for Member State governments should emphasise the goal of simplicity in developing domestic financial participation structures. Supporting information should demonstrate the relevance of this by illustrating successes of simple financial participation plans in other Member States.

If SMEs see the introduction of financial participation as just one more administrative burden, it will not be adopted enthusiastically. For example, structures that require a large amount of consultation before being implemented will not be very attractive to employers, and it would be unrealistic to expect a high degree of take-up. Member State governments that have introduced financial participation structures requiring substantial prior consultation with employees have seen extremely low levels of take-up among the employers for whom these structures were targeted.

### **Spreading knowledge about the benefits of participation and ways in which it can operate**

It is accepted wisdom in any commercial enterprise that employees need to be paid to work. It needs to become equally accepted that employees can be motivated by financial participation, with advantages for enterprises and the wider economy.

This knowledge needs to permeate the business environment, reaching any person involved or likely to be involved in business as an employer, employee, adviser, consultant, government business agency, educator or social partner. Ways to achieve this might include:

- employer organisations taking a lead in informing their membership about financial participation;
- trade unions producing employee guides;
- articles in professional journals aimed at advisers and consultants - preferably focusing on real-life benefits that real companies have derived from financial participation;
- for government business agencies (including those at senior ministry level), the previously described step-by-step action plan may be an important way of awakening interest in the potential of financial participation;
- those setting curricula at university and business school level (and, arguably, at secondary school level) should be encouraged to include financial participation at an appropriate stage in management, economics and business courses. This would ensure that both potential employers and employees enter the business environment with an understanding of the role of financial participation in the wider context of employee reward and personal finance generally. If, as seems likely, the role of national governments in providing pensions is to reduce substantially, individuals will need to be better equipped in making their own arrangements, and personal financial education is an absolutely essential first step.

Once a certain number of pioneering companies have successfully introduced financial participation, others are likely to follow. Informal networks between business leaders are particularly effective at spreading the word.

Another approach that might be considered, particularly for employee share ownership (which might be harder to promote in SMEs than cash-based participation), is to focus on a particular business sector that might be particularly well suited to this form of participation. A category of technology or other 'human capital' business may be a good example. Concentrating efforts into a sector where the likelihood of success is highest will give the prospect of maximum positive results; this will generate success stories relatively quickly, and word can then be spread to companies in other sectors.

Many of the actions suggested in this chapter appear, on closer analysis, dependent on two key steps:

- obtaining government support in Member States;
- obtaining institutional support, in particular that of employer organisations and dedicated promotional bodies (to be established where necessary).

These steps can be instrumental in introducing successful financial participation schemes.

## **Can particular models be recommended?**

There are a number of successful models for financial participation in Member States, and it may be tempting to cite these as the ones which could or even should be replicated in other Member States.

For example, each of these plans, all carrying tax incentives, has been successful in its own country:

- *intéressement, plans d'épargne d'entreprise, and participation* in France;
- savings-related share options in the UK;
- profit sharing in Ireland;
- *sociédades laborales* in Spain.

While each will have its own advantages, none may be precisely attuned to the business structures and economic needs of SMEs in a particular Member State. Different Member States have different mindsets and need to be able to develop solutions that target their own needs.

It is therefore suggested that, while successful participation structures of the kind mentioned above may present valuable ideas and will often be a useful basis for a Member State seeking its own solution, they are unlikely to represent an absolute template. This report, therefore, does not recommend any particular structure(s), but concludes that there are several themes for successful financial participation in and outside the European Union that are likely to be of great value to Member States as they develop their own financial participation strategies.

The author would also like to suggest that there is a need for further clarity on the definition of financial participation. Although the Pepper report was clearly about financial participation by employees in their own firms, a wider definition is sometimes suggested, in which participation in third-party companies is also included. For example, arrangements under the French Loi Fabius have been regarded as financial participation: these allow a group of companies to set up an arrangement under which their employees may each invest in all the companies within the group.

Arrangements facilitating employee participation in third-party companies may have a number of benefits but, as yet, there is no evidence that they create productivity or employment benefits. It is, therefore, important to ask whether this wider definition is appropriate. Should financial participation be defined to include arrangements purely involving employee investment in third-party firms?

## **Should financial participation be viewed as a potential pension?**

There is a further area where caution is needed. Two factors are currently having a fundamental and lasting impact on the provision of retirement benefits:

- the decline in the ability of governments to finance retirement benefits;
- increasing difficulty for private sector employers in meeting the cost of defined benefit/final salary pension arrangements.

Employees will increasingly need to make their own, personal arrangements if they are to maximise their financial comfort in retirement.

Can financial participation arrangements play a role in this? Potentially, yes, but only as part of a portfolio of other, more diverse investments and only where employees have sufficient financial knowledge or advice (ideally both) to make informed investment decisions.

In the UK, employees may acquire shares in their own company which are income-tax free under a SIP. They then, under proposed legislation (Finance Bill 2004), obtain further income tax relief if they place those shares in their pension plan. While this may seem very attractive, it clearly carries risks. For some employees, the value of those shares will decline and, for the minority unfortunate enough to work for a company that goes bankrupt, value will disappear entirely.

Financial participation is intrinsically about risk but, for most employees, pension planning and longer-term saving is about security. It is essential to ensure that financial participation rewards are kept separate from longer-term savings and pensions. Decisions to place employer shares in a pension plan, for example, should be made only after careful consideration of savings/investment objectives and the relative risk (compared with alternatives) of including those shares as a plan investment.

## **Realistic approach**

Finally, it is important to be realistic about what can be achieved in terms of employee financial participation.

### **Importance of prioritising**

Many smaller SMEs may never be able or willing to choose financial participation, and priority may need to be given to those SMEs considered most likely to be persuaded of its benefits. These might include companies:

- not employing a high proportion of casual labour;
- with more than a minimum number of employees;
- operating in industries where there is maximum potential for more motivated employees to add value.

### **Relevance of employee share ownership**

Pendleton (2001) finds that employee share ownership is relatively rare in SMEs, mainly due to owner inertia, the potential complexity of operating an internal share market, and an unwillingness to share control. Although these can each be addressed to different degrees, he identifies four particular scenarios in which employee share ownership may be more relevant for SMEs:

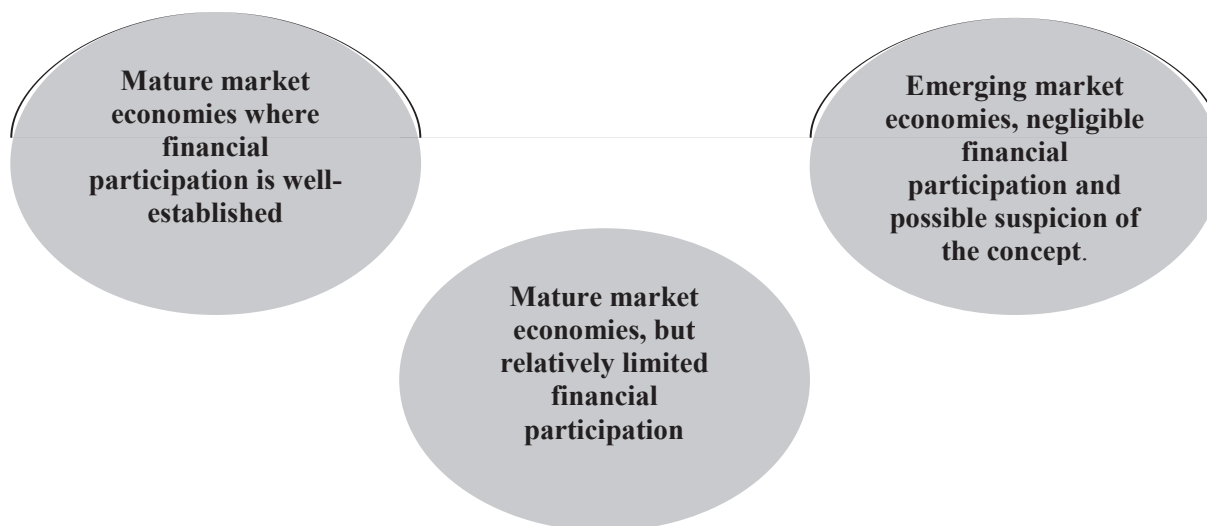
- management or management/employee buyouts;
- dot.coms and new economy firms;
- owner exits;
- firms experiencing difficulty with recruitment and retention.

The author's experience working with SMEs confirms the accuracy of this view. It is suggested that employee share ownership has considerable potential in each of these scenarios. However, for SMEs to which these scenarios do not apply, cash-based participation plans may be considerably more relevant.

### **Levels of readiness**

Different Member States have different levels of readiness for financial participation, and they need to find their own way. There is potential for extensive growth in financial participation in all Member States, but the author has identified three broad levels of readiness:

Figure 2: *Readiness for financial participation in EU countries*



Some further analysis would be required to determine which of these descriptions best applies to each Member State although, in the author's view, this would currently be a relatively straightforward task for most Member States.



The previous chapter has set out a number of potential solutions; this chapter makes some initial suggestions as to how those solutions might be put into practice. To some extent, the suggested approaches may address more than one solution. This chapter also proposes ways to help Member States to monitor their own progress in creating a business climate for SMEs that is encouraging for, and conducive to, financial participation.

## Putting solutions into practice

The following charts illustrate how the solutions described above might be put into practice.

<b>Promotion by employer organisations</b>	→	<ul style="list-style-type: none"> <li>• publicise this report;</li> <li>• seek the personal support of directors of employer organisations by one-to-one contact;</li> <li>• generate a short action pack to help employer organisations start work;</li> <li>• seek organisations' own views;</li> <li>• provide ideas on how to fund promotion of financial participation;</li> <li>• ensure trade unions have opportunity to contribute.</li> </ul>
<b>Creating promotional bodies for financial participation in Member States</b>	→	<ul style="list-style-type: none"> <li>• adopt/adapt existing models;</li> <li>• encourage Member State government agencies and employer organisations to facilitate their creation;</li> <li>• invite interested professional advisers to help with preliminary work voluntarily.</li> </ul>
<b>Enlisting support of Member State governments</b>	→	<ul style="list-style-type: none"> <li>• generate a clear EU policy statement accompanied by a generic action plan for Member States: benefits, key common obstacles and solutions, examples of tax incentives, outline model structures, etc;</li> <li>• lobbying by promotional bodies, employer organisations and possibly trade unions.</li> </ul>
<b>Creating a better environment for financial participation</b>	→	<ul style="list-style-type: none"> <li>• employer organisations can generate and spread know-how;</li> <li>• consultation with trade unions.</li> </ul>
<b>Creating workable structures of financial participation</b>	→	<ul style="list-style-type: none"> <li>• recognise that, for SMEs, arrangements will often need to be low risk and non-contributory, although there is always some form of risk;</li> <li>• recognise that cash-based arrangements are likely to be of wider application for SMEs than share-based ones; identify the situations in which share-based approaches may be more relevant, and provide models;</li> <li>• ensure that any models suggested are simple; refer to real successful models wherever possible.</li> </ul>
<b>Spreading knowledge of financial participation and personal finance generally</b>	→	<ul style="list-style-type: none"> <li>• encourage educational bodies to include financial participation in their curricula (school, university, business school);</li> <li>• engage the support of trade unions;</li> <li>• employer organisations to take a lead in informing their membership;</li> <li>• awaken interest in government agencies by creating an EU-wide generic action plan.</li> </ul>

## Helping Member States monitor their progress

The broad measures of progress suggested below are mainly qualitative, and thus likely to be hard to measure independently. However, their purpose is to enable each Member State to self-assess its own progress in creating a financial participation-friendly environment for SMEs rather than to allow for external monitoring.

### Qualitative measures

#### Positive indicators

Employer organisations actively promote financial participation.

Trade unions support financial participation (may be subject to certain caveats such as maintenance of fixed wages).

There is a promotional body whose role it is to promote financial participation.

Simple, accessible models exist.

Models are suitable for SMEs: no unreasonable financial risk, include cash-based profit and/or gain-sharing arrangements.

There is a supportive legal structure.

Employees have access to personal financial education.

Government agencies actively support financial participation.

Tax incentives are available for employers and employees.

#### Negative indicators

Employer organisations do not, or only passively, promote financial participation.

Trade unions are hostile to financial participation.

No dedicated promotional body exists.

Models of financial participation do not exist or are hard to find.

Models of financial participation are unsuitable for SMEs, more attuned to the needs of listed companies.

There are one or more major legal impediments to the creation of financial participation suitable for SMEs.

Employees have no such access and/or have low levels of financial knowledge.

There is no conscious government policy to support and promote financial participation.

There are no or few tax incentives or, if they exist, their conditions are too complex for SMEs to comply with.

### Quantitative measures

The Foundation has commissioned a separate report concerning the development of indicators for the benchmarking of national policies and practices of financial participation in the European Union. When completed, the indicators identified, or selected indicators, might be applied to SMEs in Member States as a measure of their actual success in encouraging those SMEs to create financial participation plans.

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# Appendix: Forms of financial participation in the EU

This table summarises the principal generic forms of financial participation applied in the European Union, and their possible roles. It may be useful for Member States seeking a quick overview of the most common approaches:

Type	Role	Tax incentives	Examples
Free shares	reward for performance, incentive to stay; all employees may participate	no income tax or social security on value of shares; growth in value may be free of tax on capital gains	<i>PÉE</i> (France – if matched by share purchase), SIP (UK), profit sharing (Ireland)
Share options	as above, but participation may be limited to key people; heavily used by young companies seeking to grow	no income tax or social security on growth in value of shares between option grant and exercise	EMI and CSOP (UK)
Share purchase	creating a sense of ownership, with risk of loss as well as potential for gain	income tax relief on cost of purchase	SIP (UK)
Profit sharing	reward for performance, based on enterprise profit	no income tax or social security on cash paid	<i>intéressement</i> (France)
Gain sharing	reward for performance, based on a measure other than profit	none currently available in the EU	gain sharing based on key performance indicators – applied throughout the EU
Employee-owned companies	a possible succession solution, and may help create new enterprises	some relief against corporation tax	<i>sociédades laborales</i> (Spain)

Robert Postlethwaite, Proshare

EF/04/100/EN